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The review provides a detailed analysis of main trends in Russia's economy in 2013. The paper contains 6 big sections that highlight single aspects of Russia's economic development: the socio-political context; the monetary and credit spheres; financial sphere; 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.

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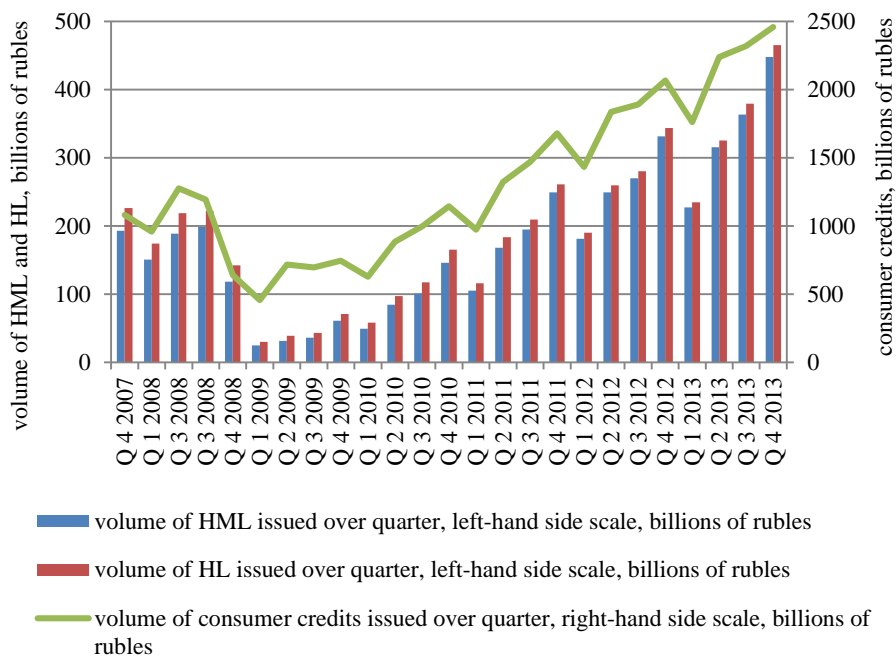
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**Housing Mortgage Lending in Russia in 2013**

In 2013, according to data released by the RF Central Bank, 657 credit institutions issued a total of 824.8 housing mortgage loans (HML) in the amount of Rb 1,353.6bn, which represents a 19.2% rise on 2012 in terms of number of loans, and a 31.2% rise on the aforesaid year in money terms. The quarterly movement of the lending indices (*Fig. 9*) points to stable growth, over the past few years, in the sectors of both consumer and housing mortgage lending. However, the total volume of consumer loans issued in 2013 (Rb 8,778/2bn) is only 21.5% above the corresponding index for 2012, which is less than the growth rate displayed by the volume of HML.

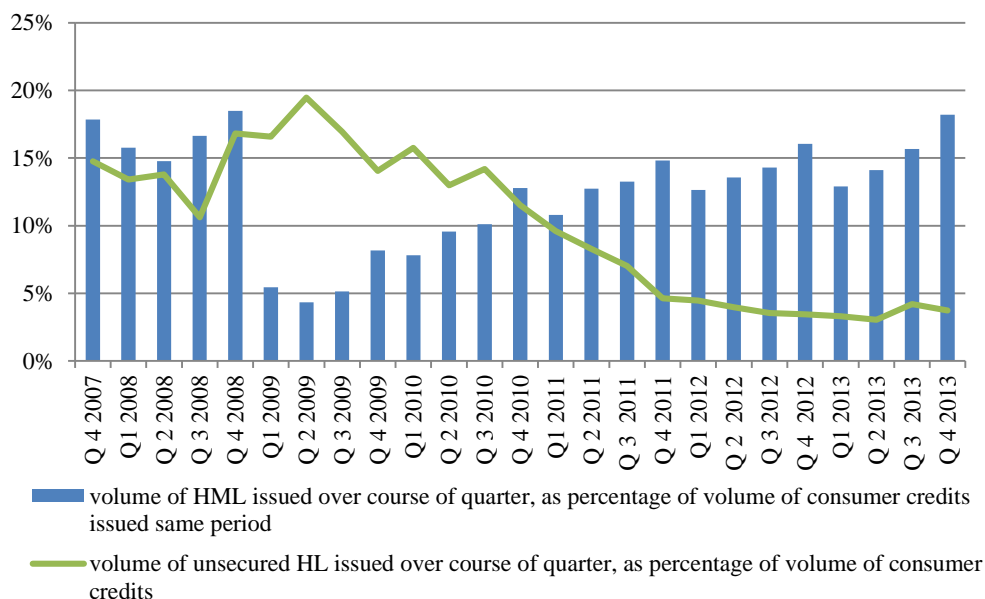


Source: data released by the RF Central Bank.

*Fig. 9.* The Dynamics of Loans Issued to Individuals over the Course of a Quarter, 2007-2013

In Q4 2013, the share of HML in the volume of consumer lending grew by 2.2 pp. on Q4 2012 - to 18.2%, while still staying 0.3 pp. below its pre-crisis record high registered in Q4 2008. The downward trend displayed by the share of unsecured housing loans (UHL) in the total housing lending volume continued over the course of 2013, with some fluctuations. The share of UHL in the total volume of HL issued in Q4 2013 increased 0.3 pp. above the corresponding index for Q4 2012 (*Fig. 10*). This trend, most likely, is going to persist in 2014 due to the RF Central Bank’s policy aimed at toughening the requirements for obligatory (required) reserves against unsecured loans (Regulation No 254-P ‘On the Procedure for the

Creation, by Credit Institutions, of Required Reserves against Potential Losses on Loans and Outstanding Debt against Loans and Similar Categories of Outstanding Debt ‘.

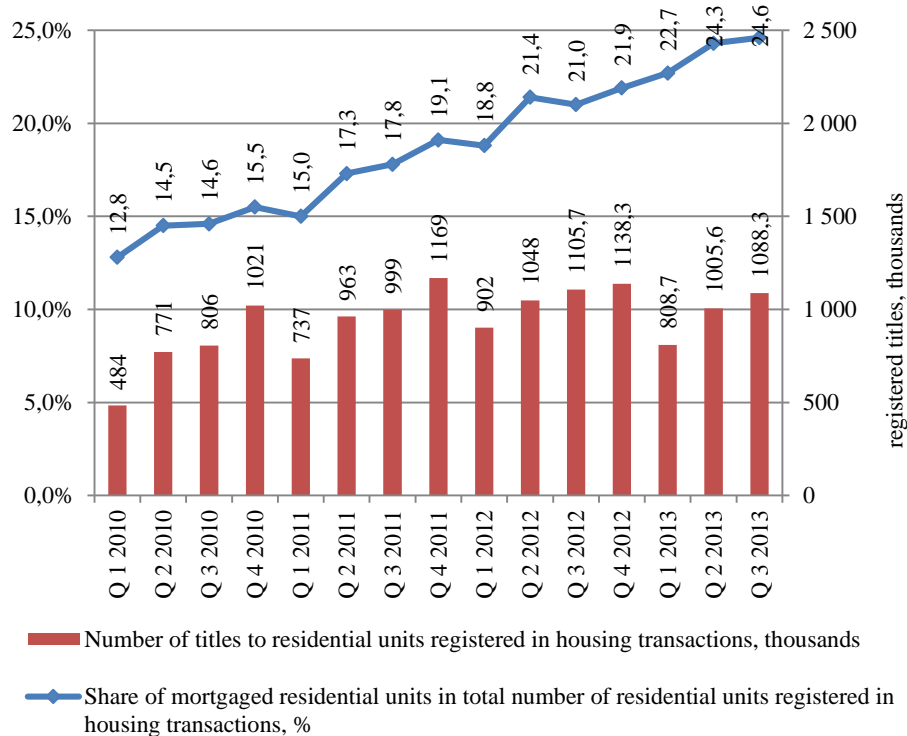


Source: data released by the RF Central Bank.

Fig. 10. The Dynamics of the Housing Mortgage Lending Volume as a Percentage of Consumer Lending Volume, 2007-2013

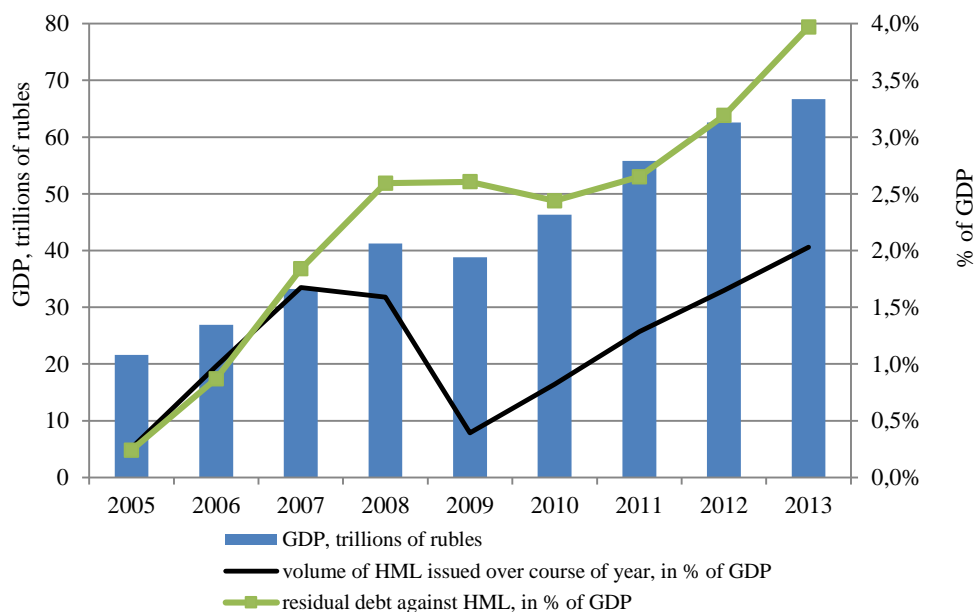
According to *Rosreestr's* data released by the Agency for Housing Mortgage Lending (AHML) (Fig. 11), in Q3 2013 the share of mortgaged real estate objects in the total number of real estate objects registered in housing transactions rose on Q3 2012 by 3.6 pp. - to 24.6%; i.e., one in four housing transactions was a residential mortgage transaction. Over the same period, the number of titles to residential units registered in housing transactions dropped by 1.6% and amounted to a total of 1.1m.

In spite of the declining economic growth rate displayed by Russia's national economy, the volume of HML issued in 2013 increased, as a percentage of GDP, to 2.0% (vs. 1.7% in 2012), and so surged 0.35 pp. above its pre-crisis record high registered in 2007 (Fig. 12). The total amount of debt against HML as of 1 January 2014 amounted to 4.0% of GDP, which is by 0.78 pp. higher than this index's value for 2012. However, in the post-crisis year 2012 the amount of debt against housing mortgage loans in the USA rose to 60% of GDP, or \$ 9.5 trillion. If we look at the European Union, Europe's average index of HML as a percentage of GDP amounted to 51.7%; more specifically, in the UK it amounted to 84%, in Spain – to 62%, in Germany – to 45%, and in The Netherlands and Denmark it rose above 100%. Russia's HML rate was 15 times below that of the USA, and 13 times below that of the EU.



Source: OAO «AHML» data, released by Rosreestr.

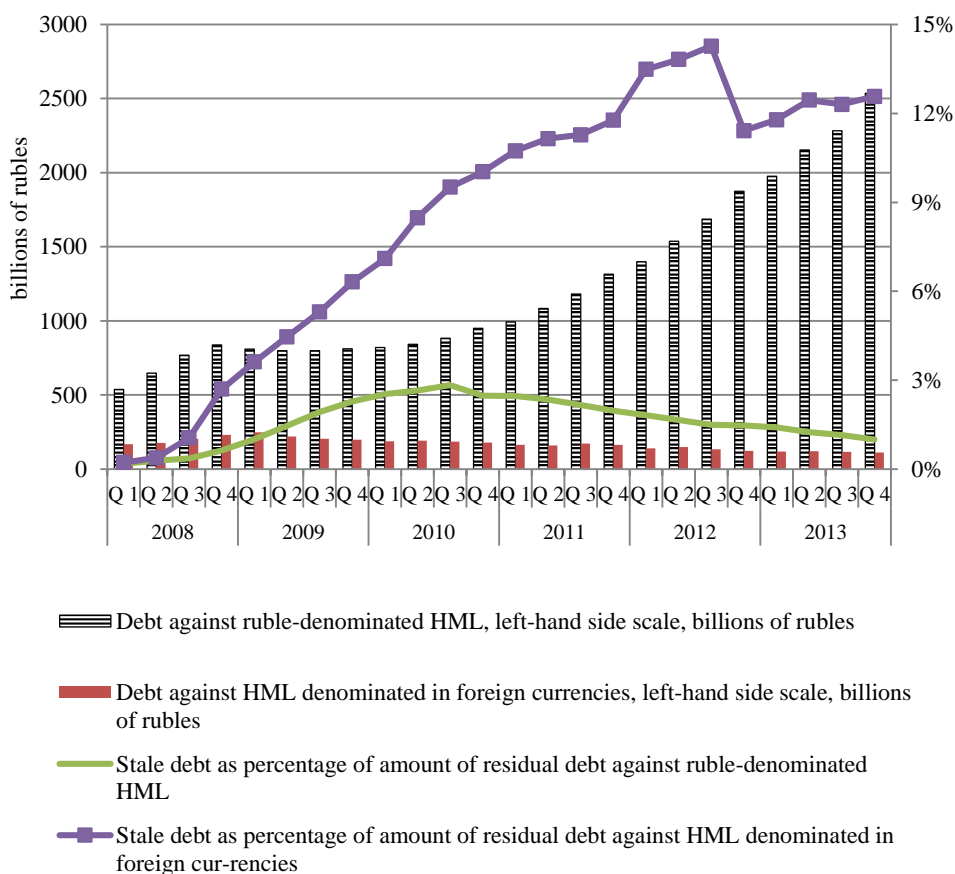
Fig. 11. The Dynamics of the Number of Residential Units Registered in Housing Transactions (Units), and the Share of Mortgaged Residential Units in Total Number of Residential Units Registered in Housing Transactions, 2010–2013



Source: data released by the RF Central Bank.

Fig. 12. The Dynamics of Housing Mortgage Lending as a Percentage of GDP, 2005–2013

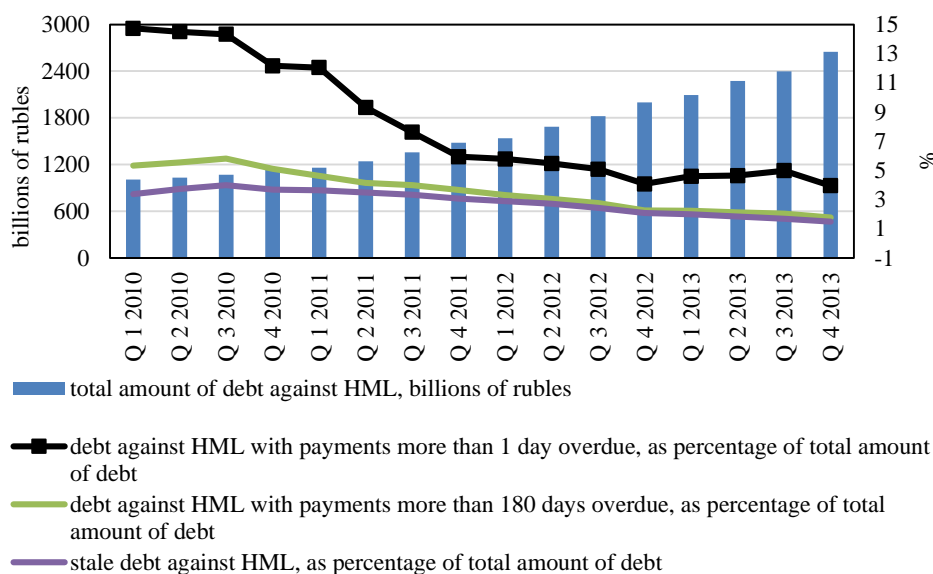
In 2013, the amount of debt against HML denominated in rubles increased by 35.3% on 2012 – to a total of Rb 2,536.4bn (*Fig. 13*). In spite of the increasing size of the ruble-denominated HML portfolio, its quality also improved, because the amount of stale debt against HML denominated in rubles (25.4 bn Rb) shrank by 7.6% on 2012, and by 0.15 pp. - to 1.0% the amount of residual debt. The quality of the portfolio of HML denominated in foreign currency, on the contrary, deteriorated. Over the same period, although the amount of residual debt against HML denominated in foreign currency declined by 9.0% to Rb 111.8bn, the amount of stale debt (Rb 14.1bn) increased both in terms of money (by 0.2%) and as a percentage of the amount of residual debt (by 0.26 pp. to 12.6%). The share of effective stale debt in effective residual debt declined to 1.5% as of 1 January 2014.



Source: data released by the RF Central Bank.

*Fig. 13. The Dynamics of Residual and Stale Debt against Housing Mortgage Loans, 2008–2013*

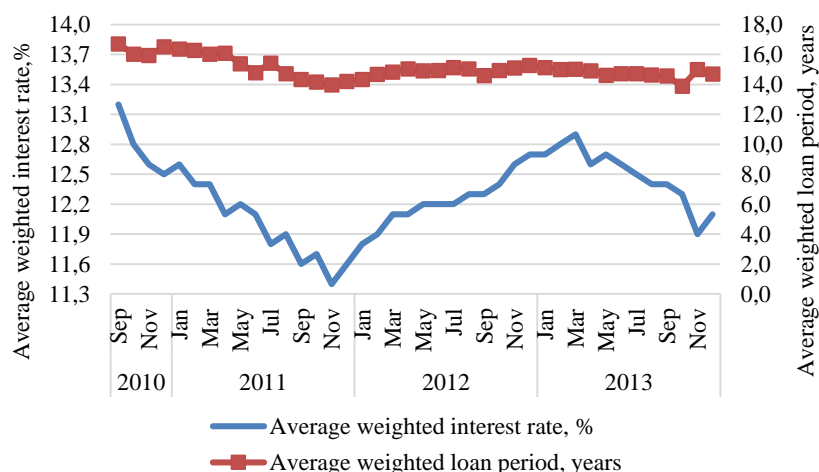
The HML portfolio's quality also improved in terms of the period of overdue payments. As of 1 January 2014, the share of residual debt against HML with no overdue payments (Rb 2,648.3bn) in the total amount of debt amounted to 96.1%, which represents a 0.12 pp. rise on its index as of 1 January 2013. The share of debt against HML with payments more than 180 days overdue (debt against defaulted loans) in the total amount of debt as of 1 January 2014 was at the level of 1.8%, or by 0.48 pp. below its level as of 1 January 2013 (*Fig. 14*).



Source: data released by the RF Central Bank.

Fig. 14. The Dynamics of Debt against Housing Mortgage Loans, by Period of Overdue Payment, 2010–2013

The average weighted interest rate on ruble-denominated HML issued over one month dropped from 12.9% in March 2013 to 11.9% in November, and then again rose to 12.1% in December 2013. The average weighted loan period for ruble-denominated HML issued over one month hit its record high (15.1 years) in January 2013, and its record low (13.9 year) – in October 2013 (Fig. 15). For reference: in Q1 2013, the representative annual percentage rate (APR) for HML in Sweden was 2.7%, in Germany – 2.8%, in Spain – 2.9%, in France – 3.0%, in the UK – 3.5%, in Poland – 6.0%, and in Hungary – 11.2%. In early 2013, the inflation rate in the EU was at the level of 1.8–2.0%. Thus, in the Eurozone the margin between the interest rate of 3.0% on housing mortgage loans was only 1%, while in Russia it amounted to approximately 5.5%.



Source: data released by the RF Central Bank.

Fig. 15. Average Weighted Data on HML Denominated in Rubles, by Month, 2010–2013



As of 1 January 2014, the average weighted interest rate on HML denominated in foreign currencies, issued since the year's beginning, dropped to 9.6% on its 2013 record high of 10.1%, registered as of 1 June 2013. The average weighted loan period for HML denominated in foreign currencies and issued since the year's beginning amounted to 12.7 years as of 1 January 2014.

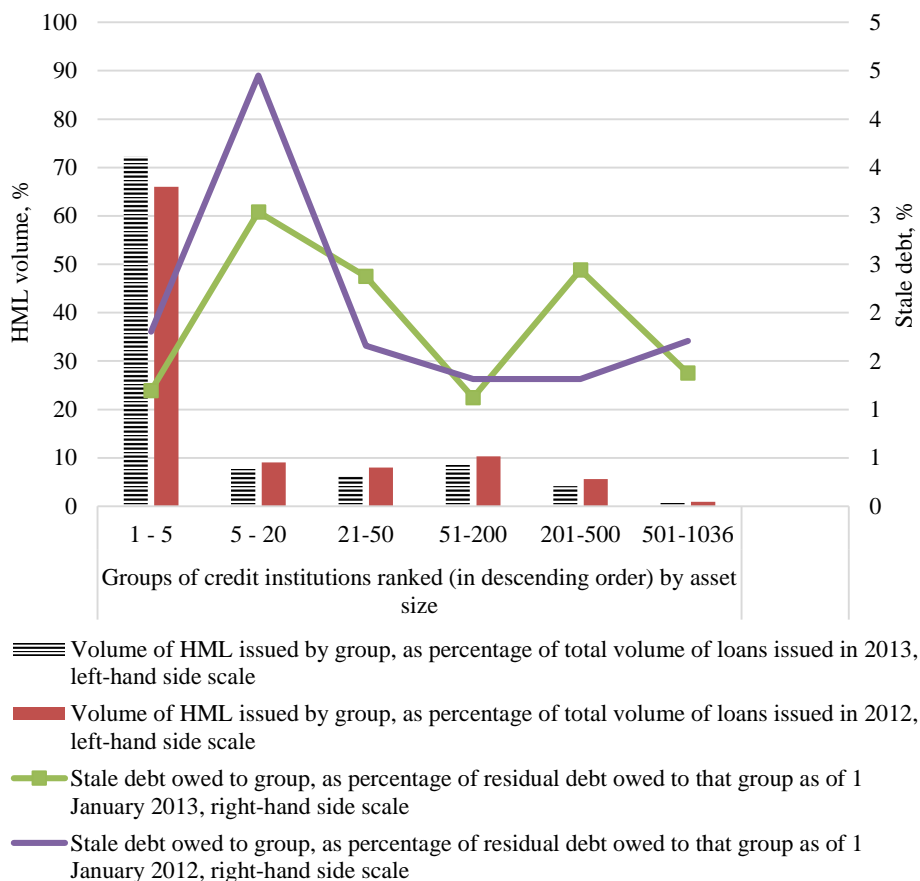
Housing mortgage lending as a priority tool to be employed in acquiring a dwelling becomes attractive in the eyes of consumers when the yield obtainable in the framework of available saving schemes is higher than the interest rate on housing mortgage loans. In this case even those who have some money to spend would prefer to take a housing mortgage loan and save the money for other purposes – which is essential for economic development.

However, another situation is possible - when housing prices grow at a higher rate than the payments against housing mortgage loans do. In this case, housing mortgage lending, instead of a method of acquiring a dwelling, becomes a financial mechanism for getting a good yield on investment, even if the actual amount of money to be invested is very limited. Credit risks plummet, there emerges a 'class' of borrowers capable of getting unsecured loans, and the resulting 'housing mortgage boom' pushed up prices on the housing market, with the looming threat of a housing mortgage crisis.

In 2013, the share of HML denominated in foreign currencies, issued since the year's beginning, in the total volume of HML and the share of debt against HML denominated in foreign currencies in the total volume of debt against HML continued their downward movement and as of 1 January 2014 amounted to 1.1% and 4.2% respectively. The share of stale debt against HML denominated in foreign currencies in the total volume of stale debt against HML varied in the course of 2013 from 33.5% to 36.0%, amounting as of 1 January 2014 to 35.6%, which points to the fact that the quality of HML denominated in foreign currencies is significantly lower than that of HML denominated in rubles.

The share of the topmost group of credit institutions with the largest assets, comprising 5 such entities, in the total volume of HML issued over the course of 2013 amounted to 72.2%, having gained 6.23 pp. on its 2012 index (*Fig. 16*) and 18.46 pp. on its 2011 index, a fact indicative of the ongoing monopolization in the housing mortgage market. The share of all the other groups of credit institutions shrank accordingly. Given the existing trend towards a decline in the share of stale debt in total debt across Russia -1.5% in 2013 vs. 2.1% in 2012 - the second group of credit institutions continued to keep the largest share of stale debt (3.0%), which means that its HML portfolio is the most risky one. As of 1 January 2014, the first two groups of credit institutions accounted for 80.1% of the HML market (*Fig. 16*).

According to the expert estimation carried out by the Agency for Housing Mortgage Lending (AHML), in 2013 the share of HML in the primary housing market, including the construction projects in progress, continued to be on the rise and over the period January – November 2013 amounted to 30.0% of the total volume of HML, having risen by 10.0 p.p. on 2012. As of 1 July 2013, housing mortgage loans in the amount of Rb 113.1bn had been repaid ahead of schedule with the borrowers' own money, which represents a 4.1% rise on 1 July 2012. This sum amounts to 20.8% of the total of HML issued over the first half-year period, and 77.7% of the total volume of HML repaid ahead of schedule, which represents a drop of 0.04 pp. on the first half-year period of 2012. The amount of HML repaid before schedule by the money raised through the sale of mortgaged properties was Rb 1.6bn, or by 20.5% less than the amount repaid over the first half-year of 2012.



Source: data released by the RF Central Bank.

Fig. 16. The Dynamics of the Volumes of Issued HML and State Debt, by Group of Credit Institutions Ranked by Asset Size

In 2013, the Agency for Housing Mortgage Lending refinanced a total of 32.7 thousand ruble-denominated mortgage loans in the amount of Rb 48.0bn, which represented a 21.3% drop on 2012 in money terms, and a 28.1% drop on the aforesaid year in terms of number of loans. Over January - November, the mortgage redemption rate set by the Agency for Housing Mortgage Lending amounted to 11% (for the following standard products: ‘Standard’, ‘House Under Construction’, ‘Young Teachers – Standard’, ‘Young Scholars’ and ‘Military Mortgage’), which is by 1.47 p.p. lower than Russia’s average weighted rate for that period, based on RF CB data.

The Agency for Housing Mortgage Lending is switching over part of its resources to the direct support of housing construction projects, and the elaboration of special support programs. Over the period from 1 October 2009 through 1 November 2013, it assumed obligations under the *Stimul* [Stimulus] project in the amount of Rb 95.8bn, of which a total of Rb 37.2bn has already been invested in the project's implementation. Out of the total sum of Rb 48.5bn issued by banks to legal entities to be invested in housing construction under the *Stimul* [Stimulus] project at an average interest rate of 13,2%, the Agency refinanced a total of Rb 47.9bn at the rate of 7.8%. While the average market price of standard residential units in the *Stimul* project is Rb 56,130 per square meter (Q2 2013), the average market selling price declared by the program’s participant was Rb 63,213 per square meter.

The declining economic growth rate in the RF makes it difficult to adequately estimate the prospects of the housing mortgage lending market in 2014. Nevertheless, in 2013, housing affordability somewhat increased – the housing affordability coefficient in 2013 dropped by 10%. The growth rate displayed by the housing mortgage lending market was higher than that in the consumer lending market. In this connection, the volume of HML issued in 2013 increased as a percentage of GDP, to 2.0% vs. 1.7% in 2012, while the total volume of debt against HML amounted to 4.0% of GDP – thus rising 0.35 pp. above its pre-crisis record high achieved in 2007. The HML portfolio's quality improved: the amount of stale debt against ruble-denominated HML shrank to 1%, the total amount of stale debt – to 1.5% of the amount of residual debt, and the amount of debt against defaulted loans - to 1.8%. The upward movement of the interest rate observed in 2012, in 2013 changed its direction – largely because the lower interest rates introduced by Sbarbank and the Agency urged other banks to follow this example in their interest rates policies. It should be added, however, that in December 2013 the interest rate once again gained 0.2 pp.

#### 6.5.5. The Prospects for the Housing Market's Development

The period of post-crisis recovery is over, but no new economic growth drivers have emerged so far. The forthcoming cuts in budget expenditure is an unequivocal signal to Russia's economic agents that the current situation in the national economy is uncertain and precarious – a fact that has been officially recognized.

The RF Government's basic scenarios for Russia's economic development in the next three years (until 2016) build on the assumption that the trends prominent over the past one-and-a-half years will either persist or disappear as a result of some fundamental changes. A fundamental change implies that the main economic indicators will once again display growth at a rate of 3% per annum or higher. It is precisely this scenario (let us call it 'the optimistic one') that has been applied in the official forecast oriented to economic revival in the next three years:

- accelerated domestic demand growth;
- revival of growth demonstrated by investment in fixed assets;
- stable consumer spending indices;
- improving competitive capacity of domestic industry;
- an intensive process of import substitution.

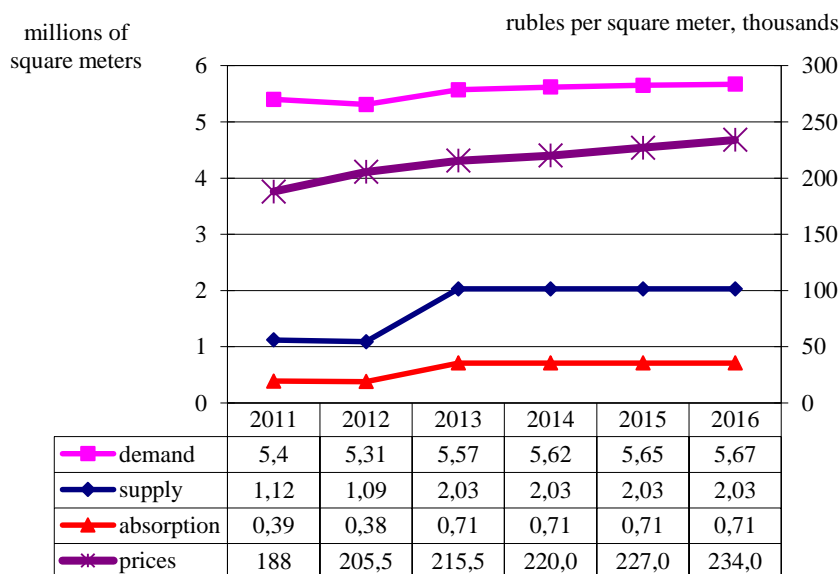
The second scenario (chosen by the Ye. T. Gaidar Institute for Economic Policy's experts as a basic one) implies that economic activity in the next few years will remain at a low level; at the same time, it is assumed that the economic growth rate will be gradually accelerating in response to the implementation of a comprehensive government program designed to improve the business climate in the Russian Federation. The key factor of this growth will be a persistently positive external situation, primarily maintained by high oil prices (at levels above \$ 100 per barrel) and a stable demand for Russia's exports of raw materials (in individual volumes). We believe that this scenario (stagnation-oriented) is the most realistic one. The principal theme of the basic scenario is a low rate of economic growth (below the world's average), its factors being negligible growth of the investment activity and a slowdown in the household final consumption expenditure. The population's real disposable money income in 2014–2016 will be growing at the rates of 0.9%, 0.4%, and 1.0% respectively.

However, if oil prices plummet to the level of \$ 80 per barrel, another scenario will evolve (let us call it a pessimistic one), triggered in the main by a negative growth rate in the real sector,

significant depreciation of the ruble, and so on. In other words, even the stagnation-oriented (or realistic) scenario implies that the external background will remain positive.

In accordance with the realistic (stagnation-oriented) scenario, a forecast for the future housing market development in Moscow and Perm until 2016 was prepared. The calculations are based on a local residential real estate market model (version 2.0, 2013)<sup>1</sup>. The results are shown in *Fig. 17* and *18*<sup>2</sup>.

### A. The Primary Market

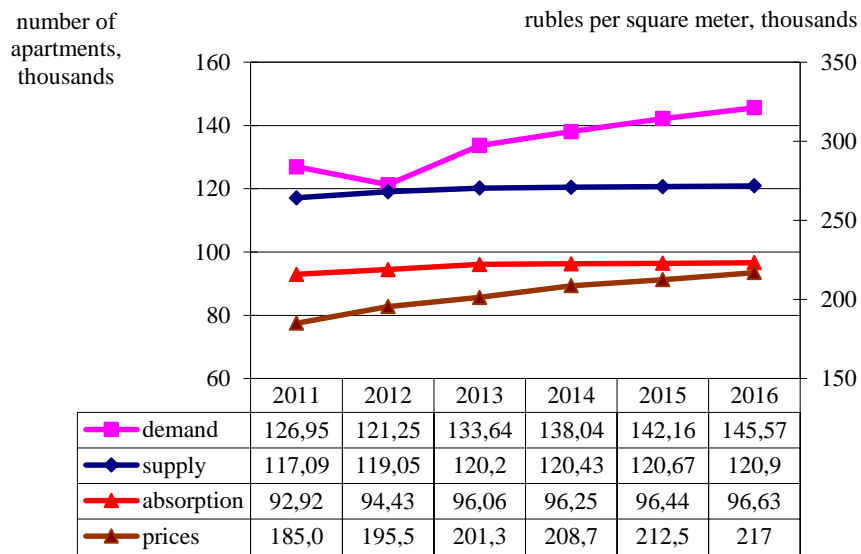


### B. The Secondary Market

<sup>1</sup> Sternik G. M., Sviridov A. V. *Sovershenstvovanie i retrospektivnaia proverka metodiki srednesrochogo prognozirovaniia razvitiia lokal'nogo rynka zhiloi nedvizhimosti* [Improvement and Retrospective Verification of the Methodology of Medium-term Forecasts of the Local Residential Real Estate Market's Development] // *Imushchestvennye otnosheniia v Rossiiskoi Federatsii* [Ownership Relations in the Russian Federation]. 2013. No 10 (145). P. 48–63. <http://realtymarket.ru/metodi-eskie-materiali>.

Sternik G. M., Sviridov A. V. *O vliianii makroekonomicheskikh uslovii na razvitiie rynka zhiloi nedvizhimosti (na primere Moskvy)* [The Influence of Macroeconomic Conditions on the Development of the Residential Real Estate Market (A Case Study Based on Moscow's Data)]. A report delivered at the International Development Association (IDA) Conference. 30 August 2013. <http://realtymarket.ru/konfa.html>.

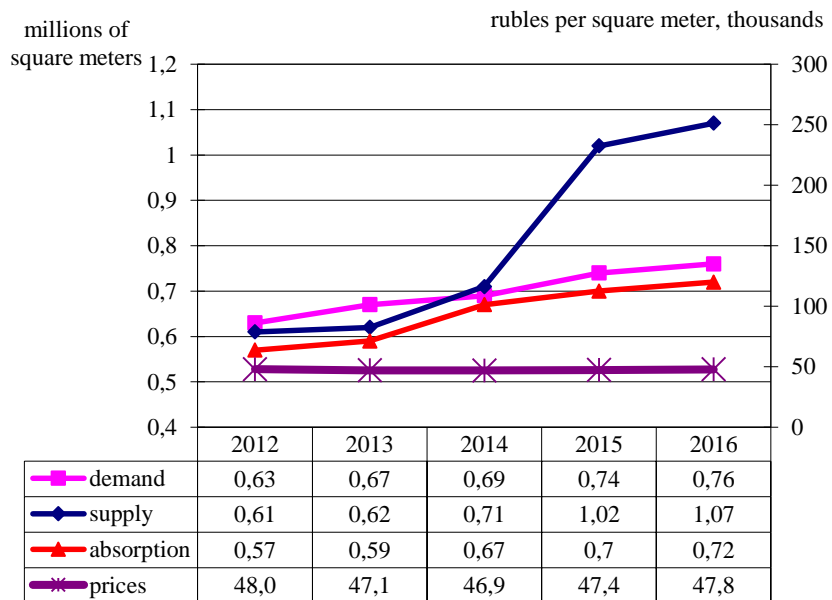
<sup>2</sup> In *Fig. 17* and *18*, the absorption curve reflects the movement of the number of purchase-and-sale and exchange transactions in the secondary market, and the total floor area of apartments sold in the primary market. The unit applied to measure the absorption volume in the secondary market is the number of apartments, that in the primary market – square meter.



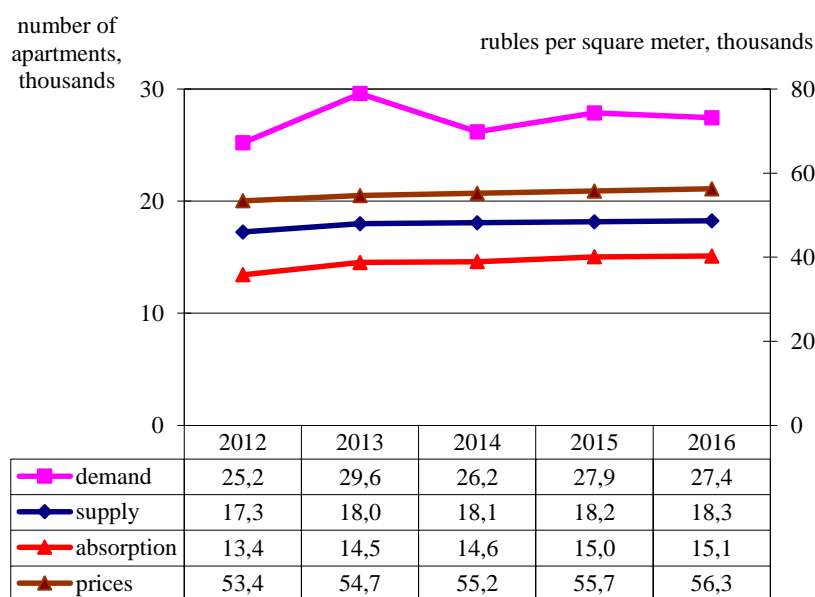
Source: OOO Sternik's Consulting.

Fig. 17. Forecast of Moscow's Residential Real Estate Market in the Macroeconomic Conditions Plotted under the Most Probable Scenario

### A. The Primary Market



### B. The Secondary Market



Source: initial data - by LLC *Analiticheskii Tsentr KD-konsulting* [KD Consulting Analytical Center], Perm; calculations by LLC *Sternik's Consulting*.

Fig. 18. Forecast of Perm's Residential Real Estate Market in the Macroeconomic Conditions Plotted under the Most Probable Scenario

According to this forecast, the most likely situation in the residential real estate markets of these two cities (Moscow and Perm) will be characterized by stability with a low rate of growth/decline of prices, supply volumes, and floor area absorption in the primary and secondary markets (+/- 3–4% per annum).

## 6.6. Defense economy and military reform in Russia

The national military establishment of Russia continued developing in 2013 in the same manner, i.e. ill directed, as it was launched in and proceeded after 1992. This refers to both the reforms of the Ministry of Defense of the Russian Federation and the modernization of Russia's Armed Forces (AF).

Technically, in 2013 Russia had all the documents required for stagewise development of its military potential, namely the State Armaments Program for the Period of 2011–2020 (SAP-2020), the National Security Strategy (NSS-2020), and the Military Doctrine of the Russian Federation. The foregoing documents were approved by the then incumbent Presidents.

However, not all of these documents saw successful implementation, in particular in addressing socio-economic problems faced by the military personnel. All in all, the Russian military personnel didn't seem to feel content with a "new image" of the Armed Forces and the Ministry of Defense of Russia. A fraud row broke out nationwide on the eve of 2013. President Putin had to replace those in charge of the military development program. Strategic miscalculations were revealed.

Therefore, the year 2013 saw an unscheduled turning point in the development of the national military establishment in Russia. After the Russian President made short-notice

replacements of those military high-ranked officials who dishonored their names, “by-default” civil servants began to view the strategic concept of the military reform only through Presidential orders. Under the circumstances, however, pursuant to the regulations of a law-governed state and the management theory, the NSS-2020 and the Military Doctrine should have been updated and the unsuccessfully launched SAP-2020 adjusted so that all those involved in the management can consider these documents as long-term guidelines.

Conceptual changes required to the national military establishment of Russia still remain to be defined clearly. Even a decision to introduce a new branch of troops capable to conduct information-specific (cyberspace) operations was announced but not covered in the strategic planning documents. In 2013, the newly appointed officials in the Ministry of Defense neither recalled nor reminded of the NSS-2020 and the Military Doctrine. All of them were engaged in correcting the “errors” committed by the replaced military officials.

It should be noted that a few years ago, after the United States and some other countries introduced similar troops into their armed forces, the Kremlin didn't rush into commissioning the Ministry of Defense with the same task, restricting itself to setting respective tasks to other government agencies, mostly the Federal Security Service of the Russian Federation (FSC), which can be explained by that protection should be provided to individuals (the population) as the key target of potential information wars. Moreover, the situation in the area of information changed especially with regard to the population. For example, the share of adults with cell phones increased to 91% in Russia while Internet services expanded. Consequently, the role of government-controlled television and printed media declined. Even when natural emergencies occurred, the population received a great deal of information from non-government sources of information, as was the case with the flood in Krymsk, the asteroid crash in Chelyabinsk etc., when mass communication sources outstripped government-controlled mass media. This explained why the Kremlin was so cautious about the recent war events in the Middle East which showed that mass communication sources may well have an unwanted effect on the noncombat (until a certain point) population and their uncontrolled “self-organization”.

It was later realized that modern information (cyberspace) systems may impact not only humans but also fully computerized technical (military) systems with automated control processes. This implies that it is not only the FSC of Russia and similar agencies, but also the Ministry of Defense which operates military and technical systems in the Armed Forces and seeks various ways of impacting the systems operated by potential enemy forces, that should be engaged in planning and running information wars.

There was another reason why foreign state's leaders expressed concerns about means of information wars in 2013, i.e. the situation was further aggravated by a recession that hit most of the economies and impacted both respective government agencies and the population who were discontent with degrading living standards.

Addressing these issues, a few states updated the development concept of their national defense and security agencies, especially the armed forces. The goals and objectives of military agencies were revised. As a rule, new insights of foreign state leaders were documented based on serious scientific research.

For instance, a new document – France New Strategy: The 2013 White Paper<sup>1</sup> – was adopted in April 2013. Without setting ourselves a task of comparing this document with the NSS-2020 (or a package of the provisions set forth in President Putin’s orders), we can highlight the following. According to the developers of the new French document (the fourth one in the history of France), it was an indication of a new stage in ensuring the national security of both France and the entire Europe”. Furthermore, many strategic provisions of the previously developed concepts were kept intact. However, some significant innovations were introduced. A key aspect of the document concerns the establishment of an agency for counteracting information and cyber threats (l’Agence de la sécurité des systèmes d’informatiques) aimed at both ensuring national security and being engaged in offensive operations.

Nonetheless, French military (national defense) outlays are expected to decline despite its growing geostrategic ambitions. The developers of the strategy suggest that financial supply to future operations should be shared among the EU members. Other states including the United States, also had to update their military development concept and limit the traditional military (national defense) outlays to keep their population stay happy.

This review is not intended to cover such issues as whether or not Russia may begin to make up a new (or update the old) development concept (strategy) of its Armed Forces and, most importantly, dare to curtail its military (national defense) outlays.

However, the following relevant aspects are worth noting. First, growth in the federal budget military (national defense) outlays after 2010 and their bias towards spending on the Armed Forces equipment, so-called “development outlays”, against spending on the Armed Forces maintenance (“consumption”) was based on disinformation rather than reliable military and economic data. The authors of this review repeatedly pointed to such facts in their previous publications<sup>2</sup> with reference to the primary source of information, but the facts were ignored.

Second, it is not the President but lower level officials who need the documents to be refined and updated so that they can better understand the concept of the modern modernization and “horizontal” cooperation in addressing sub-problems and tasks. Furthermore, it would be useful to raise general public awareness of the changes to the Russian Armed Forces.

#### 6.6.1. Topic military construction issues and how they can be addressed

None of the military and political leaders, or an insider made an attempt to explain publicly the economic feasibility of the military reform concepts and their actions as administrators, so that it can be available for analysis by independent experts. No speeches for the population and reporters can replace a scientific discussion with independent experts.

Under the circumstances, Sergei Shoigu was unexpectedly appointed as Russian Defense Minister. He took the office predictably beginning with addressing the issues which cannot be considered either topical or requiring new substantial outlays, and investigation into sophisticated fraudulent schemes.

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<sup>1</sup> Watanabe L. France New Strategy: The 2013 White Paper]. URL: <http://www.isn.ethz.ch/Digital-Library/Publications/Detail/?lng=en&id=169217> (date of access: 15.07.2013). Summary translation into Russian is available at: <http://csef.ru/index.php/ru/oborona-i-bezopasnost/project/340-voenno-strategicheskie-otsenki-i-prognozy/1-stati/4742-strategiya-frantsii-2013-ofitsialnyj-dokument>.

<sup>2</sup> *Tsymbal V. I.* Military construction plans need to be adjusted // *Economicheskoye Razvitiye Rossii*. 2013. No. 8. pp. 49–52 ].



Shoigu announced his first decision at a meeting with the senior executives of the Ministry of Defense which was held immediately after his appointment as Minister of Defense. He issued an order directing cadets from the Suvorov Military School and the Nakhimov Naval Academy to take part in Victory Day Parades. So they did on May 09, 2013. Additionally, the Minister announced his plans to reassign the control of military higher education institutions which under former Minister of Defense Serdyukov A. used to be coordinated by the Ministry of Defense Education Department, to Commanders-in-Chief and branch commanders on whose behalf the military personnel are supposed to be trained as new weapons come into operation. This was done too.

The Defense Minister's statements concerning the military uniform received a positive response. Additionally, other minor, as it may seem, but important daily-life issues have been addressed.

The concept of rational military formation structure and dislocation of troops has been refined. In particular, the "division – regiment" organizational structure was restored in the Air Force (AF), as well as air defense and aerospace defense brigades were reorganized into air defense divisions. The AF deployment became to be based on the "one regiment – one airfield" principle.

Much more complicated is the situation with recovering the "lost" assets, i.e. those that were virtually stolen at the time when A. Serdyukov held the Minister's office. The case is doomed to encounter challenges, because the skillfully disguised allegedly legal nature of the deals requires filing legal actions aimed at terminating and invalidating such deals.

It would be much easier to predict what is going to happen with the excessive stock of non-core military assets (property) left at the Ministry of Defense. It is the Federal Agency for State Property Management (Rosimushchestvo) that is expected to be assigned to dispose of such assets (property).

The Ministry of Defense is still facing the issue of getting rid of unneeded stock of outdated military hardware, a total of almost 300,000 tons of dangerous "metal scrap" which need to be guarded for the time being. Not only may long-lasting efforts to destroy these hardware using the Ministry of Defense's resources result in manpower losses but they are also inefficient.

Of great importance is the new Defense Minister's statements about the Ministry getting more transparent, making public its plans and performance results. The introduction of conference calls with varying composition of participants, as well as publishing the results of such conferences in mass media has proved efficient. Although the expected release of the Ministry of Defense White Book was delayed, the Ministry published its MO-2013 Report on the official website, which can be considered a positive result<sup>1</sup>.

Summing up the results of Shoigu's actions in 2013, most of them can be considered efficient. However, it might take long to see the effect of such actions.

#### 6.6.2. Military recruitment policy and procurement

The appointment of a new Defense Minister and reappointment of some of the top executives at the Ministry of Defense was followed by a proposal to make adjustments to, above all, the military recruitment policy (MRP), and bring back all skilled specialists. Regretfully, this hardly seems feasible though, after so many years of "reforms" and because of personnel ageing, loss of research schools and succession.

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<sup>1</sup> <http://vil.ru/files/result2013/index.html>

The originally initiated by Serdyukov A. and Makarov N. reduction of total commissioned officers strength from 335,000 to 150,000 persons and subsequent increase up to 220,000 has raised the question of whether the military recruitment policy was smart enough? Is it well estimated for the time being? Isn't this number of regiment officers too big for the announced manpower strength in the Armed Forces totaling 1 million? The Land Force and Navy need specialists at the low and mid-levels of military command.

Furthermore, a few so-called "science squadrons" staffed with "most gifted graduates" were introduced into the Armed Forces. It will take long, however, until any visible results can be achieved.

At the same time, this has been opposed by those lobbying traditional-type military education institutions and training programs. The lobbyists aren't concerned by that military schools and higher education institutions should graduate about 10,000 persons annually to maintain the number of military officers at a level of 220,000. Any bigger number of graduates will be excessive. Nevertheless, higher military schools accepted cadets were accepted 15680 in 2013.

There is misbalance in selecting and training the required number of enlisted military personnel and junior command personnel for the voluntary contractual military service. The President's call for increasing the number by 50,000 annually means not only selecting newly contracted military personnel, but also retain though any possible incentives those who serve well. Furthermore, numerous studies show that the amount of military compensation (MC) including other incentives should be higher than the national average wage (AW). At present, the basic MC, net of new increments, amounts to about Rb 20,000 per month, while the national average wage is near Rb 29,000. No changes to this are expected in the short run. New increments will be introduced for some but not all of the military personnel. They managed to increase the number of contracted personnel in the Russian Armed Forces to 225,000, whereas the plan was to increase it to 241,400 at 2013 year-end, and this despite the fact that enlistment in 2013 reached 81,000, i.e. by 27% more than planned. At the same time, a bigger than expected number of the previously contracted military personnel refused to extend their contract, whereby showing low incentives to do military service.

President Putin pointed out that five years ago about Rb 600bn were allocated annually to the Ministry of Defense. The sum was subsequently doubled, and in 2014 it will amount to Rb 2,3 trillion. Furthermore, most of the increment refers to the equipment of the Russian Armed Forces. The Government was and is "running short of the money" which is required to increase the MC to contracted military personnel (approximately Rb 30bn by estimates). And, however, there is no money to finance the promised indexation of pension benefits for the retired military personnel, and many other costs falling under the "consumption" category.

Total manning level in the Russian Armed Forces remains the same, around 82%. One may reasonably ask whether the value of this indicator is substantiated, whether it's high time to recognize a strength of less than 1 million. It is more important for the civil society to know whether this country really needs enlisted military personnel in time of peace. Even considering that the term of their basic training for full military service was reduced down to four months by making the training more intensive, one may reasonably want to know whether these personnel are able to "pay off" within the eight months left for service?

There are more issues that need to be addressed. It is not for the first time that Russia's people were assured that only contracted military personnel would be engaged in hotbeds of

tension<sup>1</sup>. There, however, are lots of facts of repeated failures to keep such promises. Some of the procurement issues, above all, the provision of military personnel with living accommodations need to be addressed too. Although a huge success has been achieved here, the dynamics runs counter to common sense, i.e. the greater is the number of provided living accommodations, the tougher is getting the situation with the “homeless” military personnel on the waiting list, which is also influenced by their (officers who were and are to be dismissed) requirements to the quality and location of the provided living accommodations. Vague differences between budget and extrabudgetary resources required to satisfy the need for living accommodations make the system tend to be less transparent, thereby making corruption unavoidable in this area.

Perhaps, this is the reason why the Defense Minister suggested that from January 1, 2014 it is not residential apartments but an adequate amount of lump sum payment that should become the key form of providing the military personnel with living accommodations<sup>2</sup>, which, as he assumes, will make it easier for those in the waiting list. A respective law was adopted in December 2013.

Enhancing operational training of the military personnel, units, forces, and conducting joint exercises can be regarded as positive results for the MRP.

Summing up the achievements and lost opportunities regarding the MRP pursued in 2013, what should not be left unmentioned is the initiatives launched by the Ministry of Defense and the legislative bodies at the end of 2013, when it became clear that the planned manning in the Armed Forces was facing even more challenges. A series of amendments to the applicable laws and regulations were drafted and submitted to the State Duma for consideration. However, there are no guaranties of success, because the two key factors still remain to be overcome, namely compulsion to military service (regarding to the enlisted personnel) and greediness (regarding to those who serve on a contractual, voluntary basis).

### 6.6.3. Military-technical policy and supplying new weapons to the Russian Armed Forces

It is difficult to analyze the results achieved in 2013 in the key areas of the Russian military-technical policy (MTP) because of numerous promises that were made in substantiating the level of military expenditures on its implementation, and indistinctness of a comparative analysis of not only actual achievements, but also lost opportunities.

As a reminder, a promise was made not only to increase supplies of new weapons and military equipment (WME) to the Russian Armed Forces, but also to address a few other issues, such as:

- 1) providing a comprehensive development of the military-industrial complex (MIC) of the Russian Federation, its technical equipment, and manufacturing personnel training;
- 2) manufacturing WME not only for the Russian Armed Forces, but also as part of the military and technical cooperation with other countries (export and import);
- 3) maintaining WME in a serviceable condition fit for combat;
- 4) developing new military technologies and latest combat weapons, as well as training of engineers and designers specializing in modern technologies;
- 5) sharing latest technologies and design concepts with the civil sector and vice versa.

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<sup>1</sup> Gavrilov Y. Professionals to be engaged // *Rosyiskaya Gazeta*. 2013. February 15, 2013.

<sup>2</sup> [http://ria.ru/defense\\_sofety/20130204/921125299/.html](http://ria.ru/defense_sofety/20130204/921125299/.html)

It is well known that these objectives were formulated inexplicitly, “literary”. They were set in the Armed Forces Long-term Strategic Objectives Plan, the SAP-2020 for the period of 2011 thru 2020, the MIC development programs, and specified in government defense orders (GDO), and a series of documents. Additionally, the objectives were ascertained as part of continuing management of the development of the Armed Forces and the MIC by Russia’s political and military leaders who often function in the manual control mode.

However, the legal and regulatory framework failed to work the way it was supposed to. Although Deputy Prime Minister Dmitry Rogozin expressed his appreciation to the legislators for drafting the required laws, “We have done what had to be done and the President signed the federal laws we adopted by the upcoming 2012 year, above all, the Federal Law No. 275-FZ On the Government Defense Order, the Federal Law No. 44-FZ On the Contract-Based System of Procurement of Goods, Works and Services for Public and Municipal Needs which is coming into force. And, of course, the Federal Law On the Advanced Research Foundation<sup>1</sup>.

Speaking of the 2013 results, it should be noted that any state armaments program (SAP) has its initial, most essential 5-year implementation period, i.e. the current program has the same period of time spanning between 2011–2015. Therefore, the year of 2013 is in a sense the principal year over the period under review, although the results of that year shouldn’t be set apart from the SAP failures in the two preceding years.

Additionally, preparations for the development of a new SAP-2025 for the period of 2016 thru 2025 have kicked off. The MIC top executives should take as obligation President Putin’s words that the Russian Federation will not expect to incur such huge SAP costs in the future (no exact period was specified).

These seemingly natural issues have so far been kept outside the scope of issues that aren’t supposed to be addressed or even discussed. It is not until the very end of 2013 that President Putin mentioned the issue in his Presidential Address and called for a solution. And, let’s face it, he did it in the right time, because a new budget for the period of 2014 thru 2016, i.e. beyond the first 5-year period of the SAP-2020, has been approved. However, it contains no signs of financing the transition to a closer end of a period of highest ever costs on the equipment of the Armed Forces.

The still remaining interpretation of the current MTP in Russia keeps the principle of “grab-swiftly-as-much-as-you-can” prevailing and most important incentive for many Russia’s top managers. Therefore, the struggle over budget allocations keeps going, and President’s words about inevitably upcoming military budget cuts are being ignored.

The net effect is that there is no integral vision at successful development of the MIC, equipment of the Armed Forces, let alone a positive effect of the MIC on the development of the national economy despite unconditional success on some of the five aforementioned objectives. This can be illustrated by the following.

### ***MIC development in the Russian Federation***

Considering that the Russia’s military establishment has been assigned the task of making the current Armed Forces into innovative ones, the former needs latest WME samples which can be provided through further upgrading the research-and-technology and engineering-and-manufacturing framework at MIC facilities. A respective MIC modernization program was developed and resources allocated.

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<sup>1</sup> Rogozin D. Reviving the defense industry. // VPK No. 49 dated 18.12.2013.

The problems faced by the MIC were discussed extensively late in 2013<sup>1</sup> during a meeting attended by Deputy Minister of Defense Yury Borisov, senior officials, and deputies CEO's of major state-run corporations and holdings, i.e. arms suppliers. The discussion was dedicated to the GDO and its role in the implementation of the SAP-2020.

According to the Deputy Defense Minister, “the use of public resources is subject to a series of conditions virtually diluting the very idea of using them. For example, there is a provision for cooperation with engineering companies. There is no way that a modern cost-efficient, high-end manufacturing can be established without sound engineering. There is another big problem, i.e. the way the federal laws and regulations regulate tenders. The state has to buy from the winner low-quality cheap products, i.e. machine tools without after-sales service and supplies of respective spare parts tools and accessories”. Additionally, Yury Borisov also pointed out that under the law 50% of machine tools should be manufactured in Russia. However, these machine tools are most often the “last century hardware”. The issues of pricing have long been left unresolved. However, neither the Ministry of Defense, nor the MIC see any reason for being blamed for this, “because the issues are first of all supposed to be addressed through laws and regulations. It's another matter that the Ministry of Defense and the MIC should intensify their lobbying efforts and participate more actively in drafting well-defined laws and regulations which promote rather than constrain the scientific and industrial development”.

Therefore, it derives from the available data on the MIC organizational and technical development that the resources allocated to the MIC have been spent ineffectively. This can be explained by an excessive monopolistic power prevailing at top levels of the MIC's manufacturing hierarchy, who tend to set prices, terms, and even WME basic characteristics. Another reason is that it is mostly principal enterprises of the MIC that managed to survive at hard times, whereas manufacturers of components degraded, failed to upgrade and compete with foreign suppliers, and many of them went bust.

Under the circumstances, some contracts cannot be concluded, because there is nobody who would wish to do it. The situation cannot be saved by simply raising the amount of allocations. “The state has to pay a dear price to purchase military equipment”, said Deputy Chairman of the Military Industrial Committee under the Russian Government (MICRG) O. Bochkarev. “This area is riddled heavily with corruption and nontransparent procurement schemes, added Polyakov I., Chairman of the MIC Industrial Branch of Delovaya Rossiya, an all-Russian public organization. Light fingered contractors tend to make sure the price is low, obtain 80% upfront, and then disappear. Furthermore, those enterprises which have failed to complete an order may easily receive a new one”.

### ***Manufacturing WME for the Russian Armed Forces and for export***

The beginning of 2013 held promise. The Russian Navy flag was hoisted on January 10, 2013 on the K-535 Yuri Dolgoruky Borei-class ballistic missile submarine (SSBN). Another underwater nuclear cruiser Aleksander Nevsky came into operation at the end of the same year as part of the same project. It should be noted, however, that this had no effect whatsoever on the Russia's strategic deterrence potential, because the notorious Bulava submarine-launched ballistic missile designed for such cruisers failed to be put into service, i.e. Russia's nuclear submarines (NS) remain disarmed for the time being. It is only the previously tried and tested strategic deterrence assets that can save the situation. As a reminder,

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<sup>1</sup> Military arts – a competent conversation. The materials of a roundtable which was held in RIANOVOSTI late in 2013.

the national strategic posture is meticulously measured on the basis of the treaty signed between the United States and the Russian Federation and, as equally important, the results are published.

The level of compliance with the arrangements on the reduction of strategic offensive arms (SOA) as of 1.09.2013 is shown in *Table 28*.

*Table 28*

**Data on the SOA quantities in the Russian Federation and the United States**

SOA title	Threshold values under the treaty	U.S.A. on actual basis	Russia on actual basis
Deployed launchers: intercontinental ballistic missiles (ICBM), submarine-launched ballistic missiles (SLBM), and heavy bombardment aircrafts (HBAC)	700	809	473
Deployed launching and non-deployed launching platforms for the same classes of launchers	800	1015	894
Warheads on deployed launchers	1550	1688	1400

*Data source:* Bureau of Arms Control. Verification and Compliance. Washington, DC: US Department of State, 2013.

It derives from the data presented in *Table 28* that Russia is currently behind the United States by number of strategic offensive assets which may be recognized within the deterrence concept. As a reminder, the United States (besides the assets recognized under the treaty) has incomparably more sea-launched cruise missiles than the Russian Federation does, as well as other assets which weren't covered by the international treaties. This implies that the balance of powers has been becoming increasingly asymmetric and approaching the deterrence threshold limit. Measuring the military assets of NATO members, such as Great Britain and France, as well as deployment of ABM systems leads even closer to the threshold limit. True, Russia cannot ignore the imbalance. Neither can it ignore the fact that China and a few other states have similar nuclear weapons (NW). This is why the situation with Russia's strategic deterrence assets was and still remains the principal, essential indicator of Russia's military potential and national security.

Besides the NW, the potential of conventional high-precision guided weapons has been growing year after year in many countries. Russia is still behind in the development of such weapons and therefore compelled to retain its tactical NW stocks and delivery systems, as well as the possibility of their use in regional conflicts.

Providing information support to the strategic deterrence assets is equally important. Russia has been making efforts to resolve this issue. In 2013, three new prefabricated radar stations (RS) for missile warning system (MWS) were built (in the Krasnoyarsk Territory, the Altai Territory, and the Orenburg Region) to control ballistic, space-based, and aerodynamic targets<sup>1</sup>.

Regarding the development of conventional combat weapons, the possibility and practicability of purchasing such weapons from other countries moved to a new phase in 2013. On the one hand, it would be wrong to resolve the issue behind-the-scenes, as A. Serdyukov wanted to do. On the other hand, Russian top executives cannot resolve it through a comprehensive analysis of all factors and controversial arguments. To date, at least the order on the supply of French made Mistral-class multirole surface warships to the Russia's Naval Force has been still in force so far.

There is neither need nor technical capacity to list in this review the achievements or, *a contraria*, failures in the development of all conventional arms. Even if we restrict ourselves

<sup>1</sup> Voенно-promyshlenny weekly journal No 2 dated 16-22.01.2013

to, for example, analysis of the results achieved in the development of military air vehicles and weapons based on the latest scientific attainments. Moreover, they are traditionally linked to the development of the civil aviation and in this context can serve as illustrative example for the given MIC objectives in general.

However, it should be kept in mind that the development of modern military air vehicles has been evolving into manufacturing of unmanned drones (UMDs), with information and cybernetic means of control playing the principal role. Russia is behind other countries in this. It cannot be but mentioned that Rb 3bn worth of long-time mission air vehicles are under development in the Russian Federation at such companies as Transas (St. Petersburg) and OKB Sokol (Kazan). A heavier UMD is being development at the Sukhoi Aviation Holding Company (JSC)<sup>1</sup>. However, like in the previous years, not a single UMD has come to operation yet to pay off the costs of their development.

It is the United States and Israel that are leading in the development and combat employment of UMDs. However, Russia is facing difficulties in terms of military and technical cooperation with these countries. The United States has been steering away from dealing with Russia's enterprises, while Israel is cooperating with certain reservations. There is an interesting information though: ADCOM Systems, an Emirati company, is ready to deliver to the Russian Ministry of Defense its United 40 drone for test. According to some data, engineers from the Kharkiv Aviation Institute were actively engaged in the development of this drone. Indeed, competitive relationships move in a mysterious way. If the Russian military need such a vehicle, it might seem more rational for the Russian party to deal directly with the Kharkiv specialists. However, relationships between Russia and Ukraine and, consequently, between their MICs are so controversial that politics leaves no room for practicality.

After all, failures to fulfill the seemingly key objective with a huge financing are the indication of that the SAP-2020 has failed to be up to a "perfectly estimated to the last kopek" program, as the Russian President described it once, and, therefore, not subject to any cuts. The defense industry simply has no enough time to spend the money which can be invested. This is why the SAP-2020 began to see gradual cuts in 2013. Russia's Finance Minister Siluanov A. gave comments on this said at the end of the first half of the year, saying that "the Ministry of Finance and the Ministry of Defense have agreed to carry over a part of the state armaments program expenditures", and explained that it refers to carrying over to 2017–2018 a part of the budget expenditures scheduled for allocation for these purposes in 2014–2016. At the same time, he pointed out that "the program's deadline, 2020, remains unchanged"<sup>2</sup> as well as the total amount of budget expenditures does.

Some experts considered this a reason to infer that "Russia's Arms Forces and the MIC are facing the main issue of deep disorganization and generally overflowing incompetence of the administrative body, rather than lack of financing, and even embezzlement. The Bulava missile has been tested for nine month, half of the missile flights were abortive. However, no one could say that this ill-fated project lacks financing"<sup>3</sup>?

Nonetheless, annual accounting is still expressed in rubles showing neither success nor visible failures.

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<sup>1</sup> *Nikolsky A.* A wide product line of drones // *Vedomosti*. 2013. December 5, 2013 (No. 226).

<sup>2</sup> [mn.ru/society/20130614/348897295.ht...](http://mn.ru/society/20130614/348897295.ht...)

<sup>3</sup> <http://www.kommersant.ru/doc/2282902>

### ***WME operation issues***

The idea to switch to EPC contracts with industrial enterprises<sup>1</sup> in order to ensure WME “life cycle” was a Defense Minister’s new proposal entailing serious effects. He stated that this is supposed to “minimize risks of failure to fulfill government defense order (GDO) assignments”. A new scheme of WME repair and disposal was for the first time suggested by the Defense Minister at a meeting with President Putin late in a January 2013. Explaining the Defense Minister’s decision, his Deputy Y. Borisov said that every device designed for the Armed Forces will be subject to support services from the release date until the disposal stage. He also assured that “such contracts have been approved by manufacturers”. Technically, it will look like service support of the products supplied “to the Russian Armed Forces effective this year ... through sub-agreements on the provision of support services, repair, and disposal throughout the device’s entire service life”. An agreement on the provision of support services to Yury Dolgoruky Borei-class ballistic missile nuclear submarine, as well as frontline, military airlift, and strategic airplanes is expected to be signed among first such contracts.

There is nothing yet to say, or worth saying, about whether or not this innovation is useful. Indeed, it should be useful for industrial enterprises, because they will have profitable orders. However, it may not be the case for military units and, broadly speaking, the national defense. It cannot be ruled out that the effect might be inverse when special conditions are required for the deployment, as it was the case with unfounded introduction of outsourcing to meet the Army needs. Furthermore, no one can quarantine an “eternal life” to manufacturing enterprises. And it will appear then that we have given up our historically proven experience in training WME maintenance personnel in regular line units, while no field experts will be available at all or such experts will not be able to reach the battlefield or operate in harsh natural conditions, for example, subarctic environment.

### ***Developing new WME and engineering personnel training***

Advanced Research Foundation (ARF) was established in order to ensure dynamic development of groundbreaking but risk-bearing technologies for the sake of national defense and security. However, it might take longer for the Foundation to be formed, and there is little hope of turning it into something that resembles successful foreign analogues, in particular, the U.S. Defense Advanced Research Projects Agency (DARPA)<sup>2</sup>.

The issue of manufacturing personnel training hasn’t been put aside. Top managers of industrial enterprises and holdings report on the issue to the Military-Industrial Commission under the Government of the Russian Federation. Overall, as it was repeatedly stated, the SAP-2020 is synchronized with the MIC Development Federal Targeted Program (FTP) whose public contractor-coordinator is the Ministry of Industry and Trade of the Russian Federation (Minpromtorg). As part of the foregoing FTP enterprises reequip their production facilities to be able to manufacture new models. However, it will take long until these works can be fully linked with the works performed as part of the projects promised by, for example, ROSNANO or Skolkovo. One cannot but hope that all these entities and foundations will approve themselves at next stages of the SAP-2020, most importantly, as part of the new SAP-2025.

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<sup>1</sup> [http://ria.ru/defense\\_safety/20130213/922638863.html](http://ria.ru/defense_safety/20130213/922638863.html)

<sup>2</sup> Tsymbal V.I. How the adoption of the ARF Act may influence the Russian economy? // *Ekonomicheskoye Razvitiye Rossii*. 2013. No. 2. pp. 48–52. What Russia’s Economy Should Expect from the Adoption of the Federal Law on the Advanced Research Foundation? [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2271110](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2271110);



The issue hasn't been forgotten, but the way it has been addressed rises some questions. To bring up questions and look for solutions, let's cite a few lines from Dmitry Rogozin's report in the State Duma: "the focus should be placed on manufacturing brand new models of arms, military and special equipment, rather than deep modernization of the models which can be manufactured by our industry. This requires new materials, new knowledge, new solutions. In other words, a new program must be innovative. This is a challenge. The huge scientific and technological potential which our fathers and grandfathers created has been exhausted. We have no new solutions left for materialization"<sup>1</sup>.

Indeed, there is no room for argument here. Nevertheless, applied research and development was financed on an annual basis. Furthermore, having succeeded in the ARF establishment, Military Industrial Committee Chairman Dmitry Rogozin suddenly points to other high-ranking officials, a new need "to upgrade the status of chief designer, a person who assumes full liability for looking for new solutions".

Where new components, let alone "dual purpose" ones, may come from if the principal generator of latest scientific and technical ideas is not the ARF but a team of competing chief designers aimed at creating WME end products rather than components, materials, technologies is? Doesn't such a concept contradict the U.S. DARPA concept and, consequently, that of the ARF?

### *Transferring military technologies to civil industries*

Like in the case with the previous task, no serious results were achieved here in 2013. What happened led to more questions than answers. For example, Russian Rostec Corporation, a military-oriented company, announced late in 2013 its unexpected "contribution" to the production of a new dual-screen smart phone called YotaPhone. YotaPhone's main application properties imply that it is designed to enhance reliability of transmitting vital information (if the main screen battery runs out of power) to the consumer.

Nothing was said about using such devices for military purpose, although the need to equip the Armed Forces with modern reliable and user-friendly means of communication and spatiotemporal provision, for example, GLONASS, has long been discussed. However, such a presentation of the potential dual-use feature of the gadget is unlikely to cover its production costs and enhance its military relevance. The rest of the new device is rather discouraging, because it was previously announced that nothing but the dual screen was designed in Russia. The gadget that was demonstrated to the Prime Minister turned out to be assembled of imported components in Singapore, not Russia.

Sukhoi Superjet-100 (SSJ-100), a passenger air jet, is much more serious illustration of dual (civil and military) use of the products manufactured by the MIC. However, it may hardly be considered a success. Since the original plan on sales in external markets didn't work out, the WME customers had to buy these air jets despite the strict home airfield quality requirements, which is untypical of military aviation.

Most importantly, both military and civil aviation are facing equally pessimistic prospects in Russia, as convincingly evidenced by Russia's high-profile test pilot M. Tolboev who named the main reason for the failures and even tragedies (in particular, the civil aircraft crash in the city of Kazan) that took place: "This is corruption in its pure form"<sup>2</sup>. He also predicted a pessimistic outcome.

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<sup>1</sup> Rogozin D. Reviving the defense industry. 2013. December 18, 2013 (No. 49).

<sup>2</sup> Magomet Tolboev: Bribes lead to plane crashes // Pravda.ru. 2013. December 3, 2013.

Innovation “products” are often fictitious. Let’s take a look at the results of a few audits. “Having spent huge public allocations, the Minpromtorg of Russia has failed to fulfill the objectives of developing and introducing cutting edge technologies and enhancing the research and intellectual potential of the aircraft and shipbuilding industries. The obtained results have been found to be insufficient to cover the costs of the inventions which the state has made no use of”<sup>1</sup>. Furthermore, as specified in the cited publication, “facts of the Ministry paying for unperformed R&D and overpricing have been revealed. Preliminary estimates show that the damage may reach about Rb 1bn”.

Overall, summing up the 2013 results concerning all the issues of equipment of the Armed Forces, the Defense Minister expressed satisfaction: “in 2013, R&D (research and development) GDOs were fulfilled 96%, and it cannot but satisfy. WMSE (weaponry, military and special equipment) have been purchased 93%, WMSE repair and service support – 91%. This is a serious achievement”. “We have seen a substantial growth in arms supplies: we have received 1.7 times more equipment than in 2012. The number of reclamations will be the same or less than in 2012. We have to work on further reducing the number of reclamations, and a lot depends on the Ministry of Defense Acceptance Committee”<sup>2</sup>, added the Minister.

#### 6.6.4. Military and financial policy

The 2013 federal budget implementation didn’t differ much from the schedule of the two previous years, except that two major adjustments were made in June and December. Furthermore, in June, the mid-year expenditures under the item of National Defense were reduced by Rb 6bn 540m for the first time since the recession in September 2009. Under the Federal Law on the Federal Budget, expenditures under the same item were initially established Rb 2 trillion 106bn<sup>3</sup>, or Rb 223bn less than what the Russian Government planned in the preceding year<sup>4</sup>. A decision was made at the end of the year to increase by Rb 11bn 783m the corresponding federal budget expenditures.<sup>5</sup>

As a result of the foregoing mixed changes by the end of the fiscal year federal budget expenditures under the item of National Defense increased as little as 0.25% to Rb 2 trillion 111bn 705m (3.17% of GDP), while total budget expenditures remained unchanged. Expenditures under the same budget item increased 7.4% in real terms (14.4% in nominal terms) against 2012.

Since all of the foregoing military expenditures are not available in the published budget acts, they were determined on the basis of the reports made by the Federal Treasury reports and core committees of the Russian Federation Federal Assembly. Confidentiality of federal budget expenditures was visibly enhanced in 2013 vs. the previous years, 2 p.p. above the 2006 historical high (see *Table 29*), while confidential budget allocations amounted to Rb 1 trillion 865bn 442m, of which 63% were allocated mainly as GDO to the MIC and 26%

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<sup>1</sup> Nikolayev S., Safronov I. Prosecutors in defense // Kommersant. 2014. January 29, 2014.

<sup>2</sup> [http://ria.ru/defense\\_safety/20140114/989097405.html](http://ria.ru/defense_safety/20140114/989097405.html).

<sup>3</sup> The Federal Law of 03.12.2012, No 216-FZ On the Federal Budget for 2012 and the Planning Period of 2013 and 2014.

<sup>4</sup> The draft law No. 607158-5 On the Federal Budget for 2012 and the Planning Period of 2013 and 2014. M., 30.09.2011.

<sup>5</sup> The Federal Council Committee for Defense and Security’s conclusion on the Federal Law On the Amendments to the Federal Law On the Federal Budget for 2013 and the Planning Period of 2014 and 2015. No. 3.3-04/1892 dated 26.11.2013.

to secret-service agencies. The secrecy system of federal budget allocations has seen no quality changes whatsoever, while the state keeps thoughtlessly adhering to the Soviet way of doing it.

Table 29

**The share of confidential expenditures in the federal budgets  
of 2005 thru 2013, %**

Code and item (sub-item) containing confidential expenditures	2005	2006	2007	2008	2009	2010	2011	2012	2013
1	2	3	4	5	6	7	8	9	10
Federal budget expenditures, overall	11.3	11.8	10.3	11.9	10.0	10.5	11.7	11.7	13.9
0100 NATIONAL-LEVEL ISSUES	3.7	6.3	5.5	8.7	5.1	4.8	9.8	11.4	9.5
0108 International relations and international cooperation	–	<0.1	<0.1	3.7	–	–	–	–	–
0109 State material reserves	82.9	89.2	92.2	90.2	85.0	85.1	86.6	86.8	87.2
0110 Basic research	2.1	1.2	1.1	1.0	0.8	0.3	1.0	2.7	0.7
0114 Other national-level issues	0.1	0.7	0.3	4.4	1.6	1.1	1.3	1.3	2.3
0200 NATIONAL DEFENSE	42.1	42.8	45.3	46.1	48.1	46.4	46.9	47.6	51.0
0201 Armed Forces of the Russian Federation	33.1	35.6	37.1	39.0	40.2	39.0	40.9	41.2	48.3
0204 Mobilization preparation of the economy	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
0205 Preparation for and participation in collective security and peace-making efforts	100.0	100.0	100.0	–	–	–	–	–	–
0206 Nuclear weapons complex	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
0207 Fulfilling international commitments concerning military-technical cooperation	45.2	46.9	50.7	100.0	100.0	100.0	100.0	100.0	80.1
0208 Applied research studies in the area of national defense	98.4	93.9	93.7	93.2	92.9	91.3	92.2	94.5	94.1
0209 Other national defense issues	2.5	8.8	24.4	29.2	34.6	42.0	36.8	44.9	41.9
0300 NATIONAL SECURITY AND LAW ENFORCEMENT ACTION	28.5	31.6	31.1	31.8	30.8	32.1	32.5	23.3	27.4
0302 Internal affairs agencies	4.8	6.3	5.2	5.0	3.7	4.3	3.9	3.4	3.8
0303 Internal troops	11.8	10.3	9.8	10.3	8.2	8.3	7.9	4.6	4.5
0306 Security agencies	97.8	95.5	97.3	99.1	99.6	97.1	99.6	99.6	99.7
0307 Russia's border service agencies	100.0	99.0	97.6	100.0	99.5	98.6	99.1	99.1	99.6
0309 Protection of the population and territories from natural and man-made emergencies	59.0	62.4	50.7	51.4	51.0	51.3	47.0	42.6	40.7
0313 Applied research studies in the area of national defense and law enforcement action	74.0	66.4	64.4	75.5	79.4	92.1	86.0	85.9	91.4
0314 Other issues concerning national security and law enforcement action	8.3	50.7	40.0	56.3	68.4	67.9	78.3	13.6	12.3
0400 NATIONAL ECONOMY	0.1	<0.1	0.4	0.6	0.6	1.6	1.8	2.4	4.9
0411 Communications and informatics	–	–	–	–	–	–	–	–	1.6
0411 Applied research studies in the area of national economy	–	–	5.2	5.8	4.5	5.6	11.9	14.2	18.2
0412 Other issues concerning national economy	0.1	0.1	<0.1	0.3	0.7	4.5	1.9	2.3	8.5
0500 HOUSING AND PUBLIC UTILITIES	–	3.4	0.9	7.0	10.1	19.3	14.2	6.6	11.0
0501 Residential sector	–	4.2	5.7	16.0	12.9	20.8	20.7	8.5	21.3
0700 EDUCATION	2.8	2.7	2.4	2.6	3.1	3.6	4.0	3.2	4.3
0701 Pre-school education	2.0	2.2	2.4	2.5	2.5	3.9	3.9	4.4	4.5
0702 General education	1.5	1.9	2.1	2.0	2.8	3.5	0.4	0.2	0.5
0704 Secondary vocational education	1.1	1.0	1.0	0.9	1.0	–	–	–	–
0705 Professional training, retraining, and advanced training	16.9	15.8	17.2	1.8	2.5	9.4	17.4	8.6	6.2
0706 Higher education and postgraduate vocational education	3.2	2.9	2.5	3.1	3.6	4.1	5.2	4.1	5.2
0709 Other education related issues	0.3	0.3	0.3	0.3	0.5	0.6	0.3	0.4	0.4
0800 CULTURE, CINEMATOGRAPHY, MASS MEDIA	0.2	0.2	0.2	0.2	0.2	0.2	–	–	–
0800 CULTURE AND CINEMATOGRAPHY	–	–	–	–	–	–	0.1	0.1	0.1

Cont'd

1	2	3	4	5	6	7	8	9	10
0801 Culture	0.1	0.1	0.2	0.1	0.1	0.1	0.1	0.1	0.1
0804 Periodic press and publishing companies	13.5	7.5	2.6	2.6	3.2	3.6	–	–	–

0806 Other issues concerning culture, cinematography, and mass media	<0.1	0.2	–	–	–	–	–	–	–
0900 HEALTHCARE, PHYSICAL CULTURE, AND SPORTS	4.3	4.0	2.6	4.1	3.5	3.0	–	–	–
0900 HEALTHCARE	–	–	–	–	–	–	2.7	2.4	2.7
0901 Inpatient medical assistance	5.6	4.7	2.9	3.2	2.8	2.4	2.3	2.0	1.8
0902 Outpatient medical assistance	n/a <sup>1</sup>	n/a	n/a	13.9	4.3	3.8	2.9	3.1	4.2
0905 Sanatorium and related medical assistance	n/a	n/a	n/a	14.1	15.9	10.7	11.2	10.8	12.2
0907 Sanitary and epidemiological safety	n/a	n/a	n/a	2.1	0.6	0.6	0.7	1.4	0.8
0908 Physical culture and sports	0.3	0.3	0.2	0.4	0.3	0.6	–	–	–
0910 Other issues concerning healthcare, physical culture and sports	–	–	–	1.7	1.1	1.0	–	–	–
0910 Other issues concerning healthcare	–	–	–	–	–	–	0.4	0.4	0.3
1000 SOCIAL POLICY	–	–	–	<0.1	<0.1	–	–	0.1	0.1
1003 Social security	–	–	–	<0.1	<0.1	–	–	0.3	0.3
1100 PHYSICAL CULTURE AND SPORTS	–	–	–	–	–	–	0.3	0.3	0.4
1101 Physical culture	–	–	–	–	–	–	62.0	41.5	9.1
1200 MASS MEDIA	–	–	–	–	–	–	0.3	0.3	0.4
1202 Periodic press and publishing companies	–	–	–	–	–	–	3.4	3.5	4.6
1400 INTER-BUDGET TRANSFERS BETWEEN THE CONSTITUENT ENTITIES OF THE RUSSIAN FEDERATION AND GENERAL MUNICIPALITIES	–	–	0.2	–	–	–	–	–	–
1401 Equalization transfers to the constituent entities of the Russian Federation and municipalities	–	–	0.5	–	–	–	–	–	–

Source: the Federal Budgets of 2005–2013. The data on 2005–2010 is presented in accordance with respective items and sub-items of the budget classification effective since 2011. Italicized is the data of the previous budget classification, as well as estimates which are subject to change.

Table 30 shows absolute and relative values of the basic components of Russia's direct military allocations in the federal budget and changes to these values against 2012. The data of the Federal Law of December 3, 2012, No. 216-FZ was used for 2013, because the final version of the Federal Law on the 2013 Budget<sup>2</sup> contains no data on the federal budget expenditures by item and sub-item of the budget expenditure classification. Recalculation into 2012 prices was made using Rosstat's first estimation<sup>3</sup> of the GDP deflator index for 2013 (106.5%).

Military allocations in other federal budget items are shown in Table 31. Here, unlike the practice of the previous years, special agencies' confidential expenditures on education, healthcare, housing and public utilities, etc, as well as civil defense expenditures and maintenance costs on the EMERCOM (the Ministry of the Russian Federation of Civil Defense, Emergences and Elimination of Consequences of Natural Disasters) forces are no longer classified as military expenditures in other budget items (the latter – due to changes to the UN standards for reporting military expenditures<sup>4</sup> effective since 2012 and classifying the military personnel pension provision as military expenditure).

Table 30

**Direct military allocations in the federal budget, “National Defense” item**

Budget item and sub-items	2013, millions of	The share of allocations, % / changes against 2012, p.p.
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<sup>1</sup> Non-applicable due to changes to the budget classification.

<sup>2</sup> The Federal Law of 02.12.2013, No. 348-FZ On the Federal Budget for 2013 and the Planning Period of 2014 and 2015.

<sup>3</sup> Gross domestic product (GDP) production and usage in 2013. M.: Rosstat, January 31, 2013. ]

<sup>4</sup> Government experts' report on the overview of functioning and further development of the United Nations system for the standardized reporting of military expenditures. A/66/89. UN, June 14, 2011.

	rubles / the same in 2012 prices	Changes in 2013 against 2012, millions of rubles / growth, %	2013 federal budget	in GDP
1	2	3	4	5
NATIONAL DEFENSE	2,106,462 1,977,899	131.648 7.13	15.73 1.49	3.16 0.17
Armed Forces of the Russian Federation	1,628,112 1,528,743 661	171,140 12.61	12.16 1.68	2.44 0.24
Mobilization pre-conscription and reserve military training	6,792 6,378	-938 -12.82	0.05 -0.01	0.01 -
Mobilization preparation of the economy	5,662 5,316	421 8.61	0.04 -	0.01 -
Nuclear weapons complex	29,289 27,501	26 0.10	0.22 0.01	0.04 -
Fulfilling international commitments in the area of military-technical cooperation	5,804 5,450	814 17.55	0.04 0.01	0.01 -
Applied research studies in the area of national defense	195,134 183,225	16,391 9.82	1.46 1.17	0.29 0.02
Other national defense issues	235,668 221,285	-55,789 -20.14	1.76 -0.38	0.35 -0.09

Source: Gaidar Institute's estimates.

Table 31

### Direct and indirect military allocations, other federal budget items

Budget item or type of allocations	2013, millions of rubles / the same in 2012 prices	Changes in 2013 against 2012, millions of rubles / growth, %	The share of allocations, % / changes against 2012, p.p.	
			2013 federal budget	in GDP
1	2	3	4	5
<b>National security and law enforcement action</b>				
Internal troops	129,029 121,154	-2,744 -2.21	0.96 0.01	0.19 -0.01
Russia's border service agencies	142,386 133,696	47,732 55.53	1.06 0.40	0.21 0.07
<b>National economy</b>				
Alternative civil service	6 5	-1 -10.46	<0.01 -	<0.01 -
Destruction of chemical weapons stockpiles in the Russian Federation Presidential Program	6 6	-711 -99.21	<0.01 -0.01	<0.01 -
Subsidies to transport organizations for purchasing motor vehicles to replenish the military convoy rolling stock	55 52	-3 -6.10	<0.01 -	<0.01 -
Subsidies to maintain the Russia-NATO Coordination Center	51 47	-2 -3.01	<0.01 -	<0.01 -
Construction of special-purpose and military facilities	14,306 13,433	1,666 14.16	0.11 0.02	0.02 -
Industrial Utilization of weapons and military equipment (2011–2015) Federal Target Program	87 82	-18 -18.36	<0.01 -	<0.01 -
Contributions to charter capital and subsidies to organization pertaining to the military-industrial complex	48,285 45,338	-7,066 -13.48	0.36 -0.04	0.07 -0.01
Scholarships to young personnel employed by organizations pertaining to the military-industrial complex	240 225	-15 -6.10	<0.01 -	<0.01 -
Confidential expenditures	86,124 80,867	32,479 67.12	0.64 0.27	0.13 0.05

Cont'd

1	2	3	4	5
<b>Housing and public utilities</b>				

<i>Destruction of chemical weapons stockpiles in the Russian Federation</i>	<u>362</u> 340	<u>131</u> 62.82	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
<i>Presidential Program</i>				
<i>Provision of military personnel with temporal living accommodation owned by the employer and permanent living accommodation owned by the employee</i>	<u>38,382</u> 36,039	<u>-93,615</u> -72.20	<u>0.29</u> -0.71	<u>0.06</u> -0.15
<b>Education</b>				
<i>Ministry of Defense expenditures</i>	<u>58,511</u> 54,949	<u>7,260</u> 15.23	<u>0.44</u> 0.07	<u>0.09</u> 0.01
<b>Culture and cinematography</b>				
<i>Ministry of Defense expenditures</i>	<u>2,137</u> 2,006	<u>115</u> 6.08	<u>0.02</u> -	<u>&lt;0.01</u> -
<b>Healthcare</b>				
<i>Ministry of Defense expenditures</i>	<u>47,963</u> 45,963	<u>2,924</u> 6.94	<u>0.36</u> 0.03	<u>0.07</u> -
<b>Social Policy</b>				
<i>Pension provision at the Ministry of Defense</i>	<u>254,910</u> 239,352	<u>-12,731</u> -5.05	<u>1.90</u> -0.04	<u>0.38</u> -0.03
<i>Pension provision to the Border Troops and Internal Troops under the Ministry of Internal Affairs</i>	<u>29,012</u> 27,241	<u>3,390</u> 14.22	<u>0.22</u> 0.03	<u>0.04</u> -
<i>Tangible support to specialists employed by the nuclear weapons complex of the Russian Federation</i>	<u>6,110</u> 5,738	<u>-6</u> -0.11	<u>0.05</u> -	<u>0.01</u> -
<i>Extra monthly tangible support to persons disabled as a result of war injuries</i>	<u>617</u> 579	<u>138</u> 31.34	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
<i>Assistance in repairing individual residential houses owned by the families of the military personnel who lost the bread-winner</i>	<u>216</u> 203	<u>-403</u> -66.50	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
<i>Provision of servicemen' survivor benefits</i>	<u>1,709</u> 1,605	<u>88</u> 5.81	<u>0.01</u> -	<u>&lt;0.01</u> -
<i>Benefits and compensatory payments to military personnel and equated persons, as well as the retired of them</i>	<u>7,256</u> 6,813	<u>-2,016</u> -22.84	<u>0.05</u> -0.01	<u>0.01</u> -
<i>One-time pregnancy allowance to spouses of enlisted servicemen, as well as monthly child's benefit to enlisted servicemen</i>	<u>2,503</u> 2,350	<u>82</u> 3.62	<u>0.02</u> -	<u>&lt;0.01</u> -
<b>Physical culture and sports</b>				
<i>Ministry of Defense expenditures</i>	<u>1,824</u> 1,713	<u>1,615</u> 1,653.93	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
<b>Inter-budget transfers between the constituent entities of the Russian Federation and general municipalities</b>				
<i>Subsidies to the budget of Closed Administrative-Territorial Units (ZATOs)</i>	<u>11,566</u> 10,860	<u>1,984</u> 22.35	<u>0.09</u> -0.02	<u>0.02</u> -
<i>Migration from ZATOs</i>	<u>527</u> 495	<u>-32</u> -6.10	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
<b>OTHER BUDGET ITEMS</b>	<u>884,178</u>	<u>-25,823</u>	<u>6.60</u>	<u>1.33</u>
<b>TOTAL</b>	<u>830,214</u>	<u>-3.11</u>	<u>-</u>	<u>-0.06</u>

Source: Gaidar Institute's estimates.

As a result, in 2013, total military (national defense) allocations (*Table 32*) of the Russian federal budget, as calculated compliant to the UN standards for military expenditures, were estimated at 4.5% of GDP, demonstrating equal values for Russia and the United States, as well as such countries as Azerbaijan and Myanmar (economy's encumbrance in Europe and China ranged within 1% to 2%, except for Great Britain (from 2.5%) and France (from 2.3%).

*Table 32*

### **Total military and military-related allocations of federal budget in 2013**

Allocations title	Sum of allocations, millions of rubles	The share of allocations, % / changes against 2012, p.p.	
		2013 federal budget	in GDP
Total military (national defense) allocations related to the current and previous military activity	2,990,640	<u>22.34</u> 1.48	<u>4.48</u> 0.11
Total allocations under the budget items of National Defense and National security and law enforcement action	4,144,794	<u>30.96</u> 2.68	<u>6.22</u> 0.29

Source: Gaidar Institute's estimates.

Overall, in 2013, resources under the item of 0200 National Defense were spent, saving Rb 8bn 124m (0.4%) over the allocations provided for by the latest version of the Federal Law on the Federal Budget.

Federal budget savings under the item of 0201 Armed Forces of the Russian Federation totaled Rb 25bn 725m (6.7%) through Ministry of Defense's costs on subsistence support alone against the allocations provided for by the initial version of the Federal Law on the Federal Budget. In 2013, the Ministry of Defense saw just a 0.84% increase (in real terms) in subsistence support costs after the Russian Government made no indexation of the military compensation, despite a 20% increase in the number of enlisted personnel by the end of the year, from 186,000 to 225,000 persons. The Ministry of Defense spent a total of Rb 360bn 420m (0.54% of GDP) on the subsistence support in 2013.

The Ministry of Defense spent Rb 211bn 598m on civil personnel wages, an increase of 5.41% year over year in real terms despite a 5% headcount reduction in civil personnel compliant to the Russian Federation Security Council's decision of July 5, 2013 On the enhancement of the national military establishment of the Russian Federation until 2020<sup>1</sup>.

Ministry of Defense spent 4% less (in real terms) on petroleum, oil and lubricants (POL) in 2013, amounting to Rb 59 bn 266 m, saving Rb 4 bn 609 m (or 7.2%) over the amount allocated in the initial version of the Federal Law on the Federal Budget. It may therefore be assumed that a visible increase in 2013 in the frequency of spot operability tests and field training exercises was compensated by savings through an increased use of simulators for military personnel training.

Federal budget expenditures on the Ministry of Defense's subsistence and tangible support in 2013 increased 19.3% year on year in real terms (to Rb 54bn 693m and Rb 20bn 636 m respectively). Actual budget expenditures under these two items exceeded Rb 24bn 141 m, or 45.5%, the expenditures provided for by the initial version of the Federal Law on the Federal Budget.

Ministry of Defense's construction costs on civil facilities in 2013 increased 86% year over year to Rb 14bn 488 m under the item of National Defense and dropped 67% to Rb 41bn 210m under the item of Housing and public utilities. Construction costs of special and military facilities increased substantially 35.5% year over year and 57.2% of the costs provided for by the initial version of the Federal Law on the Federal Budget. Furthermore, military infrastructure costs increased to Rb 113bn 29m by the end of the year in response to the redistribution of Rb 75bn which the Ministry of Defense originally allocated to POL. Federal budget expenditures Concerning the Savings and Mortgage System of Housing Provision for Servicemen of the Ministry of Defense increased 25% year over year to Rb 58bn 834 m.

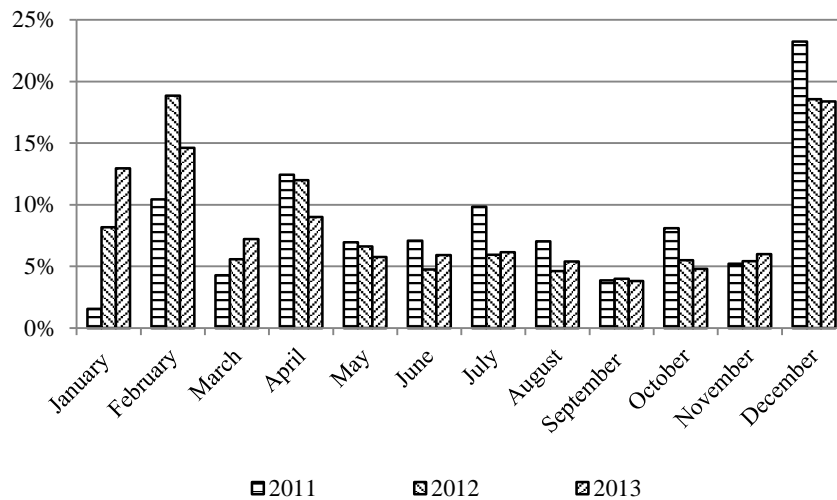
The item of 0200 National Defense keeps calling attention by rapidly growing expenditures under the sub-item 0209 Other national defense issues (Rb 259bn 602 m), where actually spent

<sup>1</sup> Approved by the President of the Russian Federation on 22.07.2013.

budget expenditures outstripped by Rb 23bn 934m (10%) the allocations provided for by the initial version of the Federal Law on the Federal Budget.

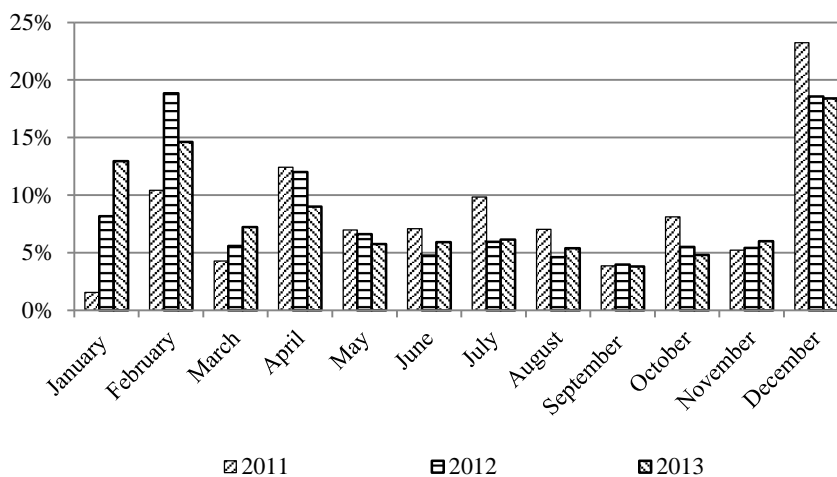
Pension provision costs on the Ministry of Defense military personnel in 2013 amounted to Rb 262bn 612 m, seeing a contraction of 2.4% year over year despite indexation, which is indicative of decrease in the number of retired military personnel.

The dynamics of actual monthly expenditures under the federal budget's major sub-items of the item 0200 National Defense in 2011 thru 2013 is shown in *Fig. 19–21*.



Source: Gaidar Institute's estimates based on the data supplied by the Federal Treasury of Russia.

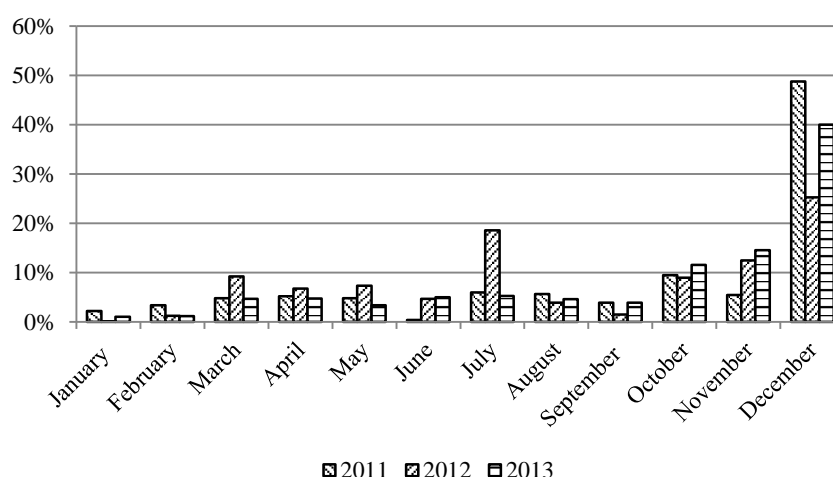
*Fig. 19. Implementing federal budget expenditures under the sub-item Armed Forces of the Russian Federation in 2011 thru 2013*



Source: Gaidar Institute's estimates based on the data supplied by the Federal Treasury of Russia.

*Fig. 20. Implementing federal budget expenditures under the sub-item Applied research studies in the area of national defense in 2011 thru 2013*





Source: Gaidar Institute's estimates based on the data supplied by the Federal Treasury of Russia.

Fig. 21. Implementing federal budget expenditures under the sub-item *Other national defense issues* in 2011 thru 2013

Table 33 presents military expenditures of the government of the constituent entities of the Russian Federation, being indicative of pertaining years-long trends. These expenditures account for 0.01% of GDP or less, whereby being considered as rather ritual expenses, and partial financing of these expenditures with federal transfers<sup>1</sup> may result in double count, what should be given a special attention during the evaluation thereof.

Table 33

**Military expenditures in the consolidated budget of the constituent entities of the Russian Federation in 2005 thru 2013, millions of rubles\***

Expenditure classification sub-item	2005	2006	2007	2008	2009	2010	2011	2012	2013
Armed Forces of the Russian Federation	–	<u>3,5</u> 0,1	<u>0,5</u> 0,3	<u>0,3</u> 0,3	–	–	–	–	–
Modernization of the Armed Forces of the Russian Federation and military units	–	–	–	<u>1,0</u> 0,5	–	–	–	–	–
Mobilization pre-prescription and reserve military training	<u>65,6</u> 65,6	<u>899,3</u> 808,6	<u>1 351,9</u> 1 245,6	<u>1 797,9</u> 1 702,2	<u>2 116,0</u> 2 021,6	<u>2 003,7</u> 1 958,4	<u>2 250,0</u> 2 187,3	<u>2 366,7</u> 2 316,4	<u>2 506,5</u> 2 444,7
Mobilization preparation of the economy	<u>485,4</u> 468,6	<u>708,3</u> 692,8	<u>861,2</u> 840,9	<u>1 137,2</u> 1 063,9	<u>1 045,4</u> 989,7	<u>1 298,4</u> 1 247,8	<u>1 351,2</u> 1 266,3	<u>1 781,0</u> 1 689,1	<u>2 343,1</u> 1 935,1
Other national defense issues	<u>109,6</u> 97,5	<u>32,8</u> 32,1	<u>5,5</u> 5,7	<u>0,7</u> 0,5	<u>4,4</u> 4,4	<u>&lt;0,1</u> <0,1	<u>2,7</u> 2,7	<u>3,2</u> 3,0	<u>3,2</u> 2,9
Internal troops	<u>9,9</u> 9,9	<u>3,5</u> 1,4	<u>1,0</u> 1,0	<u>0,3</u> 0,3	–	–	–	–	–
Russia's border service agencies	<u>0,1</u> 0,1	–	–	–	–	–	–	–	–
TOTAL	<u>670,6</u> 641,7	<u>1 647,4</u> 1 535,0	<u>2 220,1</u> 2 093,5	<u>2 937,4</u> 2 767,7	<u>3 165,8</u> 3 015,7	<u>3 302,1</u> 3 206,2	<u>3 603,9</u> 3 456,3	<u>4 150,9</u> 4 008,5	<u>4 852,8</u> 4 382,7

\* The numerator means allocated, the denominator means actually spent.

Source: Federal Treasury of Russia; Gaidar Institute's estimates.

<sup>1</sup> Financy Rossii. 2012: Statistical book. M.: Rosstat, 2012. P. 27.

Table 34 presents Russia's military expenditures incurred in the period of 1999 thru 2013, net of the military expenditures of the consolidated budget of the constituent entities of the Russian Federation shown in Table 33. The data presented in the Table allows one to assume that period-specific double-digit nominal growth rates of the military expenditures in real terms came to nought to a large extent because of outstripping growth in prices of the Russian MIC's products (for example, in 2012 the added value deflator stood at 122.9% in the shipbuilding industry and 127.7% in the aerial vehicles sector)<sup>1</sup>.

Table 34

**Key indicators of military (national defense) expenditures  
in the Russian Federation in 1999 thru 2013**

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
<b>1. In nominal terms (in current prices), billions of rubles</b>															
Federal budget implementation under the item of "National Defense" according to the current budget classification <sup>a</sup>	115,6	191,7	247,7	295,4	355,7	430,0	581,1	681,8	831,9	1040,8	1188,2	1276,5	1516,0	1812,3	2103,6
Federal budget allocations under the item of "National Defense": according to the current budget classification	93,7	209,4	214,7	284,2	354,9	427,4	578,4	686,1	839,1	1031,6	1192,9	1278,0	1537,4	1846,3	2111,7
moved to other items of budget classification <sup>b</sup>	–	–	–	–	–	–	44,3	77,7	91,3	126,5	202,4	270,8	324,4	223,1	149,2
in a comparable budget classification	93,7	209,4	214,7	284,2	354,9	427,4	622,6	763,9	930,4	1158,1	1395,3	1548,8	1861,9	2069,4	2260,9
military (national defense) expenditures, based on the UN data <sup>c</sup>	–	201,2	291,5	322,7	442,5	494,3	659,0	815,9	942,0	1118,0	1166,1	1162,5	1423,3	1689,3	–
Total defense appropriations related to current and past military activities <sup>d</sup>	137,5	292,2	301,0	424,8	549,7	578,8	780,8	952,2	1219,1	1433,8	1736,6	1893,6	2209,9	2651,3	2990,6
<b>2. In real terms (in 2013 prices)<sup>e</sup>, billions of rubles</b>															
Federal budget implementation under the item of "National Defense" according to the current budget classification	1586,6	1695,6	1645,0	1669,0	1648,6	1700,5	1863,9	1772,2	1856,0	1892,6	1962,3	1944,8	2042,1	2051,6	2103,6
Federal budget allocations under the item of "National Defense": according to the current budget classification	1286,1	1852,3	1426,5	1605,5	1645,0	1690,2	1855,0	1783,5	1872,1	1875,7	1970,0	1947,1	2071,1	2090,0	2111,7
moved to other items of budget classification	–	–	–	–	–	–	142,0	202,0	203,7	230,0	334,3	412,5	437,0	252,6	149,2
in a comparable budget classification	1286,1	1852,3	1426,5	1605,5	1645,0	1690,2	1997,0	1985,5	2075,8	2105,7	2304,3	2359,6	2508,1	2342,6	2260,9
military (national defense) expenditures, based on the UN data	–	1779,8	1936,6	1823,4	2050,9	1954,7	2113,6	2120,8	2101,8	2032,9	1925,8	1771,1	1917,4	1912,3	–
Total defense appropriations related to current and past military activities	1882,9	2584,1	1999,7	2400,0	2547,8	2288,9	2504,4	2475,1	2719,9	2607,1	2868,1	2885,0	2976,9	3001,2	2990,6
<b>3. In real terms (in 1999 prices), billions of rubles</b>															
Federal budget implementation under the item of "National Defense" according to the current budget classification	115,6	123,5	119,9	121,6	120,1	123,9	135,8	129,1	135,2	137,9	143,0	141,7	148,8	149,5	153,3
Federal budget allocations under the item of "National Defense": according to the current budget classification	93,7	135,0	103,9	117,0	119,8	123,1	135,2	129,9	136,4	136,7	143,5	141,9	150,9	152,3	153,9
moved to other items of budget classification	–	–	–	–	–	–	10,3	14,7	14,8	16,8	24,4	30,1	31,8	18,4	10,9
in a comparable budget classification	93,7	135,0	103,9	117,0	119,8	123,1	145,5	144,7	151,2	153,4	167,9	171,9	182,7	170,7	164,7
military (national defense) expenditures, based on the UN data	–	129,7	141,1	132,8	149,4	142,4	154,0	154,5	153,1	148,1	140,3	129,0	139,7	139,3	–
Total defense appropriations related to current and past military activities	137,2	188,3	145,7	174,9	185,6	166,8	182,5	180,3	198,2	189,9	209,0	210,2	216,9	218,7	217,9

<sup>1</sup> Russia's national accounts in 2005–2012: Statistical book./ Rosstat. M., 2013, p.220.

1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
<b>4. Military encumbrance on the economy, as percentage of GDP</b>															
Federal budget implementation under the item of "National Defense" according to the current budget classification	2.40	2.62	2.77	2.73	2.69	2.53	2.69	2.53	2.50	2.52	3.06	2.76	2.72	2.93	3.15
Federal budget allocations under the item of National Defense: according to the current budget classification	1.94	2.87	2.40	2.63	2.69	2.51	2.68	2.55	2.52	2.50	3.07	2.76	2.76	2.99	3.17
moved to other items of budget classification	–	–	–	–	–	–	0.20	0.29	0.27	0.31	0.52	0.58	0.58	0.36	0.22
in a comparable budget classification	1.94	2.87	2.40	2.63	2.69	2.51	2.88	2.84	2.80	2.81	3.60	3.34	3.35	3.35	3.39
military (national defense) expenditures, based on the UN data	–	2.75	3.26	2.98	3.35	2.90	3.05	3.03	2.83	2.71	3.00	2.51	2.56	2.73	–
Total defense appropriations related to current and past military activities	2.84	4.00	3.36	3.93	4.16	3.40	3.61	3.54	3.67	3.47	4.48	4.09	3.97	4.29	4.48
<b>5. By purchasing power parity (in current prices), billions of US dollars</b>															
Federal budget implementation under the item of "National Defense" according to the current budget classification	21,9	26,8	30,2	31,9	34,2	36,2	45,6	54,0	59,5	72,6	83,6	81,5	87,0	97,9	110,5
Federal budget allocations under the item of National Defense: according to the current budget classification	17,7	29,3	26,2	30,7	34,1	35,9	45,4	54,3	60,1	71,9	83,9	81,6	88,3	99,7	111,0
moved to other items of budget classification	–	–	–	–	–	–	3,5	6,2	6,5	8,8	14,2	17,3	18,6	12,0	7,8
in a comparable budget classification	17,7	29,3	26,2	30,7	34,1	35,9	48,9	60,5	66,6	80,8	98,1	98,9	106,9	111,7	118,8
military (national defense) expenditures, based on the UN data	–	28,1	35,6	34,8	42,5	41,6	51,7	64,6	67,4	78,0	82,0	74,2	81,7	91,2	–
Total defense appropriations related to current and past military activities	25,9	40,9	36,7	45,8	52,8	48,7	61,3	75,4	87,3	100,0	122,1	120,9	126,9	143,2	157,2
<b>For reference</b>															
Gross domestic product deflator, as percentage of the previous year	172,5	137,6	116,5	115,5	113,8	120,3	119,3	115,2	113,8	118,0	102,0	114,2	115,5	107,4	106,5
deflator of expenditures on final consumption of collective public administration services <sup>e</sup> , as percentage of the previous year	140,1	155,2	133,1	117,6	121,9	117,2	123,3	123,4	116,5	122,7	110,1	108,4	113,1	119,0	113,2
Purchasing power parity <sup>f</sup> , Rb/\$	5,29	7,15	8,19	9,27	10,41	11,89	12,74	12,63	13,97	14,34	14,22	15,66	17,42	18,52	19,03

<sup>a</sup> For 2013 – the Federal Treasury's preliminary data on the federal budget implementation.

<sup>b</sup> Total the Ministry of Defense's expenditures and secret outlays on items 05–09 and 11 of the federal budgets in 2005–2011, for 2012–2013 – additionally on item 12.

<sup>c</sup> For 2013 – will be presented by the Russian Government in UN in 2014, also including maintenance costs on internal troops and border troops.

<sup>d</sup> Including pensions of the retired military personnel.

<sup>e</sup> Deflated by using the deflator of expenditures on final consumption of collective public administration services.

<sup>f, g</sup> For 2013 – Gaidar Institute's estimates.

*Source:* Federal laws on the federal budgets for 2000–2013 and implementation of the federal budget in 2000–2012; Russia's national accounts in 1997–2012: Statistical book./ Rosstat. M., 2005–2013; Objective information on military issues including military (national defense) expenditures transparency. The UN General Secretary's reports in 2001–2013; Rosstat; the Federal Treasury of Russia.

\* \* \*

Military and economic situation in the Russian Federation has stabilized considerably after the notorious events that took place at the end of 2012 and ended up with Serdyukov and his inner circle resigning from their high-rank posts. On December 10, 2013, the Supreme Commander-in-Chief of the Russian Armed Forces and newly appointed top executives of the Ministry of Defense summed up in the ordinary course the results of 2013 and acknowledged that a few positive results were achieved in modernizing the Russian Armed Forces and

strengthening the national defense capability. Success in the development of the MIC and equipment of the Armed Forces with advanced combat weapons was acknowledged early in 2014.

However, there are many issues that still remain to be addressed not only at the level of Russia's national military establishment, but also at the top strategic level, requiring to ensure both successful economic development and national security at a time. It stands to reason that the Russian President began to hold regular enlarged government meetings to address, inter alia, the issues arising between the traditional government and subordinate security and law enforcement agencies.

Practical mastering of brand new WME coming into operation has become most important for the Russian Armed Forces. Therefore, the military-recruitment policy should be focused on personnel professionally trained to employ advanced technologies to fulfil their missions based on a computer-aided control and management system. Professional requirements should be applied to the personnel at all levels, i.e. from the private level to the highest level of the military command structure which should be based on a system of incentives towards a rational, long-term and efficient military service, encouraging career advancement and ensuring a high social status in the society.

Comparative analysis of the military component of the Russian federal budget with the budget of the world leading economies shows that further growth in expenditures, which previously never was reasonably substantiated, on the MIC development and technical equipment of the Russian Armed Forces has totally lost its credibility amid the current recession. Otherwise, overall level of Russia's military expenditures and, most importantly, the share of expenditures on the equipment of the Armed Forces in prejudice of costs on their maintenance and combat training may list Russia as sponsor of arms race, thereby damaging its peacemaker image.

It would be reasonable to refine the Russian budget classifier by approximating the same to the UN standard, because the UN standard and most countries' practice show that military expenditures are better to be divided into components which, on the one hand, describe the development of the Armed Forces, and, on the other hand, their current maintenance.

## **6.7. The North Caucasus in 2013: the conflicts are escalating**

The most obvious feature of the situation in the North Caucasus during last year was the disturbance of the fragile balance which had apparently begun to form in the preceding period, the escalation of existing conflicts and the emergence of new ones, including those related to resources. What was the cause of this escalation? What are its possible consequences? How does all this affect the economic situation in the region? These are the key questions which the authors aim to answer in this review.

### **6.7.1. Return to a power model: possible consequences**

The post-Soviet history of the republics of the North Caucasus has been characterised by two approaches towards the resolution of the conflicts in these regions. Usually, these are presented as two variants of the counter-terrorism policy, but in fact, the choice of one model over the other, can fundamentally affect many other aspects North Caucasian society.

The first model can be described as the "tough course" model. It has the following main features:

- the broadest possible interpretation of the concept of “terrorists and their accomplices”, which in fact includes all representatives of those Islamic movements in the region which are not considered by the government to represent traditional Islam and are therefore considered to be a source of radical views;
- uncompromising priority given to tough methods of counter-terrorism;
- the goal is to fight to the bitter end, to achieve a full overthrow of the enemy.

In relation to the second model experts use the term the “policy of soft power”. It takes a less linear view of the problem of terrorism:

- the followers of non-traditional Islam are allowed to practise their particular religions within the freedoms guaranteed by the Constitution of the Russian Federation and are considered as being separate from the terrorists and their accomplices, i.e. separate from those people violating the law and guilty of particular crimes;
- terrorists themselves are divided into the arrant, uncompromising ones, and those who would be prepared to end their unlawful activities; the latter include some who “have blood on their hands” and some who “have no blood on their hands”;
- a different policy should be applied to each of the above groups:
  - subscribing to non-traditional Islam, in the absence of any violation of Russian laws is generally taken to be that individual’s private business;
  - young people who “got into the forest” by accident or through folly, and who do not have blood on their hands should be helped to withdraw from “the forest” as soon as possible and enabled to live a peaceful existence;
  - militants who are ready to cease terrorist activities should be enabled to adapt to peaceful life, although views on the form of this kind of ‘adaptation’ vary: from full amnesty to the commutation of sentences in return for voluntary surrender;
  - tough forceful methods should unequivocally be applied to uncompromising militants;
- enforcement action and counter-terrorist operations should be carried out in strict compliance with the law, and should observe the rights of civilians;
- the purpose of the policy is civil pacification, reduction of conflicts, and a termination of splits within society.

The period of conduct of counter-terrorism policy in the North Caucasus can be divided into three sections, each of which is characterised by a different combination of these two ideologies. Until autumn 2010 the power model almost fully dominated. The period from autumn 2010 to late 2012 can be interpreted as a combination of approaches typical of both models: along with the continuing military pressure in a number of North Caucasus regions (Dagestan, Ingushetia) with commissions for the ‘adaptation’ of militants being created and the start of an inter-confessional dialogue between conflicting Islamic movements. It can be stated that in early 2013 a return to dominance of the “tough course” model began. This change has been particularly pronounced in the Republic of Dagestan, although it also affects other territories of the North Caucasus Federal District (NCFD). It was manifested in the following ways:

1. All forms of inter-confessional dialogue and coercion of militants that had been tried and tested in the preceding year almost completely ceased. As early as 2012, the activities of the Commission for Adaptation in Dagestan were being increasingly blocked by the representatives of the national security forces included in its composition and, finally, when the government of the Republic changed in early 2013, it was liquidated with the following assessment by the leader: “it played its part but this was insignificant”. In Ingushetia, with the assassination of the

Secretary of the Security Council, Ahmed Kotiev, who had been responsible for the Commission's activities, this work, apparently, also trailed away. After the terrorist attack on Shafii Shaykh Said Afandi al-Chirkawi, one of the the most influential people in Dagestan, the dialogue also proved to be in a deep crisis.

2. Using large special operations, increasingly tough methods have begun to be applied, targeting not only the militants themselves but also their families and the communities from which they come. For example, in April 2013, during a large-scale special operation in the village of Gimry in the Untsukul'sky District of Dagestan, all the inhabitants of the village were temporarily evicted, and when they returned, they found that much of their property (both personal and public) had been stolen. Ten houses in the village had been blown up, which the local residents believe was because they belonged to the relatives of militants (even though such information was not always accurate)<sup>1</sup>.

3. Detachments, formed of local residents, were involved in military actions, and although their activities went far beyond legality, they were supported by the security agencies. There are two well-known examples of this are. In Khadzhal'makhi village in the Levashinsky District of Dagestan the activities of armed members of a vigilante group resulted in the followers of non-traditional Islam being forced to flee their village, leaving their property behind, and some of them were killed<sup>2</sup>. In Leninkent village (a part of Makhachkala) there were several forcible attempts to prevent the activities of a Salafi mosque and dozens of people were injured as a result of the clashes<sup>3</sup>. In both of the above cases, not only did the law enforcement agencies not intervene to prevent such violent actions, but on some occasions they even supported them.

4. Pressure, clearly including significant force, was applied on representatives of non-traditional Islam who were not using any violent practices to achieve their goals but were focused on promoting Islam through preaching and personal example, and who were ready to associate and cooperate with the State in areas where this did not conflict with their ideology.

5. Many of the above practices have even been recognised in legislation. For example, the basis for the approach of adaptation has been almost completely removed with the sharp curtailing of opportunities for the mitigation of punishment of militants in the case of voluntary surrender. There has been legal recognition of some forms of liability of the families and close friends of militants for their activities. The evolution of legislation in similar directions is still continuing.

Can we conclude that this change in policy, implying a return to the force scenario, is the result of the failure of attempts at non-forceful settlement? An analysis of the situation in the period from autumn 2010 to late 2012 does not provide any grounds for such a conclusion. Let us consider just one confirmation of this thesis. *Figures 22 and 23* shows the changes in the numbers of victims of terrorist activities amongst members of the national security services (total numbers of killed and wounded), according to the "Memorial" Society, for the entire North Caucasus and for the Republic of Dagestan from 2005 (the authors do not have any earlier data) to the autumn of 2010, and from autumn 2010 to early 2013. Whilst the first period is

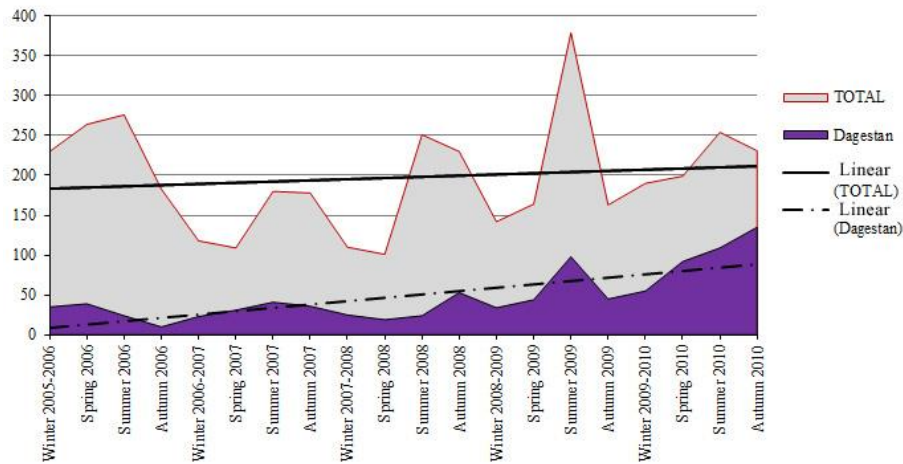
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<sup>1</sup> See, for example: R. Kadiev, M. Shevchenko. Gimry is Common Heritage of Dagestan. Kavpolit.com, 20 September 2013 (<http://kavpolit.com/ramazan-abdulatipov-gimry-eto-obshhedagestanskoe-dostoyanie/>).

<sup>2</sup> General characteristic of the situation in the village based on the media materials and the author's own impressions obtained during her visit to Khadzhal'makhi is laid out in: I. Starodubskaya, K. Kazenin. Expert report: "North Caucasus: Quo Vadis?" (<http://polit.ru/article/2014/01/14/caucasus/>).

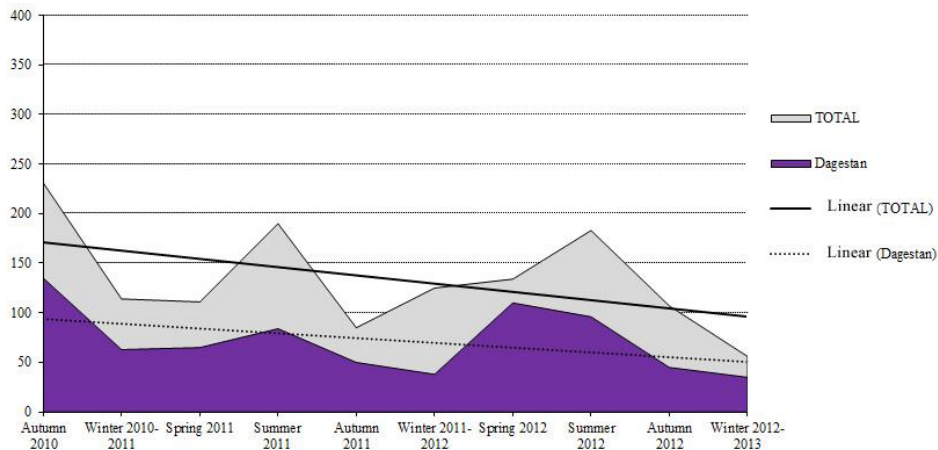
<sup>3</sup> See, for example, <http://ndelo.ru/novosti-7/2340-ozhidaemoe-krovoprolitie>; <http://regnum.ru/news/1734663.html>

characterised by an insignificant upward trend in casualty numbers, despite considerable fluctuations in the specific indicators, in the second period an obvious downward trend can be observed. These trends can be observed in the number of victims both in the NCFD and in Dagestan where casualties have recently been the most significant. It should also be noted that the trend reversal is even more obvious for Dagestan. The data available for 2013 are insufficient to draw definitive conclusions about the influence of the return to the force scenario on the dynamics of casualty numbers but there are some grounds to assume a return to the trends of the period up to the autumn of 2010. However, it is obvious that additional circumstantial factors also have some effect here, for example, the Olympic Games in Sochi.



\*total number of killed and wounded (The “Memorial” Centre for the Protection of Human Rights maintains statistics based on data from open sources: official websites of the national security agencies and the media)  
 Source: “Memorial” data, authors’ calculations.

Fig. 22. Casualties amongst members of the national security services in the NCFD and Republic of Dagestan in 2005 – autumn 2010



\* total number of killed and wounded (The “Memorial” Centre for the Protection of Human Rights maintains statistics based on data from open sources: official websites of the national security agencies and the media)  
 Source: “Memorial” data, authors’ calculations.

Fig. 23. Casualties amongst members of the national security services in the NCFD and Republic of Dagestan in autumn 2010-2013

However, the consequences of the return to a force scenario go beyond the area of counter-terrorism. In fact, such a change has considerably affected various areas of public life, including the interaction between government and business. It is especially obvious from the example of Makhachkala where the force scenario manifested itself mainly through two processes: firstly, an increase in direct pressure on the so-called Salafi businesses and, secondly, in a toughening of policy in respect of the shadow economy (in particular, in the field of payments).

First, we should explain the term “Salafi businesses”. In Makhachkala a considerable proportion of small and medium-sized businesses in various industries are run by followers of non-traditional Islam. This type of business has developed both in spheres which have particular religious connections – for example, halal cafés and restaurants (where the food and atmosphere reflect Islamic canons) and in many other areas. The origin of the term “Salafi business” is associated with the fact that all the followers of non-traditional Islam are usually equated with Salafists (one of the Islamic movements), although in fact this is not completely accurate.

Reputedly, the most well-known action against “Salafi businesses” was carried out in October 2013, when, over a period of three days, halal café employees and visitors were being detained en masse, without any explanation. They were subjected to mandatory fingerprinting and had their photographs taken, and some of the detainees were subjected to violence. As a result, one of the most famous halal restaurants in the city was closed and some others were forced to change ownership<sup>1</sup>. The reason behind such action is still not entirely clear – maybe it was an attempt at business redistribution or a peculiar demonstration of potential preventive measures ahead of the Olympic Games in Sochi. But, according to available data, such actions were taken not only with respect to halal business: “this wave ... affected private kindergartens, cafés, restaurants and the manufactures of windows and furniture, and shops selling cell-phones and clothes”<sup>2</sup>. In all cases serious damage was caused to the businesses (for example, on the pretext of the use of unlicensed software, computers were confiscated which resulted in paralysis of company activities).

While the above measures in respect of Salafi businesses have an obviously forceful nature, the effects of toughening the policy towards the shadow economy requires separate comment. At first sight, the shadow economy which operates outside the control of Russian legislation constitutes a violation of the law and the fight against it should be as uncompromising as that against any other offence. However, the situation is not so simple.

One must take into account that the reason for the shadow nature of the Dagestan economy is not solely due to an unwillingness to pay taxes. It is primarily an attempt not to demonstrate publicly the real potential of one’s business, in a situation where people possessing administrative resources could destroy or take away almost any successfully developing business. Moreover, in many cases the government agencies themselves are not interested in the legalisation of such businesses, preferring bribes and extortion over taxes being paid to the budget. For example, a few years ago a fishery in one of the coastal villages close to Makhachkala made an attempt to legalise its business. Once the fishery started demonstrating really good results, it was subjected to a huge fine forcing it to retreat to ‘the shadows’. At the same time the shadow sector provides employment and a means of livelihood to a considerable part of the city population. There are no alternative sources of employment in the city.

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<sup>1</sup> See, for example: <http://ndelo.ru/novosti-7/2110-mentovskoj-bespredel>; <http://wordyou.ru/v-rossii/religioznye-pretenzii-na-ekonomicheskoy-osnove.html>; <http://chernovik.net/content/lenta-novostey/siloviki-v-mahachkale-proveli-reydy-po-kafe-zaderzhivali-predstaviteley>.

<sup>2</sup> O. Ostrovsky. Shurik, those are not our methods ...// Chernovik, No.46, 29 November 2013.



Even now the first results of the toughening of State policy in respect of business can be seen.

Firstly, according to the available evidence, medium-sized business (Salafi businesses, initially) are making efforts to leave the Republic by moving funds to other regions of Russia or abroad.

Secondly, the possibilities for illegal employment are being reduced even though there are no legal substitutes.

Thirdly, public protest is increasing against clearly discriminatory measures towards a group of businessmen on religious grounds (the headlines of articles reporting on the raids on halal cafés speak for themselves: “Abuse of power by cops”, “Your halal threatens our freeloading”, “Shurik, these are not our methods...”).

All this is happening in a situation where small and medium-sized businesses in Makhachkala, and in the whole Republic, are already in quite a difficult position. The economy has been depleted in many respects by the large-scale financial fraud (pyramids) in which huge amounts of money were invested<sup>1</sup>. Competition in the market is increasing due to an inevitable process of penetration by national Russian companies which reduce the demand from traditional manufacturers and suppliers. Under such conditions any additional complications have particularly severe consequences.

So, paradoxically, it can be stated that the attempts to suppress negative social phenomena, in particular, terrorism-related ones, using force may have the opposite effect. People who have lost their businesses or jobs, and are outraged at clearly illegal sanctions, create an enabling environment for the propagation of radical views, including religious ones. The economy is just one of the examples of increased tension and widespread discontent in the society here, but there are many, many others. This complicates the process of combatting extremism and terrorism, so the tendency towards increasing casualties amongst members of the security services under these conditions is hardly surprising.

At this point we should like to remind you of the example of alternative policy in respect of the shadow economy that is described in the book “The Other Path” by Hernando De Soto, which has often been discussed before<sup>2</sup>. It is based on working with the communities of shadow businessmen themselves and identifying the conditions under which they would agree to legalisation. This can be facilitated by the simplification of administrative procedures and a reduction of administrative barriers, the enforcement of property rights guarantees and the creation of trust-based relations between business and government. According to De Soto, such approaches played a crucial role in the suppression of terrorism in Peru.

#### 6.7.2. Land conflicts: intensifying the confrontation

Land conflicts in 2013 continued to occupy an important position in the socio-economic and political agenda in the North Caucasus. The following can be outlined as key results in this area last year:

1. The issue of the regulation of land rights, and the access of rural peoples to land disposal, came to the fore as the main subject of land conflicts; this issue has become more important to participants in land conflicts than the so-called “ethnic boundaries” which had previously taken centre stage.

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<sup>1</sup> See, for example, <http://dargo.ru/news/2013-12-03-1417>.

<sup>2</sup> De Soto, Hernando. *The Other Path: The Economic Answer to Terrorism*. Chelyabinsk, Socium, 2008.

2. Mechanisms are still not being developed within the framework of Russian legislation to allow for the effective resolution of problems relating to “overlapping land rights”.

3. Land conflicts have repeatedly transformed into confrontations in which the party that was not satisfied with the decisions of the governmental authorities has tried to establish its own system for regulation of land issues.

*Let us first consider the transformation of land conflicts from being a conflict around “ethnic boundaries” to the fight for people’s access to land disposal.* This transformation can be considered for the example of a conflict in Belaya Rechka village (Kabardino-Balkaria; population: 3,430 people according to data of the 2010 All-Russian Population Census). The conflict around this large village and its neighboring village, Khasanya, began as early as 2005 and at that time had the classic features of a dispute for “ethnic lands”. The conflict in Belaya Rechka, as with many other land conflicts in Kabardino-Balkaria, commenced as a result of the adoption by the regional parliament in February 2005 of a set of laws on the composition and borders of municipalities in the region. According to these laws, the Balkarian villages Belaya Rechka and Khasanya were included in the urban district of the city of Nalchik, thereby losing their local self-regulation. From that moment on, the heads of the rural administrations were appointed by the City Mayor’s Office of the capital of the republic, Nalchik. From 2005 Balkarian public organisations regularly put forward demands to return Belaya Rechka and Khasanya to the status of municipalities, formulating their requirement in ethnic terms: the 2005 municipal division was presented as infringing the interest of the Balkar people in favour of republican power in which the representatives of Balkaria were in a minority. There were demands to establish in the republic another “Balkar” region like that which had existed before the deportation of the Balkars in 1944, and to include both villages therein.

The development of the conflict in 2013 marked a change in the key requirements from the republican government by the residents of Belaya Rechka. In March-April hundreds of the village residents took part in a number of protest actions against the leasing out of a land plot with total area of 25 Ha to a local entrepreneur who intended to set-up orchards there. The lands that were at the centre of the conflict had previously been assigned to Belorechensky Sovkhoz (a state-owned farm). Now they were at the disposal of the City Mayor’s Office, which planned to lease the land out. The residents’ protest was because they had reckoned to obtain plots of the land for building work (according to the village activists and the administration, the number of village residents who need a plot to build their own house, varies from 500 to 800 people). This time, the residents initially demanded, not a revoking of the resolutions on municipal borders, but to change the order of land disposal, to transfer land plots into their ownership and to avoid the situation where the lands directly adjoining the village, that had been used by its people in Soviet times, were now legally alienated from the village. (An important point in the development of the conflict in Belaya Rechka in 2013 was that the beneficiary party of the decision against which the villagers were fighting, was a fellow villager, the businessman planning to lease the land. That was why the focus of the dispute automatically moved away from being an issue of the ethnic background of the land.)

We should note that, today, the problem which has now become central in this conflict is typical of regions of the North Caucasus and one which has arisen lately in many other protest actions relating to land issues. In particular, those participating in conflicts related to the allocation of land for resort construction or various types of industry, etc., are demanding, not an abstract recognition of the fact that the land belongs to a certain ethnic group, but a precise

settlement of ownership rights<sup>1</sup>. This is not surprising given that one of the key sources of conflict over land in North Caucasian republics is the absence of private ownership of agricultural lands (a moratorium on land turnover is effective in each of the republics, except for Karachay-Cherkessia). The lands of the former sovkhozes and kolkhozes (state and collective farms) which were not privatised, were mainly at the disposal of the regional or district administrations. Under their control a lease and sublease market has developed, to which local residents often have no access. The transition of land protests from the theme of “ethnic boundaries” to the problem of people’s rights to land is, in our opinion, an important change recorded in recent last years.

At the same time, the course of the conflict in Belaya Rechka demonstrated that the regional government is not yet ready to reconsider the existing system of allocation of land assets. The villagers’ protests, which started in the spring failed to achieve a productive dialogue with the Nalchik City Mayor’s Office, after which the situation actually turned into open confrontation, where the actions of the protesters have turned much more towards being a power struggle. In November, the villagers held a meeting where they divided the land that the government planned to lease out for orchards into construction plots. The plots were allocated in accordance with informal rules developed in the course of the meeting (for example, under these rules priority was given to those families with larger numbers of children). The Republican Prosecutor’s Office and Nalchik City Mayor’s Office declared this plot allocation to be illegal, however, they abandoned the attempt to transfer the land to the businessman for lease, and the situation “froze” at a stage close to a direct conflict between traditional law and the system of land relations established by regional normative acts.

To understand the position of the regional government in this conflict one must take into account that, without its involvement, the problems of villagers’ access to the land cannot be solved, at least insofar as it relates to the regulation of the turnover of agricultural land by the regions. As to Kabardino-Balkaria, it can be said that the policy of the republican administration in this field is still unclear. In particular, in the period from 2010 to 2013, the former head of the Kabardino-Balkar Republic, Arsen Kanokov, repeatedly stated the necessity for conducting a land reform in the region, with the privatisation of agricultural lands favouring the interests of rural people; however, he took no actual steps in this direction. Yuri Kokov, who became the temporary Head of the Kabardino-Balkar Republic in December 2013, has not yet outlined his plans with regard to land policy.

*The conflict generating potential of the problem of overlapping land rights* was also manifested to the full last year in land conflicts in the NCFD. Analysis of such conflicts in the North Caucasus shows that overlapping land rights can have several origins. Firstly, they arise as a result of corrupt practices where lands which have a legal status forbidding their use for construction, are nevertheless used for such. As a result, private households are found, for example, on forest lands and often their owners have documents confirming their ownership rights to the land plot for construction purposes, with a simultaneous existence of documents stating that the status of the same land does not allow construction thereon. Secondly, special situations of overlapping rights can occur as the consequence of the many organised resettlements conducted during the Soviet period. This source of overlapping land rights plays

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<sup>1</sup> The fact that unresolved land relations impede resort construction was recognised in January 2014 by the Director General of the Open Joint-Stock Company “Resorts of the North Caucasus” Sergey Vereschagin (Sergey Vereschagin: Land Issues Impede the Development of a resort Cluster in Dagestan. IA REGNUM, January 22, 2014.<http://regnum.ru/news/kavkaz/1757231.html>).

an especially important part in the Dagestan plain where, in the 1940-50s, within the framework of many of the activities of the Soviet State, tens of thousands of peasant farmers were forcibly displaced (sometimes even twice)<sup>1</sup>. Nowadays the situation often arises where representatives of the rural communities, deprived of a certain territory during such resettlements, claim their rights to this territory. These rights may be confirmed by particular documents but are in conflict with the rights of others.

The above two sources of overlapping land rights remain a serious destabilising factor for the economy and for public relations in the North Caucasus. At the same time, as the events of 2013 have shown, effective mechanisms for the resolution of conflicts relating to overlapping land rights have still not been developed in the North Caucasian regions. Moreover, there is every indication that these conflicts are escalating. We shall illustrate this with the example of one of the biggest land conflicts of last year – the conflict around the so-called “Karaman lands” (named after the Karaman area) adjoining the northern part of the capital of Dagestan, Makhachkala.

The special feature of this conflict, which was widely covered in the regional media in 2012-2013, and which still provokes an active response from the general public in the region, is that it originates from both of the above sources of overlapping land rights. The subject of the conflict is a piece of land with a total area of 195 Ha located between the federal highway and the Caspian coast. In the 1930s these lands were transferred by state orders to several kolkhozes which functioned in three Makhachkalan suburban settlements inhabited by Kumyks – the villages of Tarki, Kyakhulai and Alburikent. In 1944, after the Chechens had been deported to Kazakhstan and Central Asia, the residents of these three villages were relocated to the suburbs of the city of Khasavyurt in Dagestan, situated close to the border with the Chechen-Ingush ASSR, in villages that had previously been inhabited by Chechens. After they returned from there in the second half of the 1950s, the residents of the three villages did not regain the lands to the north of Makhachkala which had been used by them as pastures prior to the resettlement. These lands were mainly distributed amongst farms in the mountain regions that, in the 1950-1980s received considerable areas of the plains for the seasonal grazing of cattle. In the 1990s, by order of the republican government, a part of this land was allocated for settlements belonging to the Laks who were migrating because of the abrogation of the Novolaksky District of Dagestan located next to the Chechnya border. In 2012 the residents of the three Kumyk villages claimed their rights to the 195 Ha and set up a tent camp there. They justified their rights by claiming that the state orders by which these lands had been transferred to the Kumyks kolkhozes had not been legally annulled. This became the first “historical” source of the overlapping rights to this land. However, the fate of the disputed land created an additional situation of overlapping rights in the 2000s. Since 2008 the land has been under the jurisdiction of the Federal Agency for State Property Management of the Russian Federation and has the status of forest land, however, as evidenced by the participants in the conflict, a considerable part of the land had been distributed as plots for construction which was also confirmed by specific documentation<sup>2</sup>. Houses have already been built on plots adjoining the disputed land, even though these plots are also classified as forest land.

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<sup>1</sup> For more detail see K. Kazenin. *The Elements of Caucasus: land, power and ideology in the North Caucasian republics*. M: REGNUM, 2012.

<sup>2</sup> No agreement, no compromise // *Caucasian Policy*. December 4, 2013. <http://kavpolit.com/ni-soglasiya-ni-primireniya/>

In 2013 the conflict around the “Karaman” lands indicates the significant source of tension resulting from the overlap of both “historical” land rights and rights which have arisen in recent years. In August the situation around the disputed land was inflamed as a result of the conflict between the residents of the three Kumyk villages and the Laks who were migrating to the neighboring territory from the Novolaksky District. A unit of the Special Police Force had to intervene to stop the violent confrontation which arose<sup>1</sup>. Later tension has mainly been associated with the “new” overlapping rights. The Commission for Conflict Settlement at the Head of Dagestan made a proposal to carry out an inventory check of households located on the forest land and to set up a park zone on the undeveloped land, i.e. precisely on the land claimed by residents of the Kumyk villages. This proposal received a highly critical response from representatives of the Kumyk villages: at a meeting of the residents of the three villages, held on 4 December, a demand was made to transfer the disputed land to the villages. These events evidenced that no progress in the resolution of this conflict had been made. We should also note that attempts, in the autumn, by the Dagestan government to create a dialogue between the Commission for Conflict Settlement and the participants of the “Kumyk protest” met with strong resistance: for example, on 11 November the public leaders of the villages were detained and taken to the police station<sup>2</sup>. A forceful element is also seen in the actions of the protesters as well: they keep watch on the disputed land, restricting the access of strangers to it, and, completely disregarding the status of the land, they have carried out a division of the land amongst the villagers who want it for building.

So, from these examples of two land conflicts, both characterised by particularly active public response in their regions, but quite different in the subject of the dispute, one can see that, at the moment, there are no “working” mechanisms for the settlement and congruence of interests over the control of land in the North Caucasus. Furthermore, the absence of any prospect of settlement has created a situation where rural peoples carry out their own distribution of lands, the claims to which they fail to vindicate, ignoring the unlawfulness of such procedures. This creates a risk of the occurrence of a conflict between jurisdictions in land issues. It can be stated that such actions of rural populations, which in fact constitute the introduction of a new system of settling land relations as an alternative to Russian legislation, but without preliminary legal permission, have become a notable tendency just in the last year. This confirms the seriousness of the problems in the field of land regulation in the North Caucasus.

Moreover, unresolved land conflicts continue to create considerable political tension because they remain a consolidating factor for ethnic movements: in the protest actions relating to land issues - it is not only the residents of villages directly affected by these issues who participate, but activists from ethnic movements also join in. In fact they become involved even where the essence of the conflict is not associated with a conflict of ethnic interests.

It is our opinion that, in order to decrease the tension over land issues, first of all, it is necessary to take into account the current drivers of this tension, in particular, the lack of access by rural peoples to land disposal, together with the overlapping of land rights. The solution of both problems is possible only within the framework of a full-scale land reform which should include at least the following components:

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<sup>1</sup> Dagestan Public Activist: Incident in Karaman Should Be Discussed at a Meeting //IA REGNUM. 22 August, 2013. <http://regnum.ru/news/1697871.html/>

<sup>2</sup> They are Trying to Chase Away the Camp in Karaman // Caucasian Policy. 11 November, 2013. <http://kavpolit.com/lager-v-karamane-pytayutsya-razognat/>

- the development and implementation of a mechanism for the resolution of disputes relating to overlapping land rights that should guarantee a reconciliation of the interests of stakeholders and the establishment of compromise solutions;
- a cancellation of the moratorium on the privatisation of agricultural lands followed by the transfer of land plots to the ownership of local residents.

## **6.8. Review of Legislation in the Sphere of Tax and Civil Legislation in 2013<sup>1</sup>**

This section deals with the most important changes which took place in the existing legislation. Primarily, it is the new procedure for calculation and payment of the corporate property tax which is already applied starting from 2014 by the entire range of taxpayers due to a switchover to payment of the tax on the basis of the cadastre value of the property. The purpose of introduction of a new calculation of the tax is replenishment of the budget of a constituent entity of the Federation on the basis of a real property's value which is set closer to the market price. Tax experts agree that the new calculation of the tax on the basis of the cadastre value will contribute to development of territories and ensure a more fair calculation of the property tax. It is known that the balance value of "old" buildings is rather low, so an increase in tax will primarily affect the buildings of the "old" fund, as well as those situated in "prestigious" districts.

Also, the first legislative amendments of Part 1 of the Civil Code of the Russian Federation due to the reform of the civil legislation are analyzed. An entire range of amendments aimed both at small "technical" corrections and specifications of a number of norms and bringing of the Civil Code of the RF in general in compliance with the changed realities directed at harmonization of the Russian legislation with that of European countries was introduced.

### ***Corporate Property Tax: The New Procedure for Calculation and Payment***

In accordance with Federal Law No.307-FZ of November 02, 2013 on Amendment of Article 12 of Part One and Article 30 of Part Two of the Tax Code of the Russian Federation a number of real property items in respect of which the corporate property tax base can be determined as a cadastre value was identified.

By general rule of the Tax Code of the RF, the corporate property tax base is determined as the average annual cost of property of the recognized item of taxation (Article 375 (1) of the Tax Code of the RF), that is, the corporate property tax is calculated by legal entities on the basis of the balance-sheet value of the real property. From January 1, 2014, in respect of individual items of real property the above tax can be calculated on the basis of a cadastre value (that is, the value which is maximum close to the market one) as of the first day of the regular tax period.

According to the new procedure for calculation of the tax (Article 378.2 of the Tax Code of the RF), the corporate property tax base is calculated on the base of the cadastre value as regards the following items of real property:

The 1st category: administrative and business centers and trade centers (complexes) (with total floorspace of over 5,000 square meters) and premises in those centers. It is to be noted that deemed as an administrative and business centre is a free-standing nonresidential building

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<sup>1</sup> The Review was prepared with assistance of the Konsultant Plus legal system.

(construction and structure) where premises are owned by one or several owners and which building meets at least one of the following criteria:

- the building (construction and structure) is situated on the land plot whose type of permitted utilization allows for placement of office buildings of business, administrative and commercial purposes;
- the building (construction and structure) is meant for utilization or actually used for business, administrative or commercial purposes.

The 2nd category: nonresidential premises whose purpose in accordance with cadastral passports of real property items or documents of technical accounting of real property items envisages placement of offices, retail trade facilities, public catering facilities and public amenities or which premises are actually used for placement of offices, retail trade facilities, public catering facilities and public amenities.

At least 20% of utilization of floorspace for placement of the above facilities is recognized as actual utilization of nonresidential premises for above purposes (Article 378.2 (5) of the Tax Code of the RF).

The 3rd category: nonresidential real property of foreign entities which do not carry out activities in the Russian Federation through their permanent representative offices, as well as such real property items of foreign entities as are not related to the activities of those entities through their permanent representative offices.

The type of actual utilization of buildings and premises in those buildings is determined by the authorized executive authority of a constituent entity of the Russian Federation in accordance with the procedure set by the Ministry of Economic Development of the Russian Federation by agreement with the Ministry of Finance of Russia (Article 378.2 (9) of the Tax Code of the RF). Prior to approval of the relevant statutory act, the procedure recognized by a regulatory statutory act of a constituent entity of the Russian Federation is applied.<sup>1</sup>

The authorized executive authority of a constituent entity of the Russian Federation (Article 378.2 (7) (1) of the Tax Code of the Russian Federation) has to determine on an annual basis not later than the 1st day of the regular tax period the list of real property items which are attributed to the above 1st and 2nd categories.

As a calendar year is deemed as a tax period, the relevant list of real property items is approved not later than January 1. Then, such a list of real property items is sent in an electronic format by the executive authority of a constituent entity of the Russian Federation to tax authorities at the place of location of real property items (Article 378.2 (7) (2) of the Tax Code of the Russian Federation) and places it at its official Web-sites or the official Web-site of a constituent entity of the Russian Federation (Article 378.2 (7) (3) of the Tax Code of the Russian Federation). If within a year a new real property which was not included in the list has been identified, the information on that property is to be included in the list which is being formed for the next tax period (Article 378.2 (10) of the Tax Code of the Russian Federation)<sup>2</sup>. So, in the current tax period the property tax is calculated by a legal entity in accordance with the old procedure on the basis of the average annual value.

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<sup>1</sup> See Part 2 of Article 4 of Federal Law No.307-FZ of November 02, 2013.

<sup>2</sup> It is to be noted that the data which is to be included into the list is determined by the Federal Tax Service of the Russian Federation (Article 378.2 (8) of the Tax Code of the Russian Federation). Prior to approval by the tax authorities of such an act, relevant powers are granted to the supreme state executive authority of a constituent entity of the Russian Federation by agreement with the Federal Tax Service of the Russian Federation (Article 4 (1) of Federal law No.307-FZ of November 02, 2013).

If the cadastre value is determined for the whole building in which nonresidential premises – the item of the corporate property tax – are situated and the cadastre value of those premises is not determined, the latter is calculated as the share of the cadastre value of the building pro rata the share of the area of those premises in the total floorspace of the building (Article 378.2 (6) of the Tax Code of the Russian Federation).

A special provision is made for foreign entities' real property items specified in Article 378.2 (1) (3) of the Tax Code of the Russian Federation and recognized as items of taxation (the 3rd category): if the cadastre value has not been set in respect of those real property items, the tax base is deemed equal to zero (Article 378.2 (14) of the Tax Code of the Russian Federation).

The specifics of calculation of advance payments on the corporate property tax as regards real property items whose tax base is calculated as the cadastre value has been provided for in Article 378.2 (12-13) of the Tax Code of the Russian Federation. So, by general rule an advance payment is equal to the product of a quarter of the cadastre value of the real property item as of January 1 of the year which is the tax period and the respective tax rate (Article 378.2 (12) (1) of the Tax Code of the Russian Federation). If the cadastre value of the property is not determined or the real property is not included in the list approved by the authorized executive authority of a constituent entity of the Russian Federation as per Article 378.2 (7) of the Tax Code of the Russian Federation, advance payments and the property tax are still calculated on the basis of the average annual cost of the property, that is, without application of special norms (Article 378.2 (12) (2) of the Tax Code of the Russian Federation).

So, the taxpayers do not have to determine individually whether their premises are attributed to administrative and business centers or trade centers; that is the task of the authorities. Owners of the real property have only to see to it that their property is attributed to the list of premises in respect of which the property tax is calculated on the basis of the cadastre value.

In particular, for example, in accordance with Article 378.2 of the Tax Code of the Russian Federation the Government of Moscow has determined the 2014 list of real property items in respect of which the tax base is determined as their cadastre value<sup>1</sup>. The 2014 list includes 1,842 real property items with the total floorspace of over 33m square meters. The list includes buildings with the floorspace of over 5,000 square meters if a type of permitted utilization of the land plot in which that building is situated suggests placement of retail, office, administrative and commercial facilities<sup>2</sup>.

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<sup>1</sup> The above list is made up in accordance with provisions of Article 1.1 (1) of Law No.64 of the City of Moscow of November 5, 2003 on The Tax on the Property of Legal Entities; it is specified in the annex to Resolution No.772-PP of November 29, 2013 of the Government of Moscow on Determination of the List of the Real Property Items in Respect of Which the Tax Base is Determined as Their Cadastre Value in 2014.

<sup>2</sup> In reality, a type of permitted utilization of a land plot may not comply with actual utilization of the building. To eliminate conflicts that may arise due to the above, it is determined by Resolution No.772-PP of November 29, 2013 of the Government of Moscow that in case of disagreement with inclusion and/or failure to include the relevant real property to the specified list the interested parties are in a position to turn until December 18, 2013 to the State Inspectorate in Charge of Control over Utilization of Real Property Items of the City of Moscow with an application to check compliance of the actual utilization of the building (construction and structure) with the type of permitted utilization of the land plot in which that building (construction and structure) is situated (construction and structure). The outputs of the examination are sent by the State Inspectorate in Charge of Control over Utilization of Real Property Items of the City to the Department of the Municipal Property of the City of Moscow. On the basis of the results of consideration of the above outputs and in case of confirmation of the facts on noncompliance of actual utilization of the building (construction and structure) with the type of permitted utilization of the land plot in which the building (construction and structure) is situated, draft resolution of the Government of Moscow on introduction of relevant amendments to the above resolution is prepared. In cases



It is to be noted that in new Article 380 (1.1) of the Tax Code of the Russian Federation maximum admissible values of tax rates are set in respect of the real property whose tax base is calculated as the cadastre value. It is to be noted that gradual increase in the upper limit of the above limitation from 1% in 2014 to 2% in 2016 and in subsequent years is envisaged. As regards Moscow, higher maximum rates as compared to other constituent entities of the Russian Federation were introduced for the first two years (*Table 35*).

*Table 35*

	<b>2014</b>	<b>2015</b>	<b>2016 and in subsequent years</b>
Moscow	1.5%	1.7%	2%
Other constituent entities of the Russian Federation	1%	1.5%	2%

According to Law No.63 of November 20, 2013 of the City of Moscow on Amendment of Law No.64 of November 5, 2003, the tax rate in respect of real property items whose tax base is determined as their cadastre value is set as follows: 0.9% – in 2014; 1.2% – in 2015; 1.5% – in 2016; 1.8% – in 2017; 2.0% – in 2018.

It is important to take into account that by virtue of Article 378.2 (13) and Article 383 (6) of the Tax Code of the Russian Federation the corporate property tax and advance payments in respect of real property items whose tax base is determined as a cadastre value are transferred to the budget at the place of location of that real property.

Let's examine how evaluation of real property items is carried out. In accordance with Article 24.12 of Federal Law No.135-FZ of July 29, 1998 (as amended of July 23, 2013) on Evaluation Activities in the Russian Federation the state cadastre evaluation of capital development projects is carried out on the basis of a decision of the state executive authority of a constituent entity of the Russian Federation (such an evaluation is to be carried out at least once in five years).

So, in Moscow the state cadastre evaluation of capital development projects was carried out on order of the Government of Moscow. In accordance with Article 24.17 of Law No.135-FZ, the outputs of that examination were approved by Government Resolution No. 752-PP of November 26, 2013 on Approval of the Results of Determination of the Cadastre Value of Capital Development Projects in the City of Moscow and the information on the cadastre value was sent to the Federal Service for State Registration, Cadastre and Cartography (Rosreestr).<sup>1</sup>

As of the moment of preparation of this section, the author can state that the Rosreestr has completed determination of the cadastre value of capital development projects in Moscow. The results of evaluation can be found on the Web-site of the Rosreestr in the Cadastr Accounting Section or order a certificate on the cadastre value of the real property project from any office of the cadastral chamber.

Order No.779 of December 24, 2013 of the Ministry of Economic Development of the Russian Federation on Introduction of Amendments to the List of the Data of Cadastral Plans Approved by Order No.416 of October 19, 2009 of the Ministry of Economic Development of the Russian Federation was registered in the Ministry of Justice of the Russian Federation; at present a public plan of the Rosreestr will become a more detailed one. According to the

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established by the legislation, a decision is taken on amendment of the type of permitted utilization of the land plot in which the building (construction and structure) is situated.

<sup>1</sup> The information is published on the official Web-site of the Rosreestr: <http://maps.rosreestr.ru/>.

amendments, the public cadastral plan placed on the official Web-site of the Rosreestr will be supplemented with the following data:

- on the main parameters of buildings and their values and on the main parameters of uncompleted development projects and their design values;
- on the purpose of buildings and constructions, as well as design purpose of uncompleted development projects.

It is to be noted that due to a number of reasons the cadastre value of real property items can be much higher than the market value of the real property item. As a rule, the above is related to the so-called “mass” evaluation<sup>1</sup>, which is a rather labor-intensive process where the executive authorities may encounter such problems as insufficiency (asymmetry) of the information of the state cadastre of real property, lack of the complete and required volume of the data on a real property item and other.

Law No. 135-FZ includes norms which provide for the opportunity to individuals and legal entities to appeal against the results of determination of the cadastre value at the court of arbitration or the commission on consideration of disputes as regards the results of determination of the cadastre value in case the results of determination of the cadastre value affect the rights and obligations of those persons.

In particular, Article 24.19 of Law No.135-FZ grants the owners of real property the right to appeal against the determined cadastre value in the following order:

1) pretrial process provides for making of an appeal at special commissions which were established under the Rosreestr within six months from the day of entry of the cadastre value into the state cadastre of real property;

2) legal process provides for making of an appeal against the decision of a special commission at the court of arbitration if the owner does not agree with that decision or the period of six months set by the law for making of an appeal against the results of evaluation at commissions has passed.

The same article 24.19 of Law No.135-FZ provides for the following two reasons for revision of the results of cadastre evaluation:

1) Unreliability of the data on the real property item used in determination of the cadastre value of that property;

2) Determination of a market value in respect of a real property item as of the date on which the cadastre value of the property was set.

In case of pretrial appeal against the cadastre value, the documents which are required for submission to the commission for revision of the cadastre value are specified by Law No.135-FZ (Article 24.19). They include the following:

- An application for revision of the cadastre value;
- A cadastre passport of a real property item;
- A notary copy of a title establishing document or title certification document on the real property item in case an application for revision of the cadastre value is submitted by a person who has the title to the real property;
- Documents certifying the fact that the data on the real property item – which data is used in determination of the cadastre value – is unreliable in case an application for revision of the cadastre value is submitted on the basis of unreliability of the above data;

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<sup>1</sup> That is a unified procedure for evaluation of a large number of real property items as of the specific date with utilization of certain standard methods of statistical analysis.

- A report in case an application for revision of the cadastre value is submitted on the basis of determination of the market value in respect of the real property item;
- A positive expert opinion prepared by an expert or experts of a self-regulating organization of appraisers whose member is an appraiser who prepared a report on compliance of the report on evaluation of the market value of the real property item with the requirements of the legislation of the Russian Federation on evaluation activities.

At the same time, in addition to the above documents the applicant has the right to submit other documents to the commission for consideration.

In case of litigation, a claim is filed by the applicant (plaintiff) against a state executive authority of the constituent entity of the Russian Federation which is authorized to pass a decision on carrying out of state cadastre evaluation in the territory of the constituent entity of the Russian Federation with the above and other documents enclosed.

It is important to pay attention to the fact that as per Article 12 (3) (4) of the Tax Code of the Russian Federation legislative (representative) authorities of a constituent entity of the Russian Federation are entrusted with powers to set the specifics of determination of the tax base as regards regional taxes and, consequently, the corporate property tax.

As regards privileges introduced by regions, let's take for example the regulations introduced in the city of Moscow. The Moscow State Duma approved Law No.63 of November 20, 2013 on Amendment of Law No.64 of November 5, 2003 of the City of Moscow; according to Article 4.1 of the above Law privileges in the form of a tax deduction of the cadastre value of 300 square meters of floorspace were established. The tax base is reduced with simultaneous compliance by a legal entity-taxpayer with the following requirements:

- 1) a legal entity-taxpayer is an entity of a small business;
- 2) a legal entity-taxpayer has been registered with a tax authority for at least three calendar years preceding the tax period;
- 3) during the previous tax period the average number of workers of the business entity amounted to at least 10 persons and the sum of the revenue received from sales of goods (jobs and services) per worker amounted to at least Rb 2m.

In addition to the above, the amount of the tax has been reduced to 25% of the calculated tax amount in respect of those real property items which are utilized for carrying out of educational and medical activities, as well as research organizations which engage in R&D using budget funds.

Also, privileges in the form of tax exemptions are envisaged for all the state-financed entities, entities which are registered at special economic zones and are part of innovation centers, city public transport organizations and metro, housing cooperatives, housing associations and condominium partnerships, entities which employ disabled persons, car-making companies, defense facilities, cultural heritage facilities and religious organizations.

***Part One of the Civil Code of the Russian Federation: New General Guidelines for Deals, Representation, Decisions of Meetings and Legal Limitation***

In 2013, numerous amendments were introduced to Part One of the Civil Code of the Russian Federation; the above amendments deal with transactions including grounds and consequences related to invalidity of those deals, legal limitations and rules of calculation thereof, meetings to which the law attributes civil and legal consequences for all the persons who had the right to participate in that meeting, as well as other persons. The main amendments were introduced by Federal Law No.100-FZ of May 7, 2013 (other amendments were introduced by Federal Law

No.302-FZ of November 02, 2013) on Amendment of Subsection 4 and Subsection 5 of Part 1 and Article 1153 of Part III of the Civil Code of the Russian Federation.

In the Civil Code of the Russian Federation, new Article 157.1 “Consent on a Deal” was introduced. If a consent of the third party, a body of the legal entity, a state authority or local government authority is required by virtue of the law to make a deal, the third party or a respective authority informs about its consent or refusal to grant its consent to the person who asked for such a consent or other interested party within a reasonable period from the day of receipt of the request for a consent. In particular, consent of third persons on a deal is needed in case a person with a limited ability or a minor (at the age of 14 years old to 18 years old) intends to make a deal which he/she has no right to make at his/her own discretion. Consent is to be granted by a parent (adoptive parent) or a fiduciary (Article 26, Article 30 and Article 33 of the Civil Code of the Russian Federation).

A consent on the deal can be a preliminary one and a subsequent one (Article 157.1 (3) of the Civil Code of the Russian Federation). According to the above Article, a preliminary consent is to be expressed for transacting a deal, while the subsequent one, after the deal was finalized, so, it is also called an approval. In the preliminary consent, the subject of the transaction to which consent has been granted is to be determined. In the subsequent consent (approval), the very transaction to which consent has been given, rather than the subject of the transaction alone is to be specified. However, in Article 157.1 of the Civil Code of the Russian Federation the form of the consent has not been determined. In addition to the above, it is specified that silence is not regarded as consent on the deal, except for cases established by the law.

Amendments were introduced to Article 161: a reference to the minimum monthly wage was replaced by a lump sum of Rb 10,000. So, transactions are to be made in a simple written form, except for deals which need be notary certified:

1) deals between legal entities and between a legal entity and an individual (as was provided for by the Article before);

2) deals between individuals for the amount which exceeds Rb 10,000, while in cases provided for by the law – regardless of the amount of the deal.

By a general rule, if the Civil Code of the Russian Federation or other Federal Law provides for state registration of deals, legal effects of such deals take place only after registration. A deal which alters conditions of the registered deal is subject to state registration, too (Article 164 of the Civil Code of the Russian Federation). So, a consistent approach which was formed in the judicial practice has now been confirmed by the legislator. A reduced legal limitation has been established in cases where a party to the deal evades state registration or notary certification of the deal: a legal limitation of one year instead of a three-year legal limitation (Article 165 of the Civil Code of the Russian Federation).

New Article 165.1 “Legally Important Messages” was introduced; applications, notifications, notices, requirements and other legally important messages which by the law or under the deal have civil and legal consequences for another person entail such consequences for that person from the day of delivery of a relevant message to that person or his/her representative. A message is regarded as delivered also in cases if it was delivered to the person whom it was sent to (the addressee), but due to circumstances depending on that person it was not handed in or the addressee did not familiarize himself/herself with it. The above rules are applied unless otherwise is provided for by the law or the terms of the deal, nor entails from the custom or practice which were formed in the relations between the parties. Actually, it means

that if any legally important message was sent to the addressee, but due to circumstances depending on the addressee it was not handed in to the addressee or the addressee failed to familiarize himself/herself with that message, the message is considered as delivered.

Important amendments and adjustments were introduced to Paragraph 2 on invalidity of deals. So, a deal carried out in violation of the law is recognized now as a voidable one (the grounds for voidability of a deal are completely specified in the Civil Code of the Russian Federation) and not as a null and void deal. A deal can be recognized as null and void only in case of a simultaneous existence of the following three conditions if the deal violates the requirements of the law or other statutory act and infringes upon public interests or rights and the third party's interests protected by the law and in addition to the above there is no mention in the law that such a deal is a voidable one or other consequences of a violation which are not related to invalidity of the deal should be applied.

The legal limitation as regards claims to apply the consequences of invalidity of a null and void transaction and recognize such a deal as invalid amounts to three years. It is to be noted that the legislator has introduced an important adjustment that the period of legal limitation as regards the above claims starts from the day on which fulfillment of a null and void transaction began, while in case of filing of a claim by a person who is not a party to the deal, from the day that person learnt or was to learn about the beginning of fulfillment of that deal. It is to be noted that the period of legal limitation for a person who is not a party to the deal should not exceed at all events ten years from the day of the beginning of fulfillment of the deal.

At present, the court has the right to apply individually the consequences of invalidity of a null and void deal only in case it is needed for protection of public interests or in other cases provided for by the law (Article 166 of the Civil Code of the Russian Federation). Earlier, it was done only on the basis of an application of a party, but not on the initiative of the court. Also, earlier any interested party could demand application of consequences of invalidity of a null and void transaction by judicial means. With amendments introduced, such a claim can be made only by the party to the deal, while other persons are in a position to turn with such claims to a court only in cases provided for by the law.

The right of the party to appeal against the deal (Article 166 of the Civil Code of the Russian Federation) has been limited, in particular, in the following cases:

- the party knew or was to know about the existence of grounds for making of an appeal against the deal and at the same time demonstrated by its behavior the intention to preserve the validity of that deal and then appealed against the deal on those very grounds;
- after finalization of the deal the behavior of the party gave grounds to believe that the deal was a valid one, however, later that party declared that the deal was invalid.

The above rule is aimed at protection of that bona fide party which relied on assurances or behavior of the other party as regards the voidable transaction and acted with intention to fulfill it.

From Article 173 of the Civil Code of the Russian Federation, a mention of the lack of the license as special grounds for invalidity of the deal was excluded. Consequently, deals transacted with lack of the license if such a license was required by virtue of law can be appealed against on the basis of Article 168 of the Civil Code of the Russian Federation as being contradictory to the law because the law established a requirement as regards availability of the license. Also, the list of persons who may demand recognition of the deal as null and void on the basis of Article 173 of the Civil Code of the Russian Federation has changed; excluded from the list are state authorities which carry out control and supervision over activities of the legal

person. The only grounds preserved in Article 173 of the Civil Code of the Russian Federation for making an appeal against a deal are inconsistency of the deal with the goals of the legal entity's activities which are definitely limited in the founding documents provided that the counterparty knew or was to know about that limitation. If such goals are limited by the law alone, the above norm is not applied.

Some other articles of the Civil Code of the Russian Federation were revised, too. A deal which was transacted to the detriment of the interests of the represented person can be recognized as invalid if the counterparty acted jointly with the representative or knew (was to know) about the deal's malice (Article 174 of the Civil Code of the Russian Federation) and consequences related to fulfillment of the deal in respect of the property which disposition is prohibited or limited have been determined. The scope of the party's error in *essentia* which serves as grounds for invalidity of deals (Article 178 of the Civil Code of the Russian Federation) has been specified. Fraudulent concealment can be recognized as fraud which factor constitutes grounds for invalidity of deals (Article 179 of the Civil Code of the Russian Federation).

In the Civil Code of the Russian Federation, new Chapter 9.1 "Decisions of Meetings" was introduced; at present its norms are applied by default to any general meetings (from September 2013 Article 181.1 and Article 181.2), that is: decisions of collegial governing bodies of a legal entity; decisions of meetings of creditors in case of a bankruptcy and other. However, establishment in the Civil Code of the Russian Federation of those general provisions on decision of meetings does not exclude application of a special legislation.

So, a decision of the meeting to which the Law attributes civil and legal consequences gives rise to legal consequences – at which the decision of the meeting is aimed at – for all the persons who had the right to take part in that meeting (participants in the legal entity, co-owners, creditors in case of a bankruptcy and other participants in the company), as well as other persons if it is established by the law or stems from the substance of relations. Decisions of the meeting are deemed as passed if they were voted for by a majority of participants in the meeting and at least 50% of the total number of participants of a relevant company took part in the meeting. Decisions of the meeting can be taken by absentee voting (it is to be remembered that such a practice can be prohibited by individual laws). It is to be noted that in the Civil Code of the Russian Federation there is not mention of the fact that a meeting can be held in a mixed form (in person and in *absentia*).

General rules of keeping minutes of a meeting are provided for. An individual decision on each issue on the agenda is to be taken unless otherwise is established by a unanimous decision of the meeting. General requirements to the minutes of the meeting have been set. Those requirements depend on the form of the meeting. The minutes of the meeting which is held in an in-person format (in the form of joint attendance) should include the following information: date, time and place of the meeting; information on persons who took part in the meeting; the results of voting on each issue on the agenda; information on persons who counted votes and information on persons who voted against the decision and demanded to make an entry about that fact into the minutes. In the minutes on the results of the absentee voting, the following information is to be specified: the date until which the documents which included the information on voting by members of the company were received; the information on persons who took part in voting; the results of voting on each issue of the agenda; the information on persons who counted votes and information on persons who signed the minutes. The minutes are to be executed in a written form.

Unless otherwise is established by the law, the decision of the meeting is null and void in the following cases: a decision was taken on the issue which was not included in the agenda (it is to be noted that the rule does not work if all the participants/members of the relevant body take part in the meeting); the decision was taken in the absence of the required quorum; the decision was taken on the issue which is not within the competence of the meeting; the decision is in conflict with the fundamentals of the rule of law or good morals (the above grounds are new ones). It stems from Article 181.5 of the Civil Code of the Russian Federation that the list of grounds for recognition of meeting decisions as null and void is a closed one. Consequently, decisions of meetings in case of violation of other norms of the law can be appealed against (Article 181.3 of the Civil Code of the Russian Federation).

An important amendment was introduced to Article 186 on a power of attorney; the above amendment eliminates a power of attorney's maximum period of validity of three years. At present, it is established that any period can be specified in the power of attorney. As before, unless a period of validity is specified in the power of attorney it remains in force within a year from the day of its issue.

A notary certification is not required in respect of powers of attorney issued by way of substitution by legal entities and managers of branches and representative offices of legal entities. Prior to introduction of amendments to Article 187 of the Civil Code of the Russian Federation, a lack of notary certification of powers of attorney issued by way of substitution was admissible only in respect of powers of attorney to receive a person's wages or other income and etc (Article 185 of the Civil Code of the Russian Federation).

A representative who delegated authorities to another person by way of substitution does not lose his/her authorities in respect of the original power of attorney, however, otherwise can be specified in the power of attorney or the law (Article 187 of the Civil Code of the Russian Federation). Also, by general rule a subsequent substitution is not admissible, that is, a person who received authorities from the original representative is not in a position to assign them to somebody else. Though otherwise can be provided for only by the law or the original power of attorney, it can by no means be vested in the power of attorney issued by way of substitution. Initiation of bankruptcy proceedings against the represented person (a representative) can constitute grounds for termination of a power of attorney.

It is worth mentioning introduction of new Article 188.1 "Irrevocable Power of Attorney" which is issued for the purpose of fulfillment or enforcement of fulfillment of obligations of the represented person before the representative or persons on whose behalf the representative acts. If such an obligation is related to carrying out of business activities, the represented person may specify in the power of attorney issued to the representative that such a power of attorney cannot be cancelled before expiry or can be cancelled only in cases provided for in the power of attorney. In any event, such a power of attorney can be canceled after termination of the obligation for which fulfillment or enforcement of fulfillment it was issued and also at any time in case of abuse by the representative of his/her powers, as well as in case of circumstances which explicitly point to the fact that such an abuse of power can take place. An irrevocable power of attorney is to be notary certified.

Also, other amendments were introduced to the Civil Code of the Russian Federation, in particular, amendments of provisions as regards legal limitation (Article 196, Article 200, Article 202 and Article 207 of the Civil Code of the Russian Federation). In particular, in any event the legal limitation cannot exceed 10 years from the day of the beginning of fulfillment of the deal (Article 181 (1) of the Civil Code of the Russian Federation). Earlier, there was no

such a limitation in the Civil Code of the Russian Federation. An exception is made only for one case, that is, indemnification of damage caused to the property as a result of a terrorist act. In such a case, legal limitation as regards a claim is set within the limits of the legal limitation of criminal proceedings brought against a person for commission of a crime.

The rules of calculation of legal limitation have been changed as regards obligations whose date of fulfillment was either not determined or determined as the date of demand. At present, legal limitation is calculated from the day of creditor's demand as regards fulfillment of that obligation. Earlier, the beginning of legal limitation was regarded the date on which the creditor has received the right to make such a demand. However, at any event legal limitation cannot exceed 10 years from the day of creation of the obligation.

In addition to a penalty, security or surety, additional requirements include interests. So, with expiry of legal limitation in respect of the main demand the legal limitation is considered expired, too, in respect of interests, including those accrued after the expiry of legal limitation as regards the main demand.