

RUSSIA'S DEFENCE INDUSTRY COMPLEX COMES OUT OF SHADOW

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The Ministry of Industry and Trade of Russia has officially published a list of enterprises operating in the Russian Defense Industry Complex (DIC), thereby making it possible to assess the key indicators of the DIC's size which have changed insignificantly over the past six months. However, the publication itself of such data is indicative of Russia's intention to create a transparent defense economy. Further steps are required to create and publish official statistics of contracts for and prices of defense products, disclose federal budget allocations on actual expenditures concerning the state defense order.

A list of enterprises entered into the Consolidated Register of Enterprises Operating in the Defense Industry Complex (DIC) was for the first time officially published in June 2014 on the official website of the Ministry of Industry and Trade of the Russian Federation¹. Therefore, it took just a little less than two years (21 months, to be specific) to implement the principal of the Russian Government's Executive Order² which excluded, beginning from September 4, 2012, the foregoing list from restricted information. The three well-known previous lists³ are still available in commercial electronic reference systems⁴.

The total number of enterprises entered into the most recent version of the register, comparing to the first version published in February last year, has gained only one unit to reach 1341 over 16 months, although the number contracted to 1330 in October last year and increased again to 1339 in April of the current year.

1 Приказ Министерства промышленности и торговли РФ от 2 июня 2014 г. № 1067 «Об утверждении перечня организаций, включенных в сводный реестр организаций оборонно-промышленного комплекса». [The Order of the Ministry of Industry and Trade of the Russia of June 2, 2014 No. 1067 On the Approval of the List of Enterprises Entered into the Consolidated Register of Enterprises Operating in the Defense Industry Complex] URL: <http://minpromtorg.gov.ru/common/upload/files/docs/1067.pdf> (date of access: 18.07.2014).

2 The Russian Government's Executive Order of August 21, 2012, No. 843 On the Amendments to the Russian Federation Government's Executive Order of February 20, 2004, No. 96.

3 Приказы Минпромторга России от 5 февраля 2013 г. № 137, от 23 октября 2013 г. № 1703 и от 22 апреля 2014 г. № 758. [Executive Orders of the Ministry of Industry and Trade of the Russia of February 5, 2013, No. 137, October 23, 2013 No. 1703, and April 22, 2014 No. 758.] The Ministry published retroactively the text of the first and second orders, without providing the respective lists. URL: <http://minpromtorg.gov.ru/docs/orders/> (date of access: 18.07.2014).

4 Garant information and legislation portal. URL: <http://www.garant.ru>; справочно-правовая система «Консультант Плюс» [Konsultant Plus, a reference and legal system.] URL: <http://www.consultant.ru>.

Major variations in size of the registry were caused by mergers of the existing enterprises (like the affiliation of the Sukhoi Experimental Design Office, the Chkalov Novosibirsk Aviation Production Association, and the Gagarin Komsomolsk-on-Amur Aviation Production Association as branches of the Sukhoi Aviation Holding Company (JSC)), changing the core activity and giving up manufacturing of defense products (e.g., the Kazan Engine Production Association and the Kovrov Mechanical Plant), with taking off and entering into the register, in the fall of 2013, 18 consumer industry enterprises contracted by the Ministry of Defense of Russia. Additionally, the substantial qualitative changes in the registry are associated with further corporatization of Federal State Unitary Enterprises (FSUE) whose number has reduced by 19 over the period under review, whereas the number of open joint-stock companies increased by 10, and mergers, but this time without excluding branches from the register (e.g., six branches of Shvabe Holding were retained in the next to the latest version published in April).

As a result, the enterprises operating in the Russian DIC have undergone redistribution by type of ownership as follows (*Fig. 1a*). However, it should be taken into account that no share of state participation in the DIC can be determined on the basis of the data available in the Consolidated Register. *Fig. 1b* shows departmental affiliation of the enterprises operating in the DIC, as set forth in the latest version of the Consolidated Register.

The fact that the number of the enterprises owned by the Ministry of Defense of Russia remains unchanged (169) during almost 1.5 years is indicative of that affiliation of some of the defense repair plants with the Ministry of Industry and Trade still remains a figure of speech, existing only in plans.

Territorial concentration of enterprises operating in the DIC (*Fig. 2*) has changed insignificantly.

Almost half of them (591 or 44.1%) are still situated in the Central Federal District, where Moscow

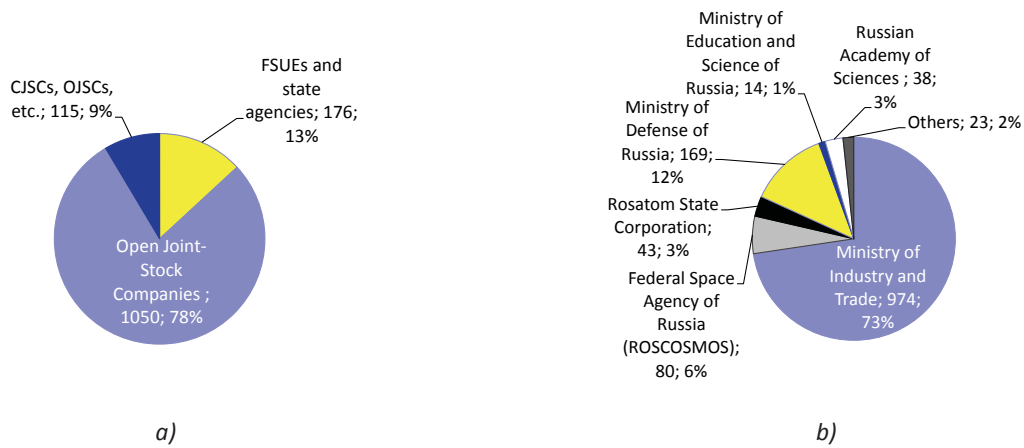


Fig. 1. Type of ownership and departmental affiliation of enterprises operating in the DIC (June 2014)



Fig 2. Russia's DIC territorial concentration (June 2014)

(307 or 22.9%) and the Moscow Region (114 or 8.5%) are ranked at the top. The Volga Federal District (239 or 17.7%) and the Northwestern Federal District (220 or 16.4%) are ranked second and third consequently, where the Nizhniy Novgorod Region (55 or 4.1%) and Saint Petersburg (166 or 12.4%) are dominant. The Sverdlovsk Region (42 or 3.1%) and Novosibirsk Region (35 or 2.6%) are traditionally distinguished among other federal districts.

The Central Federal District is ranked at the top in terms of increased number of DIC enterprises since February last year. Five new DIC enterprises emerged in the District, mostly in the Moscow Region, although some growth was also observed in the Voronezh Region, Ivanovo Region, Kaluga Region, Oryol Region,

Ryazan Region, Tver Region, and Yaroslavl Region. The situation in the Crimea remains unchanged – the Registry still contains, like in February 2013, the 1020th Ship Repairing Yard and the Construction Department of the Black Sea Fleet owned by the Ministry of Defense of Russia, all of which are situated in the city of Sevastopol.

Assessing the fact itself of the Ministry of Industry and Trade's official publication of the Consolidated Register of Enterprises Operating in the DIC, it should be noted that the Ministry has made a significant, albeit delayed as noticed above, step towards pulling the Russian DIC out of shadow and practical meeting the President's requirements to create a transparent defense economy. To be able to take this step, all the

responsible ministries and agencies should combine their efforts in compiling and publishing official statistics on orders and prices of defense products, making available the data on budget allocations and actual federal budget expenditures concerning the state defense order and the results of audits conducted by the DIC by the Federal Service for Defense Contracts (Rosoboronzakaz) and the Accounts Chamber of the Russian Federation.

If we fail to accomplish the foregoing, we will keep facing inefficient military spending and systemic corruption. However, the entrance of an enterprise into the Consolidated Register by no means can guarantee its adherence to good practice. For example, inefficient spending of budget resources reached Rb 1,23bn in 2012 during the purchase of 712,000 tons of oil products of Rb 23bn at mandatory sale quotas from Rosneft, one of the oil companies listed the Consolidated Register, due to the fact that the purchase price was higher than the average market price¹.

Regretfully, in the current circumstances, despite the establishment of joint supervisory commissions, with the prosecutor's office and investigation being involved, a special emphasis on the side of the Russian

President's Executive Office, not to mention the efforts of the Military Industrial Committee under the Government of the Russian Federation, the entrance of enterprises into the Consolidated Register is regarded by some of the managers of such enterprises as a kind of indulgence entitling them to violate the state discipline. The following violations have become systemic in the Russian DIC²:

- breaching the rules of initial contract pricing (fraudulent pricing);
- improper receipt and use of advance, when the money received from the state is failed to be transferred to subcontractors and paid for internal works;
- failure to meet the product quality requirements;
- breaching the rules of keeping a separate accounting of expenses, and complete inobservance of the rules by every tenth enterprise;
- CEO's default in providing the required documents.

It is therefore not surprising that the Armed Forces fall short of "every fifth unit of the contracted products"³ year by year, i.e., 20% of the federal budget expenditures on the state defense order are wasted.

1 Потапов А.В. Об итогах деятельности Федеральной службы по оборонному заказу в 2013 году и задачах на 2014 год // Федеральный справочник. Оборонно-промышленный комплекс России. 2014. Т. 10. С. 148. [Potapov A. V. The performance results of the Federal Service for the Defense Order in 2013 and the tasks to be accomplished in 2014 // Federal Reference Book. Defense Industry Complex of Russia. 2014. Vol. 10, p. 148] <http://federalbook.ru/files/OPK/Soderjanie/OPK-10/III/Potapov.pdf> (date of access: 18.07.2014).

2 Ibid.

3 Yu. Gavrilov. SP guns with pirated goods // Rossiiskaya Gazeta. 2014, 19 June (No 136).