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R95 **Russian Economy in 2011. Trends and Outlooks.**  
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The review provides a detailed analysis of main trends in Russia's economy in 2011. 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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## Military Economy and the Military Reform in Russia in 2011

The transition to “a new image” of the Armed Forces of the Russian Federation that started back in 2008 and continued through 2011 was clearly planned, as the Russian top military leaders affirmed. In practice, however, these plans proved to be “unbaked” and required on-line corrections and removal of deficiencies.

Likewise was the financial and economic support to the military construction. The encouraging statement made by Finance Minister A. Kudrin on the eve of 2011 that “the ministries and departments will receive 98% of the budget expenditures for their full disposal”<sup>1</sup> “have come to nothing. A new government arms program (GAP) for 2011 – 2020 signed by President D. Medvedev on the last day of 2010, was not aligned, as appears, with a regular federal target program for upgrading the military-industrial complex that had not been adopted in 2011. It is obvious that these events could not but affect negatively the quality of planning and execution of the state defense order (SDO) for 2011.

The 2011 results in the military economy and the military reform demonstrate that there are more than enough grounds to talk about serious problems and contradictions at the new stage of the military reform in the RF in addressing five key tasks set by President D. Medvedev more than three years ago<sup>2</sup>.

### Structural transformations of the Armed Forces

Even a recap of the organizational and structural transformations in the RF Armed Forces that took place during the last three years makes a great impression. Late 2008, a new military administrative division of the RF was established: four military districts were set up instead of six and accordingly four united strategic commands (USC) were established to control all military forces based on the territory of such districts except strategic forces. At the top levels of the military hierarchy, a tree-tier command and control system was set up: the district USC - operative command (armies) – brigades and other military units. In 2009, the structure of the Armed Forces changed from the division-regiment based to the brigade-based one (except the Airborne Landing Forces and Strategic Missile Forces)<sup>3</sup>.

As a result of functioning of the Armed Forces in their new structure in 2010, a number of issues was identified including maintenance of the AF combat readiness at a high level and having a mixed compulsory and voluntary system of enlisted and junior command personnel.

The establishment of Aerospace Troops (AST) as an independent unit is a major structural innovation of 2011. To some extent this may be considered as a restoration of the ex-USSR Armed Forces type called national Air Defense Forces.

The division of the command and control functions into two “branches” during the last three years was another important structural innovation: the first branch was in charge for compre-

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<sup>1</sup> V. Petrov. In a week-s time.// Rossijskaya Gazeta.2010. December 2 (No. 272).

<sup>2</sup> Russian Economy in 2009, Trends and Prospects (Ed. 31) M., Gaidar's Institute. 2010. p.637–638.

<sup>3</sup> Russian Economy in 2009, Trends and Prospects (Ed. 31) M., Gaidar's Institute. 2010. p.640.

hensive support (Russia's Ministry of Defense and the Armed Forces) while the second branch – in charge of the Armed Forces buildup, planning of troops employment and their combat training. The first branch is staffed mainly with civilian specialists (according to the practices of the civilized states) while the second – with military persons. Note that the move to this structure that was selected back in May 1992 as the most reasonable for Russia took almost 20 years. At that time it was announced at a Joint Staff conference as a target set by the then President of Russia Boris Eltsin by the top military leaders: Minister of Defense P. Grachev and his First Deputy A. Kokoshkin. The Russian Generals apparently did not support the proposed restructuring and tried to impede the process striving to keep the key financial and economic levers in their hands together with the associated capabilities. A lot of efforts and time was wasted.

Now the first command and control branch acquired two major tasks – financial and economic support to all the activities of the Ministry of Defense and the Armed Forces and interaction with the defense-industrial complex to ensure supplies of military equipment and hardware.

The newly created procurement services of the RF AF united in the second branch structure the rear services support and the technical services support; that was also in line with the best practices of the advanced countries. The reduced scope of tasks led to reduction of the administrative military staff by four times while the remaining administrators were reoriented to military objectives. Many purely economic activities were withdrawn from the RF Ministry of Defense and included into the scope of services of OJSC Oboronservice namely: maintenance of arms/hardware and military equipment, modernization, repairs, liquidation of surplus stocks, utilization of arms and military equipment, maintenance of all real property facilities, production and supply of agricultural products and goods, trade and daily services, catering, printing products, hotel services, etc. As for other procurement functions, some of them were outsourced (wholly or partially) to third parties and covered such types of procurement as food supplies, bath and laundry service – for the military people; aerodrome maintenance, truck shipments, fuelling, technical maintenance and service – for troops and military equipment and arms. As a rule, OJSC Oboronservice has acted as a general agent of the Ministry of Defense using the bidding system for contractors.

The Ministry of Defense and the Armed Forces have never gone through such radical changes before. Their functioning in 2011 revealed both pluses and minuses. Among the pluses, there have been quite valuable results, in particular regarding troops disposition. It is worth noting that the number of guarded military settlements reduced from 22,000 down to 4,000 with the prospects to continue reduction to a less than a thousand of such settlements. Only 7,000 people will be employed to guard them. The Air Force airfield network that used to have 356 airfields has been reduced down to 7 air bases with a more powerful infrastructure; this ensures better quality of airfields maintenance and operation. The released settlements and other facilities have been passed over to the local governments.

### The RF military policy and its implementation

Early autumn 2011 it appeared that the Ministry of Defense could not approve the contracts for construction of two nuclear submarines of “Borey” type and one multipurpose nuclear submarine of “Yasen” type with OJSC OSK (United Shipbuilding Corporation). As A. Serdyukov, Defense Minister, announced, OSK refused to disclose the price structure on its

products as the customer demanded (the last portion of Rb 20bln out of Rb 581bn as a total value of the state order for 2011 were involved).

Though this scandal did not directly affect the combat potential of the Russian sea-based nuclear forces (there were no missiles for new submarines), still it was very disturbing since the government officials made a lot of promises to settle the situation in the second half of the summer. It is clear now that the attempts of Russia's President and the Federal Government Chairman to get involved helped to save their faces only. Both officials made very important statements with regards to the military expenses and the national military and technical policy.

Thus President D. Medvedev addressing the members of the strategic exercise "Center-2011" on September 27, 2011, in the Chelyabinsk region<sup>1</sup> announced that "spending on defense, new arms, money allowances for the servicemen, their household activities and their apartments will remain the highest priority of the government. There are no two ways about it." Having evaluated this statement as an ethic prescription ("... this is imperative") he reaffirmed that "we (though the budget may regret this) will always have large expenses to support the defense and the security as this is our mission in relation to our citizens and our neighbors" and linked this to such factors as the territory of Russia and its membership in the UN Security Council and availability of nuclear arms.

Unfortunately this statement of Russia's President not only creates doubts as to his logics (regarding the mission of Russia with regards to the neighbors) but contradicts Articles 23 and 112 of the RF National Security Strategy for the period ending 2020 approved by President (SNB-2020)<sup>2</sup>, that do not include military expenses as one of the national security priorities or any aspect of the national security. Moreover, this document does not give the definition of the notion of "a supreme priority" (unlike the notion of "the strategic national priority"). Misunderstanding or ignoring the optimal balance concept expressed in SNB-2020 means that the "great power" status and not the growth of national welfare is given preference, that the investment resources will be frozen and rates of economic growth decline in a long-term perspective.

V. Putin, Chairman of the Federal Government, in his introduction to the meeting dedicated to the issues of the defense and industrial complex on October 7, 2011<sup>3</sup> declared that "there is a great large-scope task in front of us: to re-equip fully our army and Navy in the near 10 years". Though earlier D. Medvedev stated that the aim of our state arms program for the period 2011 – 2020 was a 70% re-equipment (30% by 2016) and not a 100%.

The challenge of a 100% or 70% re-equipment during 10 years seems to ignore the native and/or foreign experience and demonstrates that the program developers have not been aware of the balance principle and unable to look beyond the 10-year horizon.

The rationale of the 2020 state arms program and the opportunity for its implementation looks doubtful with account of the statements made by V. Putilin, the then First Deputy of the Chairman of the Military-Industrial Commission at the RF Government that the Ministry of Defense had no reasonable justification of the program; the former Deputy to Defense Ministry

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<sup>1</sup> Meeting with unit commanders involved in combat exercise "Center 2011" (short-hand notes) September 27, 2011. <http://news.kremlin.ru/transcripts/12836>.

<sup>2</sup> National security Strategy of the Russian Federation up to 2020. Approved by RF President Decree of May 12, 2009 No. 537.

<sup>3</sup> V. Putin's introduction at the meeting on the issues of development of the defense and industrial complex (short-hand notes) October 7, 2011. <http://premier.gov.ru/events/news/16656/>.

V. Popovkin also made it clear in March last year <sup>1</sup> that in Russia “the share of state-of-art arms in the military equipment fleet is 20% for strategic nuclear forces and under 10% for general-purpose forces. For comparison: in the armies of the leading foreign states such share is 30% to 50%.”

If these data about the situation in the Armed Forces of the leading works countries are true, it means that Russia must reach these indicators as early as 2016 and surpass this level by 2020. It looks that the developer of the Russian arms program for 2011-2020 has never asked himself why the share of new arms and equipment in the world leading countries does not exceed 50%? The announced 70% re-equipment plans by 2020 are unreachable due to the poor potential of the national economy, and the first year of the program delivery has proved this. What the plants of the defense and industrial complex will do if after 2020 the Army and the Navy are fully re-equipped: will they have to re-orient themselves to foreign markets since the arms samples have a service life of 25 to 30 years.

It is impossible to make a correct assessment of the Russian military and technical policy in 2011 without the account for the events occurred in 1H. May 2011 was extremely important in this respect since on May 10, President D. Medvedev held in the Gorky a meeting<sup>2</sup> dedicated to the development of the Russia’ military and industrial complex where he informed that for the state arms program adopted late 2010 budget allocations would be four times larger than for the previous program.

On March 21, 2011, Prime Minister Vladimir Putin addressing the meeting in Votkinsk on the implementation results of the state arms program<sup>3</sup>, and on April 20, in the report of the RF Government on the results of his activity for 2010 in the State Duma affirmed that for the new arms program the government intends to allocate funds by approximately three times more vs the previous program<sup>4</sup>. It is obvious that if we compare the arms programs (for all power ministries) the President’s assessment of May 10 is more correct than the government assessment given the declared growth of allocations from Rb 4.9 trillion up to Rb 21.5 trillion. It is worth noting that the said growth for the arms program of the Ministry of Defense was actually five times higher (more accurately by 4.9 times: from Rb 4 trillion to Rb 19.5 trillion).

It is hard to understand why the federal government has been disseminating false information for such a long time. Possibly, our government is used to ignore such “trifles” and/or this is a simple arithmetic error. But it is quite probable that the use of such “not fresh” information determined, to a certain extent, the successful, in terms of the Russian military-industrial complex, approval of the state arms program by President since in terms of the budget almost triple growth of the budget allocations is not so “frightening” than the fivefold.

The approval of the state arms program for 2011-2020 by President Dmitry Medvedev is a case study. This fact became known only late February 2011 when Deputy Defense Minister Vladimir Popovkin announced at the meeting with journalists that the program was approved by President back on December 31, 2010, and this information was unexpected for the majori-

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<sup>1</sup> We cannot afford buying poor arms// Military Industrial Courier. 2011. 2–8 March (No. 8); D. Litovkin “Triumph” and “Circon” march off to troops// The News. 2011. 11 March; National Defense. 2011. March.

<sup>2</sup> Meeting on the issues of development of the Russia’s state arms program (Short-hand notes) 10 May 2011. <http://www.kremlin.ru/transcripts/11206>.

<sup>3</sup> Introduction by V. V. Putin at the meeting on the implementation of the state arms program for 2011–2020 . (Short-hand notes). Votkinsk, 21 March, 2011. <http://premier.gov.ru/events/news/14545>.

<sup>4</sup> Short-hand notes of the RF State Duma meeting of April 20, 2011. <http://transcript.duma.gov.ru/node/3423/?full>.

ty of the attendees since the Defense Ministry liable sources asserted otherwise through January.

What made the Russian government conceal the approval of the state arms program worth over Rb 20 trillion for more than two months is difficult to say. The reference to the secrecy of the Decree does not sound convincing as there is an official practice of publication of extracts, statements and information about the signing of classified documents. It may be possible that the program was signed in the first days of January 2011 retroactively in order not to repeat mistakes made in signing two previous programs when unexplainable intervals between their approvals reached 10-12 months.

The previous practice with the state arms programs has shown that the attempts to delay their signing in order to improve the quality are not successful since the last minute finalized programs have not been duly implemented. The Russian state arms programs are unachievable in principle.

This fact escapes the interested community, possibly, due to the unique combination of ten-year (horizon) planning with the five-year plan adopted for our programs in the ex-USSR. It is often believed that the new state arms program is passed because the previous program failed – this is not true since the new program is adopted because time has come to do it: in Russia there is an established practice to adopt such programs once every five years. As the development of the next program starts several years before the first part of the previous program is finished the developers indeed have no possibility to review the results of the program implementation. However, the implementation results can be seen with a naked eye regardless of the traditional screen of the state secret. It is quite possible that the government authorities did not want to make a focus on the actual approval of the state arms program because of this. The implementation results of the state military order in the first year of the program confirm our skepticism.

Thus, instead of the growth of the military production by 14% expected by the RF Ministry of Industry and Trade<sup>1</sup> in shipbuilding, this production fell down by 15.7<sup>2</sup> while commissioning of “Borey” strategic ballistic missile submarines that, according to some optimistic declarations<sup>3</sup> are almost ready for combat alert duty, is 6 to 12 months behind the schedule and expected at best by the end of 2012.

In 2010 and 2011, the shipbuilding production under the state military order was worth Rb 126 bn and Rb106bn and 765m accordingly, and these enable spending of Rb4,7 trillion of the state program for re-equipment of the Russian Navy<sup>4</sup> only under the condition of annual growth of military shipbuilding production by 30.6% during the remaining 9 years. In 2020, the shipbuilding production under the state military order will exceed the 2011 production tenfold.

In a more realistic assessment of the production surplus by 10% at best, the required allocations for the shipbuilding part of the state military program do not exceed Rb1.7 trillion, in other words, the budget spend for the Navy equipment can be reduced by 64% (almost by three times). Thus a logical step (not in terms of budget saving but in terms of spending the

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<sup>1</sup> Report of the RF Ministry of Industry and Trade: 2004–2011.

<sup>2</sup> Shipwrights will not corrode, Red Star, 2012, February 4 (No. 19).

<sup>3</sup> E.g. see “To be strong: the guarantees of national security for Russia// Russian Gazette. 2012. February 20.

<sup>4</sup> Buildup of the force// Vzglyad (A View)// 20122, February 6.



allocated budget) is to procure foreign warships like “Mistral” in France. However the need to include the four procured warships in the Pacific Fleet looks doubtful<sup>1</sup>.

The forecast of delivery of the 2012 state order by the shipbuilders is not very optimistic: when allocations for the 2012 draft federal budget were prepared in July-August 2011, there was no information on the prices for the sector products. The 2011 contracts under the state military order for nuclear submarines that were to be built and tested in the White Sea were signed by the Defense Ministry and USC on November 9, 2011 in the presence of Prime Minister Vladimir Putin: actually two weeks before the established date of the product delivery. After the contracts were signed, USC continued to resist disclosing the information on the price structure for their products, which may be understandable in the context of price fluctuations in the shipbuilding sector reflected in Russian statistics of the national accounts in the previous years.

On the other hand, the efforts of the Ministry of Defense in 2011 aimed to implement the resolutions of the RF President of November 25, 2010, Order No. Pr-3443, proved to be successful by the year-end. According to Joint Staff Commander, General of the Army N. Makarov<sup>2</sup> the contract prices on diesel submarines were reduced by 34%, on corvettes – by 15% and on frigates – by 26%.

The behavior of certain military and fleet commanders considerably aggregates the situation with the implementation of the military and technical policy and the state arms program. For example, the Navy Chief Commander Admiral V. Vysotsky, obviously violating the line of authority and contradicting the statements of the state first persons not to build aircraft carriers<sup>3</sup>, continues advocating the plan of their building starting from 2015<sup>4</sup>. Note that the full protection of information about the state arms program allows such behavior.

Unfortunately, a similar situation with the equipment is observed in the Air Force:

- SU-34, a bomber aircraft, bought back in 2008, was officially passed into service by the state commission in September 2011;
- a fighter aircraft SU-35M that was bought earlier still undergoes testing;
- a surface-to-air missile system C-400 “Triumph” was made operational in 2007, but up to now it has not been equipped with 400 km distance missiles though it was given the index 400 according to this type of missile; the development of the missile is to be completed this year, though federal funds for construction of two plants for the C-400 serial production have been released since 2010.

In 2011, the Air Force did not receive a new bomber aircraft Su-34, a fighter aircraft SU-35M, three Su-27SM, two helicopters “Ansat-U”. Besides, a strategic bomber aircraft TU-95MS and an airborne interceptor MiG-31B remained under repair.

Given the absence of advance models ready for manufacturing, the Leaders of the Ground Forces and the Airborne Forces almost stopped procurements of armored vehicles and focused on modernization. The purchases of missile and artillery materials have been insignificant due to the same reason. On the whole, for 2011, the Russian defense industry did not fulfill the

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<sup>1</sup> The Fleet: priorities and prospects // Red Star. 2012. February 15–21 (No. 26).

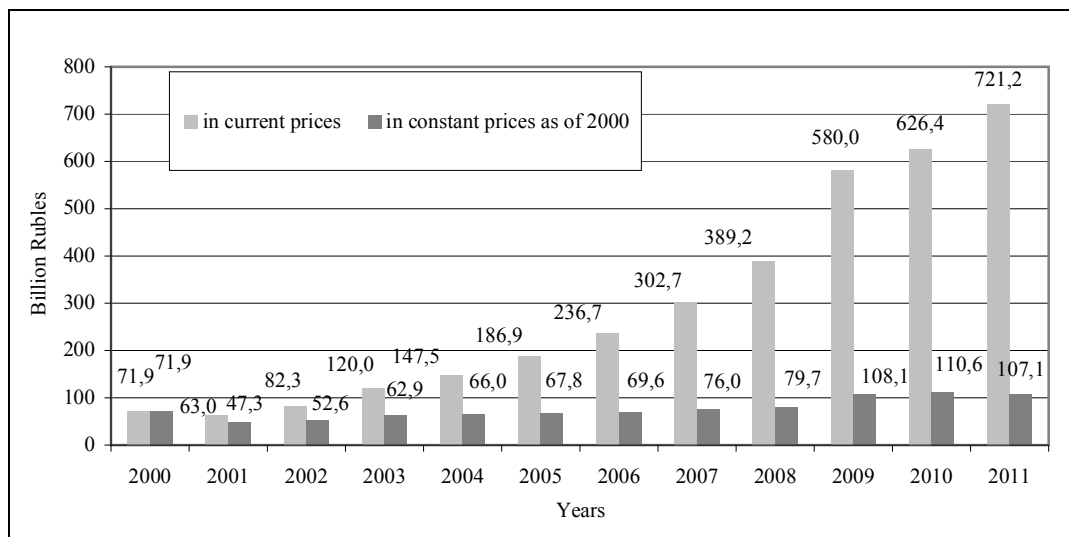
<sup>2</sup> The military reform as it is. Speech by N. Makarov, Russian Joint Staff Commander, at the Public Chamber. M. November 17, 2011. [http://www.oprf.ru/files/Prezentaciya\\_mioboroni.ppt](http://www.oprf.ru/files/Prezentaciya_mioboroni.ppt).

<sup>3</sup> e.g.: So far we do not have this in our plans” (V. Putin). // Short-hand notes of the meeting in Sarov on February 24, 2012 at <http://premier.gov.ru/events/news/18248/>.

<sup>4</sup> The Fleet: priorities and prospects//Red Starr. 2012. February 15–21 (No. 26).

state order under 84 contracts for Rb 42bn<sup>1</sup>, i.e. the 2011 state military order was delivered at under 94%.

The results of the multi-year policy of building up budget spend for the state military order by the Ministry of Defense in the situation of full secrecy is shown on *Fig 36* (an expenditure deflator for the final consumption of the state services is used).



Source: Rosstat.

*Fig. 36.* State Military order of the Russia's Ministry of Defense in 2000–2011

The confidence of the Russia's leadership in that the state guarantees a minimal productivity at 20% in the industrial and defense sector which will ensure the transition to its innovatory development and the required output<sup>2</sup> actually has no basis and is a result of promotion efforts by the Russian military-industrial lobby who is interested in re-distribution of the oil rent income. According to PwC (former PriceWaterhouseCoopers)<sup>3</sup>, the average profitability in 100 leading western aerospace and defense companies was 7.8% and 9.0% in 2010 and 2011 respectively, and such indicators enabled their development based on innovations, to step up their production and pay out dividends to their shareholders.

#### Improvement of the legal and regulatory framework of the Armed Forces operation

This stage of transformations of the RF Armed Forces required the improvement of the legal and regulatory framework. First, to review the set of program and regulation documents was required that regulated the procedures and the rules of modern military actions with account of their types and administration of troops and forces. Secondly, a lot of efforts were

<sup>1</sup> V. Litovkin. Bottleneck in the state military order // Independent Military Review. 2012. February 3–10 (No. 3).

<sup>2</sup> “We assume that the profitability of the enterprises should be at least 13–15%, even let it be 20%” (V. Putin) // Short-hand notes of the meeting at Komsomolsk-on-Amur, February 20, 2012 <http://premier.gov.ru/events/news/18194/>.

<sup>3</sup> Aerospace & Defence 2010 year in review and 2011 forecast. PwC, 2011. <http://www.pwc.com/aerospaceanddefence/>.

taken to revise the documents regulating the functions of the Armed Forces in peaceful times, including the regulations/manuals (Internal Service Regulations, Combat Manual, Disciplinary regulations) and various instructions. The participation of the Defense Ministry specialists in the development of draft laws on money allowances (MA) for servicemen and on retirement pays became a most important area of activity. The IEP experts also took part in this effort<sup>1</sup>.

The main comments to the MA draft law developed by the Ministry of Finance and Ministry of Defense were as follows: the new MA system will deepen the gap between military and civil officers, and between the military officers who serve in different departments inside the power block. The MA is not linked to the average national wage and to the budget process, if done, this could align the MA indexation. Corruption-biased wordings are used in certain law provisions. The key thing is that for lower ranks of the servicemen the MA level is inappropriate, and this would make the army recruitment even more difficult.

There are numerous comments to the provisions setting retirement pays. These provisions are very unfair in treating the old age pensioners, and may cause a lot of complaints immediately after the new pensions are paid.

Unfortunately, the justified comments caused no reaction, and the drawbacks in the draft laws have been incorporated in the laws.

### Changes in the military staffing policy

Early 2011, the first theoretical and practical conference of the Ministry of Defense was arranged on the topic “The formation of the innovative educational environment in the system of educational institutions of the RF Ministry of Defense”. As per the established tradition, that meant training of the officers only with simultaneous reduction of the number of academies and colleges, and this approach caused strong dissatisfaction among the servicemen. Nevertheless, the changes have been implemented as planned. Now in the RF Armed Forces there are three scientific and training centers, 11 military academies under the Joint Chief Academy, and two universities (Military University and Military Aviation Engineering University). The Academies train staff for such troops as missile strategic forces, army signals, army troops, NBC defense troops, engineering troops, artillery troops, battlefield air defense troops, military space troops, combined service forces. The focus was also made on the training of troops in advanced combat training centers where in addition to individual training, units will be trained.

However, the attention to training of ranks and files and junior command personnel was not appropriate. The major part of the military personnel continues to be conscripted. The Armed Forces Commanders, namely the Commanders of the ground troops acknowledged that the current practice of a five-month training of the called-up specialists does not meet the modern requirements. Note that the reduction of the service term to one year was provided in the federal Government Regulations adopted back in 2003, and the respective amendments were made in the legal framework in 2007. However, “the tests of the new training program for jun-

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<sup>1</sup> See, e.g. V. Tsymbal, A. Privetkin. A failure of the strategy for social development at the financial front // Independent Military Review. 2011. June 3–9 (No. 20); V. Tsymbal, A. Privetkin. The servicemen are promised a worthy pension in a quarter of a century. Independent Military Review 2011. June 10–16 (No. 21); E. Trofimova Certain achievements and issues of the social development of the RF Armed Forces//Economic and political situation in Russia, 2011. No. 2; A. Privetkin, E. Trofimova. On the fund of money allowance of the RF servicemen// Economic and political situation in Russia, 2011. No. 7.

ior specialists” designed for 3 months “in connection with the transition to one year of service” began in 2011 only<sup>1</sup>.

The need to refuse from the call-up principle was hushed up (in autumn 2010, the Joint Staff Commander announced 700,000 positions for conscript servicemen) early this year though full enlisting was clearly impossible. The Border Guards and the Federal Penal Service abandoned the call-up principle long before. Recently, the Interior Ministry Troops being aware of the conscription difficulties have decided to contract the staff and tried to improve the attractiveness of such service<sup>2</sup>.

By March 2011, the Ministry of Defense had matured to be aware of the true situation with enlisting. The report at the meeting in the RF Academy of Military Sciences can give some evidence to that<sup>3</sup>. It was said that the number of the conscripted servicemen should be reduced by 10–15% of the total membership. And the report also focused on the attractiveness of the contract enlisting. Some NATO country-members, Poland, in particular, were mentioned as an example. It appeared that by 2017 the number of rank and files and junior command officers serving under the contract should be 425,000 instead of current 184,000.

Activities on “humanization” of the military service have been carried out in the troops: a new plan of the day (with an after-lunch rest) and a five-day service week with possible weekend leaves was introduced; to use rank and files in fatigue duties was limited or even forbidden; the food ration and quality were improved; mobile phones were allowed. The principle of “service close to home” was implemented where possible. Nevertheless, there is still no contest for the military service, and there are many draft evaders.

The institutions of priests and military police have been promised recently for implementation. However, in 2011, the promises remained unfinished.

The necessity to abandon the call-up enlisting seems obvious, but the top commanders hesitate to acknowledge this though President Dmitry Medvedev did recognize this necessity but for a faraway perspective. There is no political will yet to do this.

### Social support to the servicemen and their family members

Housing is an obvious example of how the Armed Forces deal with social and economic issues. There is a tremendous burden of such issues in this sector since the national leaders used to put off them for a number of years. Once there was an attempt to re-shift this burden from the federal to the regional authorities. Eventually, the military and political leaders of Russia elected to stop pushing aside this problem. After all the housing needs were registered in 2009 it became clear that 175,600 servicemen and military retirees had to be provided with housing.

Early 2011, the Ministry of Defense while talking about the house provision plans announced their ambitious target “to do away with the waiting list of the servicemen in need of housing by 2012”<sup>4</sup>. This announcement was very challenging since in that year there was no properly functioning Unified Register of the Servicemen in need of housing accessible via Internet, i.e. the system of recording and control was still in the process of development. However, by October 2011, the list reduced down to 63,800 families and by the year end further to 41,600, according to the report of the Joint Staff Commander to the Public Chamber.

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<sup>1</sup> A. Gerasimov. Special courses for junior specialists//Red Star, 2011 February 3, (No. 17).

<sup>2</sup> Interior troops invite//Red Star 2011. February 4 February (No. 18).

<sup>3</sup> N. Makarov. Up to date//Red Star. 2011. March 29 (No. 51).

<sup>4</sup> D. Semenov, V. Mokhov. No waiting lists should remain // Red Star. 2011. January 14 (No. 2).

Nevertheless, the problems are still there: there are corrupt officials and bribetakers involved, the files of the servicemen on the demand list was lost, the computerized recording and control system does not function properly, apartments are provided in locations where people do not want to reside.

The second important area of solving social issues is the increase of the money allowance from January 2012. Let us talk about the MA amounts. The main MA components, namely the basic salary for the service position (SSP) and for the military rank (SMR) are given in *Table 34*.

*Table 34*

**Comparison of the military ranks, positions and money allowances  
of the RF AF servicemen after January 1, 2012**

Grade	Proposed position*	Proposed SSP*	Approv. SSP**	Standard military position (Regulation 922)**	Proposed military ranks	proposed SMR*	Appr. SMR**
1	2	3	4	5	6	7	8
50	First Deputy Minister	45000	45000	First Deputy, RF Minister of Defense	Army General		27000
49	Deputy Minister	44000	44000	Deputy, RF Minister of Defense	Army General		27000
48		42000	42000	Commander-in-Chief, AF type	General-Colonel	20000	↑25000
47	Military District (MD) Commander	40000	40000	Director-General, Central Office (CO) Department Director, Commander-in-Chief, Corps; MD Commander-in-Chief	General-Colonel	20000	↑25000
46		38000			General-Lieutenant	17000	↑22000
45	Deputy, MD Commander	37500			General-Lieutenant	17000	↑22000
44	Army Commander	37000	37000	Deputy to: CO Director-General, Department Director Army Commander-in-Chief	General-Lieutenant	17000	↑22000
43		36500			General-Lieutenant	17000	↑22000
42		36000	36000	Director-General: CO, MoD Department :	General-Lieutenant	17000	↑22000
41		35500			General-Lieutenant	17000	↑22000
40		35000			General-Lieutenant	17000	↑22000
39		34500			General-Lieutenant	17000	↑22000
38		34000	34000	Deputy Director-General: CO, Department :	General-Lieutenant	17000	↑22000
37	Deputy Army Commander	33500			General-Lieutenant	17000	↑22000
36		33000			General-Lieutenant	17000	↑22000
35	Corps Commander	32500	32500	Commander, motorized rifle corps, Director-General, Department in USC, MD	General-Lieutenant	17000	↑22000
34		32000			General-Major		20000
33		31500			General-Major		20000
32	Deputy Corps Commander	31500	31500	Section Head: CO, Department	General-Major		20000

*cont'd*

1	2	3	4	5	6	7	8
31	Division Commander	30500	30500	Commander, motorized rifle (tank) division	General-Major		20000

30		30000	30000	Deputy Section Head: CO, Department	Colonel	13000	13000
29	Deputy Division Commander	29500	29500	Section H in USC /MD Department	Colonel	13000	13000
28	Brigade Commander	29000	29000	Commander, motorized rifle (tank) brigade, Section Head, Army	Colonel	13000	13000
27		28500	29000	Group Head in Central Office/Department Section, MoD of Russia	Colonel	13000	13000
26		28000	28000	Senior Officer (CO Section, Department)	Colonel	13000	13000
25	Deputy Brigade Commander	27500			Colonel	13000	13000
24		27000	26500	Officer (CO Section, Department)	Colonel	13000	13000
23	Regiment Commander	26500	26500	Commander, motorized rifle (tank) regiment	Colonel	13000	13000
22		26000	26000	Senior Officer, USC Department. MD	Sub-colonel		12000
21		25500	25500	Senior Officer, All-arms army administration	Sub-colonel		12000
20	Deputy Regiment Commander	25000	25000	Officer, USC Department, MD	Sub-colonel		12000
19		24500	24500	Officer, all arms army administration	Sub-colonel		12000
18	Battalion Commanding Officer	24000	24000	Commander: motorized rifle (tank) battalion, missile/artillery division	Major	11500	11500
17		23500			Major	11500	11500
16	Deputy Battalion Commanding Officer	23000			Major	11500	11500
15		22500			Captain		11000
14	Squadron Commander	22000	22000	Commander: motorized rifle (tank) squadron, anti-air missile battery	Captain		11000
13		21500			Senior lieutenant		10500
12	Deputy Squadron Commander	21000			Senior lieutenant		10500
11		20500			Lieutenant		10000
10	Platoon Commander	20000	20000	Commander, motorized rifle (tank) platoon	Lieutenant***	10000	10000
9		17000			Senior Warrant Officer		8500
8		16500			Senior Warrant Officer		8500
7	Deputy Platoon Commander	16000			Warrant officer		8000
6		15000			Sergeant		7500
5	Squad Commander	14500	↑15000	Commander, motorized rifle (tank) squad	Senior Sergeant		7000
4		12500			Sergeant	6500	6500
3		11500			Junior Sergeant		6000
2		10500			Private First Class		5500
1	Rifleman	10000	10000	Rank and file positions of soldiers and seamen under contracts	Soldier	5000	5000

\* The military ranks, position grades and salaries related to ranks and positions: see “the State defined the price of the military service// Military and industrial courier. 2011. April 13 (No. 14).

\*\* RF Government Resolution of December 5, 2011 No 992 “On the establishment of base salaries of the cash allowance of the servicemen who serve under the contract”.

\*\*\* There is no “junior lieutenant” rank in the table since it is very rare and assigned only in exceptional cases (e.g. to sergeants who graduated from short-term qualification courses or to lieutenants who are reduced to a lower rank).

Let us do the following comment to the data in *Table 34*. MA for high-ranking military officials and commanders was increased even above the level that had been discussed when the MA draft laws were reviewed. But the lower ranks of the military hierarchy “lost the game”. The gap between the rank-related salaries of the Colonel and General Major was Rb 7,000; this is actually the amount that makes the difference between the rank-related salaries of the Junior Sergeant and the Colonel - how’s that?

The situation with promises given to contracted soldiers is even worse. In 2012, at the start of the service, the soldier will get not the promised Rb 28,000 but less: Rb 15,00 – Rb 20,000 per month. The soldier will have to wait for two to three years to get the promised allowance, and this will depend on the attitude of his commanding officer. For reference: by the end of 2011, in Russia the average wage went up to Rb 22,000. Thus the voluntary military service has not become attractive on the employment market.

So far the Russian military leaders feel optimistic by declaring the contracting plans (and the contest selection) up to 50,000 people annually (in reality with account of the replacement of those who retire this figure must go up to 70,000) but they hardly take into account the situation on the employment market and the current demographic trends.

### Military and financial policy

Through 2011, the Ministry of Finance was an ongoing supporter of reduction of the military expense. In May, at the meeting in the RF Government with the agenda on the RF budget for 2012-2014, Minister of Finance made proposals<sup>1</sup> to cut down the key additional expenses related to the pre-election obligations of the Kremlin and the White House regarding budget military costs. The key proposal was not to step up the number of officers and contractors of the Ministry of Defense with the consequent saving about Rb 160bn annually up to 2014 inclusively. The Ministry of Finance also proposed not to increase the army but to reduce it further by 15% over next three years and to cut down the budget costs for the state military order during this period by Rb100bn per year. There was another proposal not to increase the financial provision of the saving-and-mortgage system for the servicemen thus saving up to Rb78.2bn in 2012. Besides the Ministry of Finance suggested to cut down costs for the Ministry of Internal Affairs: by Rb 97 bn in 2012 and by Rb 99.1 bn in each of the following two years.

However, the MinFin initiatives were not accepted by the military and political leadership of the country.

As for the federal budget that has been adopted by that time the practice of its execution in 2011 turned back to the pre-crisis scheme with two annual corrections of the initial version<sup>2</sup> – in summer<sup>3</sup> and in autumn<sup>4</sup>, but with an additional correction in July<sup>5</sup> when mainly secret and top-secret applications related to the state military order were changed with no modification of

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<sup>1</sup> P. Neteba. The budget gets rid of expenditure units// *Commerçant*, 2011 May 25 (No. 92).

<sup>2</sup> Federal Law of December 13, 2010 No. 357-FZ “On the federal budget for 2011 and the planning period of 2012 and 2013”.

<sup>3</sup> Federal law of June 1, 2011 No. 105-FZ On amendments in the Federal Law “On the federal budget for 2011 and the planning period of 2012 and 2013”.

<sup>4</sup> Federal Law of November 6, 2011 No. 302-FZ On amendments in the Federal Law “On the federal budget for 2011 and the planning period of 2012 and 2013”.

<sup>5</sup> Federal Law of July 20, 2011 No. 251-FZ On amendments in the Federal Law “On the federal budget for 2011 and the planning period of 2012 and 2013”.

the overall federal budget expenditures. The July correction may be viewed as another demonstration of the unusual boom in the Russia military and technical policy during 2011.

As a result of all the said changes, by the year end the federal budget allocations for “National Defense” increased by 1.3% from Rb1 trillion 517bn 91mn to Rb 1 trillion 537bn 444mn in 2011 with the total growth of budget expenditures by 4.3%. In real terms, these allocations increased by 4.2% (nominal growth – 20.3%) vs 2010, while their size remained at 2.8% of the GDP.

The above mentioned figures of military expenditures cannot be drawn from the published Budget Law given that after 2007 the non-transparency of the Russian federal budget has sharply increased, and the analysis of the Budget Law should be supplemented with additional sources; thus in preparation of the review we used the materials of the government version of the federal budget, the monthly report of the Federal Treasury on the execution of the budget in January 2011 and the documents of the State Duma<sup>1</sup>. Such an indirect approach cannot but influence the accuracy of the evaluations.

In 2011, the degree of secrecy of federal budget expenditures increased by 1.4 vs 2010 (*Table 35*), and its secret allocations reached Rb1 trillion 302 bn 839mn. Secret/classified allocations were returned to subsection “Intermediate vocational education” and to section on inter-budgetary transfers. The secrecy level remained in such sections as “Physical culture and sports” and “Mass media” (these have been independent sections since 2011), and the share of secret expenditures in the overall expenditures for physical culture was more than half (53.31%, according to our estimates) surpassing the section “National defense” and getting closer to the level of secrecy traditional for the security authorities. Also secret are some allocations for “Preschool education” and “Culture”, by tradition. The share of secret allocations to “National economics” is reaching 2%, and to sub-section “Housing” goes above 25.03%.

*Table 35*

**The share (%) of secret allocations in the federal budget expenditures in 2005–2011**

Code and the title of section (sub-section) with secret expenditures	2005	2006	2007	2008	2009	2010	2011
1	2	3	4	5	6	7	8
Overall federal budget expenditures	11.33	11.80	10.33	11.92	10.01	10.46	11.82
0100 GENERAL GOVERNMENT ISSUES	3.67	6.28	5.52	8.66	5.05	4.75	8.56
0108 International relations and international cooperation	–	0.01	< 0.01	3.66	–	–	–
0109 State material reserve	82.86	89.23	92.18	90.17	85.01	85.08	88.15
0110 Fundamental research	2.13	1.22	1.12	0.97	0.78	0.32	0.66
0114 Other general government issues	0.05	0.72	0.28	4.42	1.56	1.05	0.27
0200 NATIONAL DEFENSE	42.06	42.77	45.33	46.14	48.09	46.42	47.56
0201 Armed Forces of the Russian Federation	33.07	35.59	37.11	39.04	40.21	39.03	41.41
0204 Mobilization of the economy	100.0	100.0	100.0	100.0	100.0	100.0	100.0
0205 Preparation for and participation in assurance of collective security and peace-making efforts	100.0	100.0	100.0	–	–	–	–

*cont'd*

1	2	3	4	5	6	7	8
0206 Nuclear arms	100.0	100.0	100.0	100.0	100.0	100.0	100.0
0207 Implementation of international obligations in the area of military and technical cooperation	45.22	46.90	50.65	100.0	100.0	100.0	100.0
0208 Applied research in the area of national defense	98.37	93.94	93.69	93.20	92.85	91.32	92.47
0209 Other issues of national defense	2.49	8.79	24.38	29.21	34.64	42.03	37.64

<sup>1</sup> Decision of the State Duma Commission on the review of the federal budget expenditures to support defense and state security of the Russian Federation, in draft federal law No. 607158-5 “On the federal budget for 2011 and the planning period of 2012 and 2013”, M., October 19, 2011.



0300 NATIONAL SECURITY AND LAW-ENFORCEMENT	28.52	31.64	31.07	31.84	30.82	32.12	31.91
0302 Internal Affairs agencies	4.76	6.31	5.16	4.97	3.70	4.30	3.39
0303 Internal troops	11.76	10.31	9.80	10.25	8.19	8.28	5.58
0306 Security agencies	97.80	95.49	97.31	99.05	99.61	97.05	99.57
0307 Border service agencies	100.00	98.97	97.62	100.00	99.47	98.61	99.15
0309 Protection of the population and territories in emergencies of natural and technogenic nature, civil defense	59.02	62.39	50.65	51.39	51.00	51.28	49.08
0313 Applied research in the area of national security and law-enforcement efforts	73.95	66.41	64.43	75.49	79.35	92.09	87.20
0314 Other issues in the area of national security and law-enforcement efforts	8.26	50.71	39.95	56.32	68.37	67.94	88.40
0400 NATIONAL ECONOMY	0.05	0.02	0.44	0.64	0.55	1.56	1.96
0411 Applied research in the area of national economy	–	–	5.23	5.84	4.49	5.61	12.07
0412 Other issues in the area of national economy	0.12	0.06	< 0.01	0.31	0.72	4.47	2.18
0500 HOUSING AND UTILITIES	–	3.42	0.85	6.96	10.09	19.26	17.87
0501 Housing	–	4.22	5.69	15.97	12.91	20.79	25.03
0700 EDUCATION	2.76	2.69	2.39	2.55	3.06	3.59	4.33
0701 Pre-school education	2.03	2.17	2.44	2.48	2.45	3.91	5.34
0702 general education	1.51	1.91	2.14	2.00	2.75	3.45	0.70
0704 Intermediate vocational education	1.06	1.03	1.02	0.86	0.99	–	0.01
0705 Professional training, re-training and qualifications improvement	16.85	15.78	17.22	1.80	2.54	9.40	18.16
0706 Higher and post-higher education	3.15	2.93	2.53	3.08	3.64	4.08	5.34
0709 Other issues of education	0.30	0.33	0.28	0.29	0.48	0.61	0.27
0800 CULTURE, CINEMATOGRAFFY, MASS MEDIA	0.17	0.17	0.21	0.17	0.18	0.17	–
0800 CULTURE AND CINEMATOGRAPHY	–	–	–	–	–	–	0.12
0801 Culture	0.14	0.10	0.16	0.10	0.14	0.09	0.14
0804 Periodic press and publications	13.46	7.45	2.57	2.62	3.14	3.59	–
0806 Other issues of culture, cinematography and mass media	0.02	0.15	–	–	–	–	–
0900 HEALTHCARE, PHYSICAL CULTURE AND SPORTS	4.30	3.99	2.57	4.14	3.54	3.01	–
0900 HEALTHCARE	–	–	–	–	–	–	8.29
0901 Stationary medical help	5.61	4.66	2.94	3.24	2.77	2.41	2.71
0902 Outpatient care	n/a <sup>1</sup>	n/a	n/a	13.94	4.34	3.75	21.38
0905 Health-building care	n/a	n/a	n/a	14.07	15.88	10.73	11.98
0907 Sanitary and epidemiological health	n/a	n/a	n/a	2.09	0.63	0.64	0.73
0908 Physical culture and sports	0.28	0.26	0.24	0.42	0.32	0.62	–
0910 Other issues of healthcare, physical culture and sports	–	–	–	1.74	1.07	1.01	–
0910 Other issues of healthcare	–	–	–	–	–	–	0.43
1000 SOCIAL POLICY	–	–	–	0.01	0.01	–	–
1003 Social security	–	–	–	0.02	0.02	–	–
1100 PHYSICAL CULTURE AND SPORTS	–	–	–	–	–	–	0.26
1101 Physical culture	–	–	–	–	–	–	53.31
1200 MASS MEDIA	–	–	–	–	–	–	0.27
1202 periodical press and publications	–	–	–	–	–	–	3.38
1400 INTER-BUDGET TRANSFERS TO THE BUDGETS OF THE RF SUBJECTS AND MUNICIPAL ESTABLISHMENTS OF GENERAL NATURE	–	–	0.16	–	–	–	0.14
1401 Subsidies to align budget cover of the RF subjects and municipal establishments	–	–	0.50	–	–	–	–
1403 Other inter-budget transfers to the budgets of the RF subjects and municipal establishments of general nature	–	–	–	–	–	–	1.74

Source: the IEP estimates based on the federal budgets data for 2005–2011 (2003–2007 data linked to the respective sections and sub-sections of the budget classification effected since January 2008.) The classification that has been out of the effect since 2011 and preliminary estimates are shown in italics.

Absolute and relative values of the main components of direct military allocations in the federal budget and their changes vs 2010 according to the final, November version of the Federal Budget Law for 2011 are shown in *Table 36*. The 2010 prices have been recalculated by using the first estimate<sup>2</sup> of the GDP index-deflator for 2011 (115.4%) used by Rosstat.

<sup>1</sup> Non-applicable due to the changes in the budget classification.

<sup>2</sup> On the production and use of GDP for 2011 M.: Rosstat, February 21, 2011 See.: [http://www.gks.ru/bgd/free/b04\\_03/Isswww.exe/Stg/d03/20vvp31.htm](http://www.gks.ru/bgd/free/b04_03/Isswww.exe/Stg/d03/20vvp31.htm).

Table 36

### Direct military allocations of the federal budget under section “National defense”

Section/subsection title	2011 in Rb mn / same in prices of 2010	Changes in 2011 vs 2010, Rb mn / growth, %	Allocation share % / change vs 2010 in points	
			2011 federal budget	GDP
1	2	3	4	5
NATIONAL DEFENSE	<u>1 537 444</u> 1 332 274	<u>54 247</u> 4.24	<u>13.82</u> 1.36	<u>2.83</u> –
Armed Forces, Russian Federation	<u>1 140 915</u> 988 661	<u>29 098</u> 3.03	<u>10.26</u> 0.90	<u>2.10</u> –0.03
Mobilization and paramilitary training	<u>6 700</u> 5 806	<u>3 199</u> 122.73	<u>0.06</u> 0.03	<u>0.01</u> 0.01
Mobilization preparation of the economy	<u>4 895</u> 4 242	<u>–653</u> –13.34	<u>0.04</u> –	<u>0.01</u> –
Preparation for and participation in collective security and peace-making efforts	<u>421</u> 365	<u>–10 722</u> –96.71	<u>&lt;0.01</u> –0.10	<u>&lt;0.01</u> –0.02
Nuclear arms	<u>29 968</u> 23 369	<u>4 614</u> 24.60	<u>0.24</u> 0.06	<u>0.05</u> 0.01
Implementation of international obligations on military and technical cooperation	<u>4 447</u> 3 854	<u>–357</u> –8.47	<u>0.04</u> –	<u>0.01</u> –
Applied research in the area of national defense	<u>161 346</u> 139 815	<u>–8 866</u> –5.96	<u>1.45</u> –	<u>0.30</u> –0.03
Other issues of national defense	<u>191 752</u> 166 163	<u>37 934</u> 29.58	<u>1.72</u> 0.47	<u>0.35</u> 0.07

Source: the IEP estimates.

Military allocations from other sections of the federal budget are given in *Table 37* (by italics, secret allocations are shown on the basis of the draft law on the federal budget). Note that to improve comparability of the data of the Russian military expenditures according to the international practice, since 2011 expenditures on security agencies have not been accounted for as military, and the respective amendments have been made in our published perennial dynamic rows.

Table 37

### Direct and indirect military allocations under other sections of the federal budget

Section title or allocations for	2011 in Rb mn / same in prices of 2010.	Changes in 2011 vs 2010, Rb mn / growth, %	Allocation share % / change vs 2010 in points	
			2011 federal budget	GDP
1	2	3	4	5
<b>in section “National security and law-enforcement efforts”</b>				
Internal troops	<u>73 225</u> 63 454	<u>–2 980</u> –4.49	<u>0.66</u> 0.01	<u>0.13</u> –0.01
Border service	<u>82 153</u> 71 190	<u>–6 237</u> –8.06	<u>0.74</u> –0.02	<u>0.15</u> –0.02
<i>EMERCOM troops and civil defense</i>	<u>51 018</u> 44 210	<u>–1 930</u> –4.18	<u>0.46</u> 0.01	<u>0.09</u> –0.01

*cont'd*

1	2	3	4	5
<b>In section “National economy”</b>				
Alternative civil service	<u>6</u> 5	<u>–1</u> –13.34	<u>&lt;0.01</u> –	<u>&lt;0.01</u> –
<i>President Program “Destruction of chemical weapons in the RF”</i>	<u>768</u> 666	<u>–404</u> –37.74	<u>0.01</u> –	<u>&lt;0.01</u> –
Subsidies to transportation companies that purchase motor vehicles for military convoys	<u>55</u> 48	<u>–7</u> –13.34	<u>&lt;0.01</u> –	<u>&lt;0.01</u> –
Subsidies to functioning of Russia-NATO Center	<u>33</u> 28	<u>7</u> 34.85	<u>&lt;0.01</u> –	<u>&lt;0.01</u> –
Construction of special and military	<u>11 433</u>	<u>–5 224</u>	<u>0.10</u>	<u>0.02</u>

facilities	9 907	-34.53	-0.04	-0.01
<i>Federal target program "Industrial utilization of weapons and military equipment (2005-2010)"</i>	<u>91</u> 79	<u>42</u> 116.91	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
<i>Contributions to charter capitals and subsidies to organizations of defense-industrial complex</i>	<u>31 328</u> 27 147	<u>3 962</u> 17.09	<u>0.28</u> 0.06	<u>0.06</u> 0.01
Stipends to young employees of the defense-industrial complex	<u>234</u> 221	-	-	-
<i>Secret/classified expenditures</i>	<u>33 998</u> 29 461	<u>7 179</u> 32.22	<u>0.31</u> 0.09	<u>0.06</u> 0.01
<b>In section "Housing and utilities"</b>				
<i>President Program "Destruction of chemical weapons in the RF"</i>	<u>659</u> 571	<u>-847</u> -59.70	<u>0.01</u> -0.01	-
<i>Provision of office and permanent housing accommodations too servicemen</i>	<u>126 344</u> 109 483	<u>-16 433</u> -13.05	<u>1.14</u> -0.09	<u>0.23</u> -0.05
<i>Secret/classified expenditures</i>	<u>42 749</u> 37 044	<u>1 335</u> 3.74	<u>0.38</u> 0.04	<u>0.08</u> -
<b>In section "Education"</b>				
<i>MoD expenditures</i>	<u>47 798</u> 41 419	<u>-3 092</u> -6.95	<u>0.43</u> -	<u>0.09</u> -0.01
<i>Secret/classified expenditures</i>	<u>22 465</u> 19 468	<u>4 891</u> 33.56	<u>0.20</u> 0.06	<u>0.04</u> 0.01
<b>In section "Culture and cinematography"</b>				
<i>MoD expenditures</i>	<u>2 491</u> 2 158	<u>-1 535</u> -41.56	<u>0.02</u> -0.01	<u>&lt;0.01</u> -
<i>Secret/classified expenditures</i>	<u>208</u> 189	<u>-28</u> -13.34	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -
<b>In section "Healthcare"</b>				
<i>MoD expenditures</i>	<u>38 940</u> 33 744	<u>922</u> 2.81	<u>0.35</u> 0.03	<u>0.07</u> -
<i>Secret/classified expenditures</i>	<u>40 993</u> 35 523	<u>25 337</u> 248.74	<u>0.37</u> 0.27	<u>0.08</u> 0.05
<b>In section "Social policy"</b>				
<i>MoD pension provision</i>	<u>149 598</u> 140 998	<u>15 090</u> 11.98	<u>1.35</u> 0.12	<u>0.28</u> -
<i>Pension provision to Border troops, Internal troops and EMERCOM troops</i>	<u>28 143</u> 26 525	<u>3 861</u> 17.03	<u>0.25</u> 0.03	<u>0.05</u> -
Material security to specialists of the RF nuclear weapons complex	<u>5 095</u> 4 802	<u>637</u> 15.29	<u>0.05</u> 0.01	<u>0.01</u> -
<i>Acquisition of housing for retired servicemen</i>	<u>19 770</u> 17 132	<u>-916</u> -5.08	<u>0.18</u> -	<u>0.04</u> -
Additional monthly material security to disabled after a service-related trauma	<u>1 041</u> 981	<u>336</u> 52.04	<u>0.01</u> -	<u>&lt;0.01</u> -
Repairs of individual housing units owned by servicemen family members who lost their bred-winner	<u>307</u> 266	<u>-135</u> -33.72	<u>&lt;0.01</u> -	<u>&lt;0.01</u> -

cont'd

1	2	3	4	5
Compensatory payments to the family members of the deceased servicemen	<u>1 245</u> 1 174	<u>198</u> 20.35	<u>0.01</u> -	<u>&lt;0.01</u> -
Allowances and compensatory payments to servicemen, persons equivalent to servicemen, and retired servicemen	<u>8 644</u> 8 147	<u>-3 079</u> -27.43	<u>0.08</u> -0.03	<u>0.02</u> -0.01
On-off allowance to a pregnant wife of a convicted serviceman under call-up liability, and a monthly allowance for the called-up serviceman's child	<u>2 238</u> 2 109	<u>133</u> 6.72	<u>0.02</u> -	<u>&lt;0.01</u> -
<b>In section "Mass media"</b>				
<i>MoD expenditures</i>	<u>1 500</u> 1 300	<u>100</u> 8.32	<u>0.01</u> -	<u>&lt;0.01</u> -
<i>Secret/classified expenditures</i>	<u>168</u> 146	-	-	-

In section “Inter-budget transfers to the budgets of the RF subjects and municipal establishments of general nature”				
Transfers to the budgets of Closed Administrative territorial Units (ZATO)	8 876 7 692	-1 185 -13.34	0.08 -0.01	0.02 -
Development and support to ZATO social and engineering infrastructure	2 690 2 331	-359 -13.34	0.02 -	>0.01 -
Migration from ZATO	527 457	-70 -13.34	>0.01 -	<0.01 -
Secret/classified expenditures	820 711	= -	= -	= -

Source: the IEP estimates. Pensions, allowances, compensations and stipends are deflated for CPI.

Let us analyze the dynamic trend of the federal budget and its corrections in the course of the year.

In 2011, the allocations for MoD housing construction in the section “National defense” (Rb 17bn 639 mn) increased vs the previous year by 140 % (in real terms) also as a result of re-allocation of Rb 12bn in the budget year from the target item expenditures “Construction of military and special facilities”, while in section “housing and utilities” (Rb 95bn 82mn) the allocations fell down by 23%. The federal budget allocations for the savings and mortgage system of housing provision to the MoD servicemen went up by 21% (in real terms) reaching Rb 29bn 740mn.

In 2011, allocations to motor fuels/lubs reduced by 10% (in real terms) down to Rb 51bn 57mn vs 2010 as a result of considerable carry-overs of the motor fuels. Thus, according to the Accounts Chamber<sup>1</sup>, the cost of the surplus stock of motor fuels was evaluated at Rb 13bn 287mn as of June 1, 2011; during the last three years 15% up to 20% of the motor fuels (vs the established annual limits) have not been used. The shortage of motor fuels is no more a cause of low combat training since the actual average flying hours in the military aviation was about 90 hours against the 100 planned hours in 2011<sup>2</sup>.

The federal budget allocations to MoD subsistence support continued growing by 27% in real terms vs 2010. Unlike the previous year, in 2011, allocations to MoD material support grew up by 12.4% in real terms. The MoD healthcare allocations demonstrated an interesting trend having reduced by Rb 2bn 901mn in June and increased again in November by Rb2bn 991mn (about 7.7% of their total).

In 2011, the MoD allocations to MA and additional incentives reduced in real terms by 12.5% vs 2010 down to Rb 262bn 578mn in spite of the actual increase of the money allowances by 6.5% since April 1<sup>st</sup>. Simultaneously, the military personnel allocations to the MoD healthcare system reduced by 58% in nominal value during the year.

In 2011, allocations to MoD pension provision went up by 12% vs 2010 (in real terms) thus ensuring the 6.5% increase of the military pensions since April 1<sup>st</sup>, and pension provision to newly retired servicemen.

As a result, in 2011, direct military allocations from the Russian federal budget (*Table 38*) calculated according to the UN standard for military expenditures amounted to 4% of GDP while general military allocations with account of costs related to previous military functions (retirement pensions, destruction of chemical weapons, etc.) made 4.4% of GDP.

<sup>1</sup> Conclusive statement of the Accounts Chamber regarding draft federal law “On the federal budget for 2012 and the planning period 2013 and 2014”. No. ZAM-23/1. M., October 7, 2011. P. 129–130.

<sup>2</sup> Independent Military Review. 2012. 16–23 March (No 8).

Table 38

**Total military and military-related allocations  
from the federal budget**

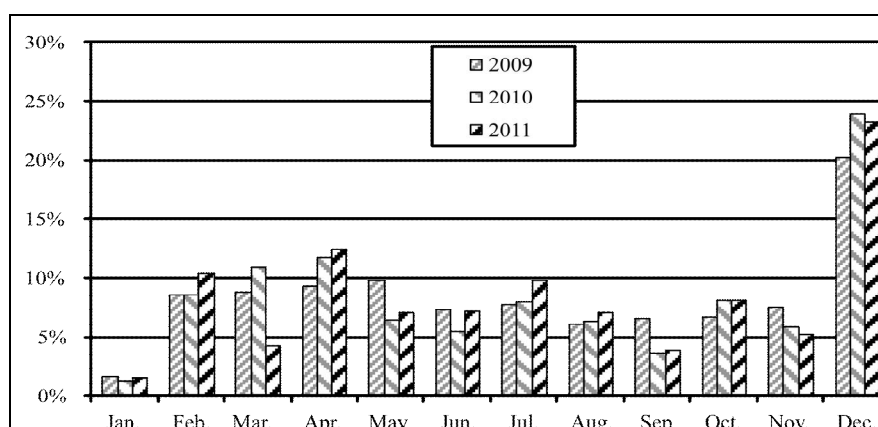
Allocation items	Allocation amount, in Rb mn,	Allocation share in % /its change vs 2010	
		in 2011 federal budget.	in GDP
Total direct military allocations	2 157 078	19.40 1.70	3.97 -0.05
Cumulative direct & indirect military allocations related to the previous and current military activities	2 375 205	21.36 1.82	4.37 -0.07
Total allocations for sections “National defense” and “national security and law-enforcement efforts”	2 779 552	24.99 1.92	5.11 -0.13

Source: the IEP estimates.

The 2011 federal budget implementation with regards to the military spend was more uniform than in 2010. According to our estimates, the excess over the limit of expenditure under “National defense” item reached its maximum of Rb5bn 866mn in July but did not exceed the limit of Rb 7bn 58mn established by part 7 Article 24 of the Law on federal budget for 2011, for the growth of military allocations at the expense of above plan budget revenues according to the consolidated budget plan.

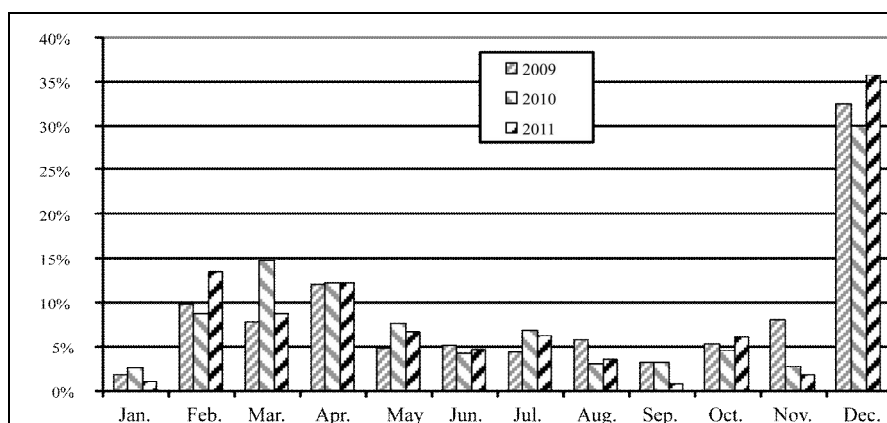
After this the said excess went to zero in November, and by the year end the consolidated plan envisaged Rb13bn of savings in section “National defense” as compared to the allocation amount sated in the budget law.

The dynamic trend of monthly execution of expenditures for major subsections of section “National Defense” in 2009-2011 is shown on *Fig. 37–39*. The expenditures of subsection “Armed Forces of the Russian Federation” that are used to fund the greater part of the MoD state military order failed to meet the two-month standard in 2011 while the December budget “tent” decreased but slightly (*Fig. 37*). The situation with expenditures in two other sections (*Fig 38, 39*) probed to be even worse and quite considerably in the last case.



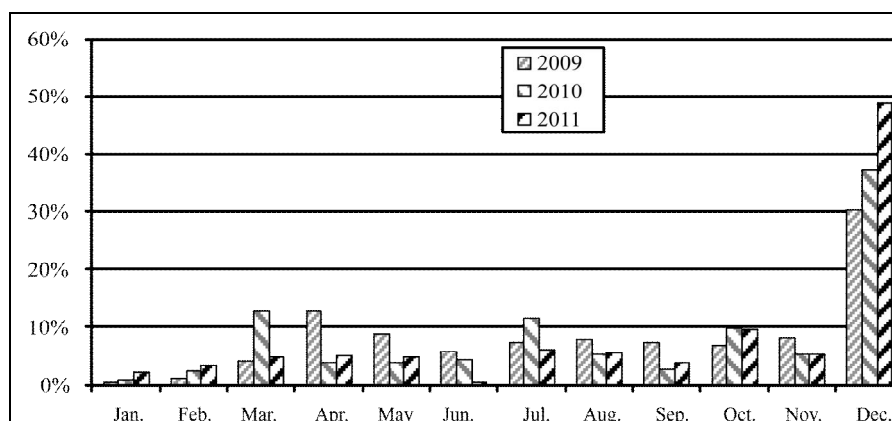
Source: the IEP estimates based on the Federal Treasury data.

*Fig. 37.* Implementation of federal budget expenditures under subsection “Armed Forces of the Russian Federation” in 2009–2011



Source: the IEP estimates based on the Federal Treasury data.

Fig. 38. Implementation of federal budget expenditures under subsection “Applied research in the area of national defense” in 2009–2011



Source: the IEP estimates based on the Federal Treasury data.

Fig 39. Implementation of federal budget expenditures under subsection “Other issues of the national defense” in 2009–2011

Table 39 shows military expenditures of the governments of the RF subjects that maintain long-term trends.

Table 39

**Military expenditures of the consolidated budgets of the RF subjects  
in 2004–2011, in Rb mn\***

Subsection of expenditure classification	2004	2005	2006	2007	2008	2009	2010	2011
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 and paramilitary 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
Mobilization preparation of the economy **	<u>532.4</u> 500.6	<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
Other issues of the national defense	–	<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
Internal troops	<u>12.4</u>	<u>9.9</u>	<u>3.5</u>	<u>1.0</u>	<u>0.3</u>	–	–	–

	12.2	9.9	1.4	1.0	0.3			
Security units	<u>6.7</u> 6.5	<u>0.3</u> 0.3	<u>16.5</u> 16.5	<u>0.1</u> 0.1	<u>0.0</u> 0.0	<u>60.0</u> 60.0	<u>&lt;0.1</u> <0.1	<u>14.5</u> 14.4
Border service units	–	<u>0.1</u> 0.1	–	–	–	–	–	–
Protection of population and territory from emergencies of natural and technogenic nature, civil defense	<u>7 968.2</u> 7 281.3	<u>11 184.6</u> 10 958.9	<u>15 636.4</u> 14 367.0	<u>19 118.4</u> 18 292.6	<u>23 895.8</u> 21 456.7	<u>23 865.0</u> 21 712.6	<u>27 218.0</u> 25 527.4	<u>34 678.1</u> 32 122.9

\*Numerator – allocated, denominator – actually spent.

\*\* Before 2005, the subsection was not included in “National defense”.

Source: Federal Treasury.

Table 40 presents Russian military expenditures in the period 1999–2011 that do not include (to avoid duplication) military expenditures of the consolidated budgets of the RF subjects shown in Table 39.

Table 40

**Main parameters of the Russian Federation military expenditures in 1999–2011**

	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
1	2	3	4	5	6	7	8	9	10	11	12	13	14
<b>1. In nominal terms (current prices) Rb bn</b>													
Implementation of FB expenditures under section “National defense” in 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	1 040.8	1 188.2	1 276.5	1 516.0
FB allocations to “National defense”: current budget classification	93.7	209.4	214.7	284.2	354.9	427.4	578.4	686.1	839.1	1 031.6	1 192.9	1 278.0	1 537.4
moved to other sections of the budget classification <sup>b</sup>	–	–	–	–	–	–	44.3	77.7	91.3	126.5	202.4	270.8	324.4
in comparable budget classification	93.7	209.4	214.7	284.2	354.9	427.4	622.6	763.9	930.4	1 158.1	1 395.3	1 548.8	1 861.9
Military expenditures, UN data <sup>c</sup>	–	202.6	294.4	325.9	447.0	499.0	665.0	822.1	850.2	1 127.2	1 176.4	1 179.3	–
Total direct military allocations <sup>d</sup>	120.9	256.1	262.2	321.3	408.4	490.9	692.1	899.7	1 085.4	1 356.5	1 652.7	1 819.1	2 157.1
Cumulative direct and indirect military allocations related to current and previous military activities <sup>e</sup>	137.5	294.3	313.4	429.1	556.2	586.6	788.2	1 000.1	1 263.3	1 502.4	1 822.3	2 006.7	2 375.2
<b>2. In real terms (in 2011 prices)<sup>f</sup>, Rb bn</b>													
Implementation of FB expenditures under section “National defense” in the current budget classification	1 202.9	1 285.6	1 247.9	1 265.4	1 250.0	1 289.3	1 413.2	1 343.6	1 407.2	1 434.9	1 491.9	1 517.8	1 516.0
FB allocations to “National defense”: current budget classification	975.1	1 404.4	1 081.5	1 217.3	1 247.3	1 281.5	1 406.5	1 352.2	1 419.4	1 422.1	1 497.7	1 519.6	1 537.4
moved to other sections of the budget classification	–	–	–	–	–	–	107.6	153.2	154.5	174.4	254.1	321.9	324.4

cont'd

1	2	3	4	5	6	7	8	9	10	11	12	13	14
in comparable budget classification	975.1	1 404.4	1 081.5	1 217.3	1 247.3	1 281.5	1 514.1	1 505.4	1 573.9	1 596.5	1 751.9	1 841.5	1 861.9
Military expenditures, UN data	–	1 358.8	1 483.3	1 396.2	1 570.9	1 496.1	1 617.1	1 620.1	1 438.2	1 554.0	1 477.1	1 402.1	–
Total direct military allocations	1 257.6	1 717.0	1 320.9	1 376.5	1 435.1	1 471.9	1 683.0	1 773.1	1 836.1	1 870.1	2 075.1	2 162.9	2 157.1
Cumulative direct and indirect military allocations related to current and previous military activities	1 431.0	1 973.4	1 578.9	1 838.3	1 954.7	1 758.8	1 916.7	1 970.8	2 137.0	2 071.3	2 288.0	2 385.9	2 375.2
<b>3. In real terms (in 1999 prices), Rb bn</b>													
Implementation of FB expenditures under section “National defense” in the current budget classification	115.6	123.5	119.9	121.6	120.1	123.9	135.8	129.1	135.2	137.9	143.4	145.8	145.7
FB allocations to “National defense”: current budget classification	93.7	135.0	103.9	117.0	119.8	123.1	135.2	129.9	136.4	136.7	143.9	146.0	147.7
moved to other sections of the budget classification	–	–	–	–	–	–	10.3	14.7	14.8	16.8	24.4	30.9	31.2
in comparable budget classification	93.7	135.0	103.9	117.0	119.8	123.1	145.5	144.7	151.2	153.4	168.3	177.0	178.9
Military expenditures, UN data	–	130.6	142.5	134.2	151.0	143.8	155.4	155.7	138.2	149.3	141.9	134.7	–
Total direct military allocations	120.9	165.0	126.9	132.3	137.9	141.4	161.7	170.4	176.4	179.7	199.4	207.8	207.3
Cumulative direct and indirect military allocations related to current and previous military activities	137.5	189.6	151.7	176.6	187.8	169.0	184.2	189.4	205.4	199.0	219.9	229.3	228.2
<b>4. Military burden on the economy, % of GDP</b>													
Implementation of FB expenditures under	2.40	2.62	2.77	2.73	2.69	2.53	2.69	2.53	2.50	2.52	3.06	2.87	2.79

section "National defense" in the current budget classification													
FB allocations to "National defense": current budget classification	1.94	2.87	2.40	2.63	2.69	2.51	2.68	2.55	2.52	2.50	3.06	2.83	2.79
moved to other sections of the budget classification	–	–	–	–	–	–	0.20	0.29	0.27	0.31	0.52	0.60	0.60
in 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	3.43	3.42
Military expenditures, UN data	–	2.77	3.29	3.01	3.38	2.93	3.08	3.05	2.56	2.73	3.03	2.61	–
Total direct military allocations	2.51	3.51	2.93	2.97	3.09	2.88	3.20	3.34	3.26	3.29	4.26	4.03	3.97
Cumulative direct and indirect military allocations related to current and previous military activities	2.85	4.03	3.50	3.97	4.21	3.44	3.65	3.72	3.80	3.64	4.70	4.44	4.37
<b>5. Purchasing power parity (in current prices), Rb bn</b>													
Implementation of FB expenditures under section "National defense" in the current budget classification	21.9	26.8	30.2	31.9	34.2	36.2	45.6	54.0	59.5	72.6	82.0	79.9	93.3
FB allocations to "National defense": current budget classification	17.7	29.3	26.2	30.7	34.1	35.9	45.4	54.3	60.1	71.9	82.3	80.0	94.7
moved to other sections of the budget classification	–	–	–	–	–	–	3.5	6.2	6.5	8.8	14.0	16.9	20.0
in comparable budget classification	17.7	29.3	26.2	30.7	34.1	35.9	48.9	60.5	66.6	80.8	96.3	96.9	114.6
Military expenditures, UN data	–	28.3	35.9	35.2	42.9	42.0	52.2	65.1	60.9	78.6	81.2	73.8	–
Total direct military allocations	22.8	35.8	32.0	34.7	39.2	41.3	54.3	71.2	77.7	94.6	114.1	113.8	132.8
Cumulative direct and indirect military allocations related to current and previous military activities	26.0	41.2	38.3	46.3	53.4	49.3	61.9	79.2	90.4	104.8	125.8	125.6	146.3
<b>For reference</b>													
GDP deflator, % to the previous year	172.5	137.6	116.5	115.5	113.8	120.3	119.3	115.2	113.8	118.0	101.9	111.4	115.4
Expenditures deflator on end consumption of collective services of public administration <sup>e</sup> , % to the previous year	140.1	155.2	133.1	117.6	121.9	117.2	123.3	123.4	116.5	122.7	109.8	105.6	118.9
Purchasing power parity <sup>h</sup> , Rb/\$	5.29	7.15	8.19	9.27	10.41	11.89	12.74	12.63	13.97	14.34	14.49	15.98	16.24

<sup>a</sup> For 2011. – preliminary data on federal budget implementation of Federal Treasury.

<sup>b</sup> Total expenditures of MoD and secret/classified expenditures under sections 05–09 and 11 of 2005–2011 federal budgets for 2011 – additionally for section 12.

<sup>c</sup> For 2011 – RF government will provide the data to UN in 2012; these will include expenditures for maintenance of the internal, border troops and civil defense

<sup>d</sup> Including maintenance of the internal, border troops and civil defense troops.

<sup>e</sup> With servicemen retirement pays.

<sup>f</sup> Deflated by the deflator of expenditures on end consumption of collective services of public administration.

<sup>g, h</sup> For 2011 – the IEP estimates.

*Source:* Federal laws on the federal budgets of 1999–2011 and on the implementation of the federal budgets of 2000–2010.; Russia's national accounts in 1997–2010 Statistical collection/Rosstat M., 2005–2011; Objective information on the military issues including transparency of the military expenditures. UN General Secretary reports of 2001–2011.; Rosstat; Federal Treasury.

\* \* \*

The objectives of the 2011–2020 state arms program to raise the share of state-of-the-art arms in the current force up to 70% by 2020 and in the strategic nuclear force – up to 100% are non-realistic and counterproductive since, firstly, these objectives are unreachable given the potential of the national industry, and this has been confirmed by the results of the first year implementation of the said program, and secondly, they doom the national industry to a more than two-fold reduction of the strategic nuclear weapons production after 2020, and of the conventional weapons for the national Armed Forces, after 2025. If these reductions take place, one should not rely on a considerable compensation of the reduced weapons at the expense of growing weapon exports, specifically with respect to the strategic nuclear weapons.



According to the Russia's Ministry of Defense data<sup>1</sup>, the share of state-of-the art weapons in the armies of the leading foreign countries makes 30% to 50%; this apparently sets up a necessary pace for development of their defense industries that supply products to the domestic markets.

Therefore, assuming that the optimal value of the said target indicator would be in the same range for Russia as for other countries with sufficiently developed military production and following the declared value of the state arms program worth Rb 20 trillion for 2011-2020, we can estimate possible saving of the budget at the expense of the arms program till 2020 inclusively within the range Rb5.3 trillion – Rb14.8 trillion (with account of the attained, by early 2012, target indicator of the arms program at 25% and 16% for strategic and conventional weapons, respectively).

To overcome the current bureaucratic stupor caused by the fight between the Ministry of Defense and the Russian defense and industrial complex may be possible only if the military and technical policy returns to the route pointed out by V. Putin back in 2004 in his President message to the Federal Council in the form of a statement on “the transparent military economy” as an absolutely necessary condition of the successful reform. This for sure will require abandoning the latest practice of thoughtless pumping of budget funds into the defense and industrial complex, improving discipline at all the tiers of the public administration and doing away with the administration irresponsibility. The directive and financial methods of managing the defense and industrial complex in the existing context of the vertical power model proved to be ineffective and inefficient both in a short-term and long-term perspective; and the 12-year long experience is a good evidence of this.

Indeed it is impossible to improve the efficiency of expenditures including the military expenditures unless accurate statistics is published, federal budget gets transparent, a policy of openness (*glasnost*) on the issues of defense is carried out and corruption is fought with effectively. *Table 35* gives you an idea of what a long way Russia will have to go.

The irrational institution of the program-based planning of weapons that is outdated in terms of the format and the content still remains the only tool of blackmailing politicians and the community forcing them to satisfy, every five years, the ever growing appetite of the Russian defense and industrial complex with no responsibility for the outcomes. This may create a *dangerous* effect that feeds up not only the ongoing growth of military expenditures but also leads to militarization of the community backed up with the statement about increasing defenselessness of Russia.

The modern Armed Forces of Russia have not been among the top five world leading armies, and so far there is no opportunity for them to reach this target set by the MoD leadership. Among the G8 states, Russia remains the only country with the army which by over one half is formed involuntary, by the call-up principle. Given the established total numerical force of one million, the efforts to staff all the military units at 100% failed due to erroneous notions about the number of conscripts and low attractiveness of the military service. The ongoing “humanization” of the call-up military service is useful, no doubt, but it is not going to resolve the problems of the service effectiveness.

The program of transition of the constant readiness military units to the contract enlisting during 2004–2007 failed for the sake of keeping the conscription and the “feeding trough” for corrupt officials engaged in conscription. Up to now, the persons at fault have not been pun-

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<sup>1</sup> Interview of V. Popovkin, Deputy Minister of Defense//National Defense, 2011, March.

ished, no lessons have been drawn from the situation and the intentions to increase the number of enlisted by contract continue running into old corruption factors and the absence of understanding by the government officials of the needs of the servicemen and their family members, and the real difficulties of the military service. As a result of this policy, the initial money allowance of the soldiers (rank and files) is going to be lower than the average wage across the country even after the latest increase of this allowance, though the Strategy of social development approved by the RF MoD fixed the 25% excess of MA over the average wage. It may be expected that the competitiveness of the army at the employment market would remain low. The attempt to equip the army with volunteers from the CIS countries who wish to become citizens of Russia seems to be totally inefficient.

Economic incentives are needed to support the declared annual increase of the numerical force of the army by 50,000 of the enlisted by contract, these incentives could ensure manning of new positions and replacement of the retired, and this would set the annual enlisting requirement up to 70,000. To reach this level would be hard if the initial amount of the rank-and-file money allowance is not increased in the near future.

The announced by the Joint Staff Commander proposals for implementation of the system of continuous military training of the servicemen that so far covers officership only, should also include soldiers and the junior command personnel.

### **Strategy of Socio-Economic Development of the North-Caucasian Federal Okrug: the First Steps**

Strategy of the socio-economic development of the North-Caucasian Federal Okrug through 2025 was approved more than a year ago, and its implementation has already kick-started. But already at the onset there arose risks which experts had long forewarned of: specifically, the Strategy implementation mechanisms may exacerbate typical of the North-Caucasian regions problems and fuel new ones. Hence an integral component of the NCFO Strategy should become a policy comprising strictly defined rules and procedures and aiming at prevention of conflicts.

#### ***Strategy in a Nutshell***

Strategy of the socio-economic development of the North-Caucasian Federal Okrug through 2025 was approved by Resolution of the RF Government No 1485-p of 6 September 2010. The mission of the strategy is “to ensure conditions for advanced development of the real sector of the regions in the Okrug, generation of job opportunities, raising the residents’ living standards”. In the frame of an optimal scenario of development of NCFO by 2025 it is planned to:

- create no less than 400,000 jobs and bring unemployment from 16% down to 5%;
- reduce the proportion of the population with incomes under the subsistence level from 16.5% to 9.2%;
- raise average salaries and wages from Rb 9,600 to 23,800;
- ensure the annual GRP increase rate at a level of 7.7% (with its cumulative growth over the period in question accounting for 2.7 times) and the annual increase rate in the industrial sector at a level of 10.1%;
- quadruple consolidated regional budget revenues per capita.

It is envisaged to ensure such a breakthrough by encouraging advancement of the real sector, including the agro-industrial complex, tourist-recreational one, energy, mining and processing industries, and transit functions. It is also envisaged to bolster innovation-educational activities and establish a federal university.

During most of the period of 2010-2011, the Strategy was largely “appended” with necessary paraphernalia, such as the normative base, organizational structure, etc. There began functioning the Commission of the RF Government for the North Caucasus led by PM V. Putin as its Chair. To implement the Strategy, there were established JSC “the North Caucasus Development Corporation”, a subsidiary to Vensheconombank, with the authorized capital of Rb 500mn, and JSC “Resorts of the North Caucasus”, a subsidiary to JSC ‘Special Economic Zones’ with participation of Vnesheconombank and Sberbank of Russia, with the authorized capital of Rb 5.35bn. The RF Ministry of Regional Development, regional agencies in charge of economic development became engaged in projects selection. A range of public advisory bodies were created: the Council under the Envoy, the Public Council of the Okrug, The Anti-Corruption Council, the Council of Elders, the Council for Youth Policy, the Council of Alims, the Okrug Commission for Cossack Affairs, the Expert Council, to name a few.

That said, not all the problems were solved even on the organizational level. Specifically, the widely publicized federal target program “Development of the North-Caucasian Federal Okrug through 2025” was not adopted. In accordance with the FTP, it was planned to allocate Rb 3.9 trillion, including 2.6 trillion out of the federal budget, for development of the North Caucasus. Devised in July 2011 by the RF Ministry of Regional Development, the FTP consists of 10 sub-programs and over 8,300 measures. It is envisaged that three currently implemented federal target programs which concern the NCFO regions, namely, “The Socio-Economic Development of the Republic of Ingushetia for 2010-2016”, “The Socio-Economic Development of the Republic of Chechnya for 2008-2013”, “South of Russia (2008-2013)” (with regard to RF Subjects within NCFO), should form structural components of the Program. It is planned to allocate, on the annual basis, some Rb 400 bn to implement this program in years to come.

However, the program has not been adopted as yet, particularly because of significant controversies with the RF Ministry of Economy and Ministry of Finance with respect to its funding. The program is to be approved by May 2012, but it is not clear how to combine a gargantuan increase in the federal spending on the North Caucasus with the task to ensure a sustained balancing of the budget and ensuring a budget maneuver in favor of sectors of the social sphere which the nation faces today in connection with the imperative of attaining its strategic development objectives on the whole.

### ***Prospects and Risks Facing the Tourist Cluster***

It was the work on shaping the tourist cluster that proved particularly active. With its Resolution No. 833 of 14 October 2010 “On creation of the tourist cluster in the North-Caucasian Federal Okrug, Krasnodar krai and Republic of Adygeya”, the RF Government ruled to establish 5 tourist-recreational special mountain skiing economic zones, of which 4 ones – in the North-Caucasian federal okrug (Matlas in Dagestan, Elbrus-Bezengi – in Kabardino-Balkaria, Arkhyz – in Karachaevo-Cherkessia and Mamison – in North Ossetia – Alania). It was envisaged that the Government would invest, through JSC “RNC”, Rb 60 bn in the transport and communal infrastructure of these projects, with the private businesses financing construction of resort infrastructure objects against the RF Government’s guarantee to return up to 70% of

their investment in the event of force majeure and vows to grant tax and customs benefits. More specifically, tax benefits include exemption from the federal component of the corporate profit tax (2%) coupled with a possible slashing to 0% of the current 18% regional component thereof, and exemption for the term of up to 10 years from land and property, and transport taxes.

The year of 2011 saw vigorous efforts to attract foreign investment into the project. The Russia-France summit in Dauville in May 2011 resulted in a joint declaration on inclusion of the project of development of a tourist cluster in the North Caucasus in the list of priority directions under the aegis of the nations' strategic partnership. At the St. Petersburg Economic Forum, JSC "RNC" signed a memorandum of intention with the French state-owned holding Caisse des Dépôts et Consignation with regard to a joint venture to contribute to the tourist cluster development project. In late 2011, a joint Russian-French venture "The International Development of the Caucasus" was incorporated, which is to commence its operation in February 2012. In compliance with the Incorporation Agreement signed by the parties thereto, the newly established joint venture plans to attract up to Euro 1 bn in investments in the project.

The work on building a mountain skiing cluster has just kicked off (construction *de facto* is in progress only in Arkhyz), but with its Resolution of 29 December 2011 No. 1195 "On special economic zones in the North-Caucasian Federal Okrug", the RF Government has already doubled in size the territory of the North-Caucasian tourist-recreational complex. More specifically, special economic zones of tourist-recreational type are established in the Republic of Ingushetia (in the territory of Jeirakh and Sunzhen districts), along the Caspian shore in the Republic of Dagestan and in a number of other territories. At this point, it should be noted that peaceful environment, the absence of ethnic and confessional conflicts and acts of terror are not typical of all those territories. There also exist plans to have the company's operations spread across other territories, including those beyond the North Caucasus. In parallel there intensify demands for public funding to build the infrastructure. It has been announced recently that it is imperative to build four new airports and reconstruct two existing ones in the region.

The envisaged deliverables indeed pursue the goal of a substantial transformation of the economic basis to bolster the region's advancement and include creation of over 1,000 km of pistes, over 200 cable tramways, erection of hotels, apart-hotels and private cabins of different categories with the overall capacity of some 85,000 beds. It is envisaged that the project implementation will generate over 330,000 jobs in the region. It is planned to have local resorts in the North Caucasus and along the Caspian shore be able to accommodate up to 250,000 tourists a day. In accordance with the publicly voiced estimates, once the project gets into top gear, the tourist inflow in the region will account for 10 mn people. The peak of construction works will fall on 2013-17 and the program is scheduled for completion in 2019.

Meanwhile, a series of fundamental questions raised a year ago regarding development of the tourist cluster in the region still remain unanswered. Let us cite three of them.

First, the *occupancy rate*. At the existing resorts in the North Caucasus, the high-season occupancy is 10-15,000 alpine skiers a day. The season lasts for 100-120 days. Besides, even prior to the 2011 developments which battered the local ski industry (see below), the number of tourists there had been dwindling<sup>1</sup>. There has been no in-depth examination of demand for services of those tourist giants which are supposed to be created in the region or, at least, respective findings were not made public.

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<sup>1</sup> See: North Caucasus –Modernization challenge.-M.: Delo Publishers, 2011, p. 222-223.

Second, *what is going to happen to the existing tourist centers?* There are at least two large ski centers in the region: at the vicinity of Mt. Elbrus (Kabardino-Balkaria) and Dombai (Karachaevo-Cherkessia). Given development of the tourist cluster, their prospects remain murky. They will obviously prove undesirable rivals to the ski cluster under construction which lower their chances for survival. That said, it is worth noting they both are holders of a real brand, with the Elbrus one boasting an internationally recognized brand of both ski and mountaineering center. They secure quite a number of job opportunities for both locals and seasonal staff and it is not guaranteed they would be able to find their niche in the frame of the new tourist industry with its greater, and somewhat different, requirements. It is not at all granted, either, that residents of once long-standing tourist industry leaders which subsequently fell prey to the state would necessarily welcome new privileged rivals. It is more likely that such a development would fuel new intense conflicts in the region and no one is insured against such conflicts growing violent.

This compels posing the third and, perhaps, the most thorny – at the moment – question: *how can development a tourist cluster* receiving 250,000 visitors a day, including women and children (as it is also planned to develop family tourism), *combine with the threat of acts of terror?* The act of terror in Kabardino-Balkaria on 18 February 2011, which left three tourists dead and another three wounded<sup>1</sup>, is a perfect demonstration of the gravity of the threat in question. The fact that the first act of terror against tourists took place after making public the gargantuan plans to develop a tourist complex in the region, thus increasing the political and economic significance<sup>2</sup> of security issues, cannot help but compel contemplating the urgency of creation of efficient anti-terrorist mechanisms. This problem is a genuine life-and-death one for the future tourist cluster. That said, while discussing respective plans in this sphere, these problems have not even been made public.

In practice, it is the forceful option that still remains predominant in this regard, with the sole response to the rise of terrorism in the Republic being a counterterrorist operation regime (CTO) since 20 February 2011. In Elbrus district and in a part of Baksan district the CTO regime was canceled only on 5 November 2011, thus having lasted for over 8 months. From the perspective of forceful action, its results were positive and the militant underground suffered a serious blow. According to the local Ministry of Interior, 95 illegal militants were killed and another 97 detained during the CTO period. That said, a longer-range success of such a policy does not seem that granted.

First, like many other actions of this sort, the one in question was accompanied with abuses of human rights, including killing innocent individuals who were taken for militants and inflict-

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<sup>1</sup> Actually, the killing of the tourists on 18 February was just the first link in the chain of terrorist attacks in the territory which aim at derailing the local tourist business. The next night, a pillar of a local cable tramway was blown, and a mine-strewn car was found at a local alpine place popular with tourists.

<sup>2</sup> Experts differ on the issue. Thus, Islam Tekushev, Director of medium Orient news agency suggests that behind the acts of terror were forces striving to topple Arsen Kanokov, the incumbent President of Republic of Kabardino-Balkaria: “It is not known when clans and local thugs represented by the Kabardino-Balkar underground began to systematically work on destabilization of the situation for the sake of their common objective, that is, toppling Kanokov... Customers realized very well that killing tourists within the zone of a federal ski resort popular with mountaineers, rock-climbers and skiers throughout Russia and European states does not fit in the framework of permissible risks set by Russian elites in the Caucasus” (Islam in the North Caucasus: history and modernity. Prague, Medium Orient, 2011, p. 178-179). In the Republic, a widespread opinion is that the spike of violence is directly associated with the struggle for control over the tourist business.

ing damage on non-combatants' property. Specifically, once again the crackdown on the regular "mosque-goers" was on the upswing. During the CTO, mosques stayed empty in Elbrus district as local residents were afraid of dropping by. NGO "Memorial" cites an example of the local authorities' failure to engage militants' families to get their children out of the "woods". A month and half after airing their mothers' video with an appeal to put an end to the civil war there was broadcast another one which evidenced that sons of two women who had recorded the video in the summer were killed literally in their presence during a "special operation" in the town of Baksan<sup>1</sup>. It is this kind of situation that gives rise to the "vicious cycle of violence" when suffering and deaths of the innocent, often relatives, friends and mates, in the course of combat against terrorism bolsters the desire to revenge and result in augmentation, rather than fading, of the armed struggle.

Second, the territories concerned saw the local economic activity in ruins. The influx of tourists in the locality has fully discontinued since the moment of imposition of the anti-terrorist operation regime there. Hoteliers and other operators and owners of the local tourist infrastructure objects faced a grave challenge, as they had already taken loans in the hope to expand their businesses. Employees, too, found themselves on the verge of hunger, and so did small-sized businesses, including, in particular, craftsmen and artisans (there even was a probability of not sending children to school on 1 September, as there was nothing to wear). Unknown structures were vehemently buying land at giveaway prices<sup>2</sup>. While the CTO regime was canceled in early November 2011, it goes without saying it will be fairly hard to avoid its long-term adverse effects.

For one part, the residents' growing discontent is centered both on militants and the authorities, which manifested itself even on the official level. While meeting with residents of settlement Elbrus, President A. Kanokov of Kabardino-Balkaria enunciated that, "Nobody was going to impinge upon the local residents' interests, despite the dearth of talks about that". However, in private conversations the local residents cited a comment made by a high-ranked federal bureaucrat: "You are going to starve till the last Wahhabi!" Such an automatic labeling of local residents as terrorists' accomplices does not help ensure a social harmony in the Republic, either, and contributes to the said "vicious circle of violence".

On the other hand, development prospects for tourism in the region and, perhaps, throughout the North Caucasus have been jeopardized. While it is yet premature to assess prospective losses, some short-term results have become already known. Since mid-December the local resort's occupancy rate has been just 15%, while during the high season (New Year holidays) it received twice as little tourists than a year before. According to information available, local businesses' economic losses are further exacerbated by the need to invest in security and no possibility for even an inflation-adjusted price rise. Meanwhile, compensations payable to local residents for damages inflicted by ACT are preposterous: according to information available, the Elbrus district residents are entitled for a total of Rb. 1.5mn in compensations, while the neediest households received Rb. 15,000-worth compensation each.

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<sup>1</sup> Bulletin of the Memorial human rights watchdog. Situation in the zone of conflict in the North Caucasus: the human rights activists' assessment. The summer of 2011. Source: the human rights advocacy center "Memorial"/"Caucasian knot". <http://www.kavkaz-uzel.ru/articles/194174>. 18 October 2011.

<sup>2</sup> We visited this locality during the ATO period. Even on the surface the picture was terrifying: packs of hungry dogs, rags of billboards flying in the wind, and not a single human being around.

Apart from ACT, the official reason for a meager tourist inflow in the region is the snowless winter. Future will show which factor plays a greater role; however, it is already clear that restoration of the Elbrus district and the North Caucasus on the whole as an appealing ski resort can take a lot of time and costs.

At this juncture it is evident that a successful development of the local tourist cluster is up in the air without fundamentally new approaches to security challenges in the region. Most North-Caucasian Republics already rejected the credibility of the purely forceful solution.

Some efforts were made, albeit with a different level of consistency and success, in Dagestan, Ingushetia and Kabardino-Balkaria to mitigate the standoff and return former militants to peaceful life, but federal structures did not contribute to the process, thus drastically lowering its efficiency. Should such a policy be pursued further on, it may seriously torpedo the Strategy implementation.

### ***Project Financing***

The possibility to obtain guarantees or other forms of backing to investment projects aroused much interest in the region, primarily with the medium-sized business community. Practically all its representatives we interviewed last year were preparing projects to apply for the support. Meanwhile, those entrepreneurs who have already faced the selection procedure sounded ambiguous. Thus, it was noted that structures engaged in the selection process are keen to pick large, rather than small, projects and explicitly encourage the entrepreneurs to extend their projects and increase volume of investment. But the process is at its onset, and it is too early to assess its efficacy. Thus, Rb 50bn allocated in the 2011 budget for provision of state guarantees against loans attracted by legal entities to implement investment projects in the North Caucasus was carried forward to the 2012 budget (accordingly, the latter now provides for Rb 100bn in allocations for the said purpose).

Main technical problems exposed by now were quite predictable. Those were: an insufficiently high quality of projects and a low level of their development. This factor might become one of the reasons behind the decision to transfer implementation of most projects to Stavropol krai, with its lower risks and a relatively higher culture of project implementation, as evidenced by Mr. A. Khloponin, the presidential Envoy in NCFO: "For next year Rb. 6.6bn from the Investment Fund was planned in the budget, and all the allocations are for projects in NCFO, infrastructure development. But it is only Stavropol krai which is ready and already in receipt of Rb 3bn. The rest of the money has not been assigned as yet, as there are no concrete projects and documentation in accordance with which the projects need to be funded"<sup>1</sup>.

Meanwhile, conflicts engendered by implementation of state-sponsored investment projects were not long in coming. A particularly explosive situation emerged in Nogaysky district of Dagestan, where it was planned to build a sugar-processing plant.

The fuel for the future conflict had been there even before the respective decision was made and it was the land. The district in question is a territory where most lands (over 60%) fall under the category of the so called distant-pasture cattle rearing ones and as such are used by settlers from mountainous regions (the Dargin and Avar peoples), rather than the local Nogays. Ex-highlanders have also staked out most pastures in the district that did not fall under the above category, thus de-facto leaving the Nogays with a meager fraction of arable land in their

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<sup>1</sup> Yuri Goverdovsky. The North Caucasus have a Development Strategy// The Parliament Gazette, No. 48 (2464). <http://www.pnp.ru/newspaper/20101001/4614.html>. 1 October 2010.

hands. It is most of these lands (some 100,000 hectares) claimed by the sugar-processing plant development project. The locals conceived of the project as a threat from different perspectives.

First, in the absence of formal land titles, the disputable lands *de facto* prove to have been fixed with the locals. Informal property rights are widespread in Dagestan and the residents therein regard them as legitimate ones. Thus, the investor's arrival was *de facto* perceived of as a way to strip the residents off their last land plots. Besides, the Nogay *vox populi* is that sugar beet cannot be cultivated in the local climatic conditions.

Second, the construction of the prospective plant was perceived of as a means to ensure the highlanders' further migration into the territory of the district. Such conclusions were made basing on the fact that the project provided for 15,000 new jobs. But the local residents cannot supply workforce in such quantities. Besides, there practically is no qualified staff among them, as the Nogays have never been engaged in planting sugar beet. The need to attract extra workforce into the region was voiced by the Republic's leadership too.

More fat into the fire was added by the fact that the project was initiated by an Avar from Khasavyurt district of Dagestan.

The local residents' protests were ultimately a success and the project was transferred to a neighboring district. But a fragile equilibrium in the district was broken, the residents grown politically mobilized and the conflict started living its own life which was independent of the investment project which had triggered it. At the congress of the Nogay people<sup>1</sup> held in the capital of Nogay district, the settlement of Terekli-Meleb, in late May 2011, in addition to the problem of the sugar-processing plant, the residents raised more general political issues: the need to unite all the Nogays in the frame of an administrative-territorial entity, transition to direct elections of the district Head, etc. Even after the decision was made to relocate the construction project in question, the Nogays' activity did not subside, the conflict with the district authorities escalated and the range of political demands was expanding (the opposition now is against election of the local legislature on party ticket). According to mass media, "the region itself is growing into a full-fledged zone of conflict"<sup>2</sup>.

The risks emerged already at the onset of the Strategy implementation, which proved associated with escalation of the conflict potential in the North-Caucasian regions, require an additional development, in the frame of the NCFO Strategy, of a policy aiming at prevention of the rise of additional conflicts. This can be at least partly ensured through devising a set of rules and procedures which would secure a sound awareness campaign, taking into account the residents' opinion and refusal of projects that may have an adverse effect on social stability in the region.

The latter is in need for a more detailed explanation. The previous record of launching investment programs in the North Caucasus exposed an extreme danger of implementation of projects that provided for withdrawal from the economic turnover of sizeable arable land sites (eg., as a result of their impounding). By destroying traditional livelihoods without offering a credible alternative, such projects can provoke the rise of extremism in the territories concerned. It seems appropriate either to shelve such projects at all, or to secure a maximum pos-

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<sup>1</sup> Main territories of the Nogays's compact residence; Dagestan, Chechnya, Karachaevo-Cherkessia and Stavropol krai, and Astrakhan oblast. There are Nogay national districts in Dagestan and Karachaevo-Cherkessia.

<sup>2</sup> Ivan Sukhov. The Nogay Riot. The biggest district in Dagestan demands for non-party elections. Moscow news. [http://mn.ru/blog\\_caucasus/20110905/304671811.html](http://mn.ru/blog_caucasus/20110905/304671811.html). 5 September 2011. 17:12.



sible account of the popular opinion and get the projects implemented only upon mobilization of a broad public consensus. As in the conditions of the North Caucasus monitoring of genuineness of such a consensus may pose certain problems and be associated with sizeable costs, the former option (a ban on projects associated with a large-scale land withdrawal) may prove the most sound one.

The policy in question should also encompass anti-terrorist activity and provide for abandonment of a purely forceful solution to the problem and engagement of mechanisms securing public consent with participation of the federal center which should become a guarantor behind agreements reached and coordinator of law enforcement agencies and other “*siloviki*”’s contribution to the process in question.