

## Prospects for military spending in Russia in 2017 and beyond

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At the time of writing the Russian economy is showing some signs of revival after a difficult three years. This is partly because the price of oil has risen to over \$50 per barrel following the agreement of OPEC member countries and Russia to limit the volume of production. The federal budget for the three years 2017 to 2019, based on an oil price of \$40 per barrel throughout the period, was adopted in December. Efforts are underway to resolve the contentious issue of the scale of funding of the new state armament programme for the eight years 2018 to 2025, in short, GPV-2025.<sup>1</sup> Meanwhile, Russia's active military involvement in Syria has been scaled back and is probably making more modest demands on the federal budget than during 2016. There are many uncertainties but study of the budgetary process, the budget for 2017 to 2019, and the debate on GPV-2025, provides a good indication of the likely trend of future military spending. For a number of years the defence budget of Russia increased at a quite rapid pace and there was little evidence that this trend would change, but now it is apparent that spending growth is set to moderate, with a declining share of GDP devoted to the military.<sup>2</sup> This paper investigates the background to this development and seeks to establish the likely future trajectory of military expenditure.

### *The years of rapid defence modernisation*

The principal driver of Russian defence spending since 2010 has been the implementation of the state armament programme, GPV-2020. Funding of the annual state defence order (*gosudarstvennyi oboronnyi zakaz*, GOZ) accounted for an increasingly large share of total spending under the budget chapter 'national defence', reaching almost 60 per cent by 2015. Within the GOZ, the procurement of new armaments and other military hardware was by far the dominant item of spending, with more modest shares for the repair and modernisation of hardware and military research and development (R&D). The 'national defence' chapter of the federal budget covers the military activities of the Ministry of Defence (MOD), the development and production of nuclear munitions, some military-technical cooperation under inter-governmental agreements, and mobilisation preparation of the economy. But there is additional military spending according to the standard definition employed by NATO and the Stockholm International Peace Research Institute (SIPRI) in other chapters, in particular pensions of servicemen under the 'social policy' chapter, spending on the MOD's educational, health, cultural and media activities under those relevant chapters, and also the funding of other armed forces, namely the former interior troops of the interior ministry, now the Russian National Guard, and the Border Service of the Federal Security Bureau. This

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<sup>1</sup> GPV - *gosudarstvennaya programma vooruzheniya* (state armament programme).

<sup>2</sup> For the years of rapid growth of defence spending, see Julian Cooper, 'The military dimension of a more Militant Russia', *Russian Journal of Economics*, 2016, no.2, pp.129-145.

defence-related spending outside the 'national defence' chapter usually accounts for an additional 0.8 - 1.0 per cent of GDP.<sup>3</sup> Spending trends since 2010 are shown in Table 1.

Table 1

Military expenditure in Russia, 2011-15, actual spending, current prices

	2011	2012	2013	2014	2015
<i>'National defence'</i>					
Billion roubles	1 516	1812	2 104	2479	3 181
Per cent GDP	2.54	2.71	2.96	2.98	3.70
<i>State defence order</i>					
Billion roubles	554	644	930	1 190	1 882
Per cent 'ND'	36.5	35.5	44.2	49.0	59.1
Per cent GDP	0.93	0.96	1.31	1.43	2.19
<i>Total military expenditure</i>					
Billion roubles	2 029	2 505	2 787	3 222	4 026
Per cent GDP	3.40	3.71	3.92	4.07	4.84

*Source*

'National defence' and total military expenditure: author's analyses for SIPRI.

State defence order: Cooper (2016, March), p.21

GDP: Russian Federal Service of State Statistics (Rosstat), [http://www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/accounts/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/accounts/#), accessed 17 February 2017. Note, this series is the latest revision according to a new definition adopted from 2014. Rosstat is in the process of making a phased transition from System of National Accounts (SNA) -1993 to SNA-2008. So far GDP data for years prior to 2011 have not been recalculated, resulting in a discontinuity in the share of GDP series: for this reason 2010 not shown. GDP data for 2011 to 2015 are likely to undergo further revision.

It can be seen that the rate of growth of defence spending was rapid, giving a significant increase in the GDP share of total expenditure, from 3.4 per cent in 2011 to almost 5 per cent in 2015.

*The economy and the 2016 federal budget*

The 2016 federal budget was signed into law by President Putin on 14 December 2015. In view of the troubled state of the economy it was for one year only, not the normal three years. It was based on an economic forecast prepared by the Ministry of Economic Development (MED) issued in late October. With an average oil price (Urals) of \$50 per barrel, GDP was forecast to decline by 0.7 per cent, giving a total of 78,673 billion roubles, and an annual rate

<sup>3</sup> On Russian military spending and its definition, see Julian Cooper, *Russian Military Expenditure: Data, Analysis and Issues*, FOI Report on Russia, FOI-R-3688-SE, September 2013 (Swedish Defence Research Agency -FOI), hereafter Cooper, FOI (2013).

of inflation of 6.4 per cent (Dec-Dec).<sup>4</sup> For 2017, GDP growth of 1.9 per cent was foreseen, rising to 2.4 per cent in 2018. While not very optimistic, the forecast was more favourable than the results for 2015: GDP fell by 3.7 per cent (later revised to 2.8 per cent), with inflation at 12.9 per cent (Dec-Dec). The 2016 budget provided for total revenues of 13,739 bn.r. and expenditure of 16,099 bn.r. , giving a deficit of 2,360 bn.r. or 3.0 percent of forecast GDP.

Spending under the budget chapter 'national defence' was to be 3,149 bn.r, 19.6 per cent of total sending and 4.0 per cent of GDP. With account of spending in other budget chapters, total military expenditure according to the NATO and SIPRI definition was to be 5.0 percent of GDP, putting Russia into a small group of countries of the world with military spending in excess of 5 per cent of GDP. In relation to actual spending in 2015 this was a slight decline in the nominal value and as a share of GDP. However, the allocation under 'national defence' was inflated by the provision of a quite substantial reserve fund, purpose not specified, in the sub-chapter 'other questions of national defence'. More details of the 2016 budget are provided below.

Economic performance in 2016 was not very impressive though towards the end of the year times there were some signs of recovery. In the first nine months of the year GDP declined by 0.7 per cent compared with the same period in 2015, with a better outcome in the second quarter than in the first.<sup>5</sup> This led MEP to amend its forecast, now extended to 2019. GDP was now expected to fall by only 0.2 per cent in 2016, not the previous 0.7 per cent, but looking forward the view was now more pessimistic: in 2017 growth of only 0.8 per cent, in 2018 1.8 per cent and in 2019 2.2 per cent.<sup>6</sup>

On Monday 3rd October the Russian Ministry of Finance (MOF) posted a draft law on changes to the 2016 federal budget on the official website for draft legislation, [regulation.gov.ru](http://regulation.gov.ru).<sup>7</sup> This is a standard procedure allowing a period of time during which draft laws, decrees and other measures can be subject to inspection and anti-corruption expertise. Drafts are often accompanied by an explanatory note (*poynasnitel'naya zapsika*) setting out the purpose of the new measure and providing an explanation of its rationale but in this case no such note was provided. It appeared only when the draft law was transmitted to the State Duma on 8th October. The draft was quickly noted by the press and a number of stories appeared, some with rather misleading titles, in particular that carried by *The Moscow Times*,

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<sup>4</sup> Ministry of Economic Development, 'Prognoz sots'ial'no-ekonomicheskogo razvitiya Rossiiskoi Federatsii na 2016-2018 gody', <http://economy.gov.ru/minec/about/structure/depmacro/20151026>, 26 October 2015.

<sup>5</sup> Ministry of Economic Development, 'O tekushchei situatsii v ekonomike Rossiiskoi Federatsii v yanvare-sentyabre 2016 goda', p.3 (<http://economy.gov.ru/minec/activity/sections/macro/2016311003>, 31 October 2016).

<sup>6</sup> Ministry of Economic Development, 'Stsenarnye usloviya, osnovnye parametry prognoza sotsial'no-ekonomicheskogo razvitiya Rossiiskoi Federatsii i predle'nye urovni tsen (tarifov) na uslugi kompanii infrastruktornogo sektora na 2017 god i na planovyi period 2018 i 2019 godov' (<http://economy.gov.ru/minec/about/structure/depmacro/20160506>, 6 May 2016).

<sup>7</sup> Federal portal of draft normative legal acts, <http://regulation.gov.ru/projects#npa=5504>, 'O vnesenii izmenenii v Federal'nogo zakon "O federal'nomu byudzhete na 2016 god"', 3 October 2016. The specified period for anti-corruption expertise was given as 3rd to 9th October.

'Russia to Increase Military Spending While Slashing Welfare Budget'.<sup>8</sup> This was misleading because it suggested that a decision had been taken to increase the country's current military expenditure in 2016 over and above the level originally planned. But closer examination indicated that the apparent increase in military spending was of a different nature: the extra spending was not to increase current activity but to pay off past debts. However, in discussing the amended budget observers were faced with a difficult challenge as the figures provided referred in the main to open spending only, not to classified spending, which represents a sizeable share of the total allocation to the budget chapter 'national defence'.

As noted above, the 2016 federal budget was based on an oil price (Urals) of \$50 per barrel and a forecast 0.7 per cent decline in GDP. It envisaged a deficit of 3.0 per cent of GDP. In the event, the average oil price, January-October, was \$40.72.<sup>9</sup> With less than planned revenues from hydrocarbon exports, by July finance minister, Anton Siluanov, was forecasting a budget deficit in 2016 of 3.3 per cent, not the 3 per cent specified in the budget law.<sup>10</sup> In April it was decided that any amendment of the 2016 would be delayed until after the Duma elections scheduled to September. The newly elected Duma would consider the draft budget for 2017-2019 and an amended 2016 budget, both based on a common economic forecast submitted by MED.<sup>11</sup> The Ministry of Finance (MOF) took advantage of a greater degree of freedom it had been granted to make adjustments to spending without submitting the budget for amendment by the Duma. This was made possible by a law amending some provisions of the budget code adopted by the Duma in late May.<sup>12</sup> By October total spending had been increased to 16,331 bn.r., i.e. by 232 bn.r. but on 'national defence' had been reduced to 3,080 bn.r., 79 bn.r. less than specified in the law on the budget. In the first ten months of the year defence spending was only 3.2 per cent of GDP, well below the forecast 4 per cent for the year.<sup>13</sup>

The draft law on changes to the 2016 federal budget increased total budget spending by over 300 bn.r. compared to the original budget law, to 16,403 bn.r., notwithstanding a 370 bn. r. reduction in budget revenues. At the same time, forecast GDP was amended from the 78,673 bn. r. in the original law to 82,815 bn.r., this change reflecting Rosstat's latest GDP revision. MED revised its forecast once again to a decline of GDP of -0.6 per cent, with an oil price for 2016 of \$41 per barrel.<sup>14</sup> As a result, contrary to expectations, the budget deficit increased to

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<sup>8</sup> <http://themoscowtimes.com/news/russia-to-increase-military-spending-while-slashing-budget-55583>, 4 October 2016. It could be added that the amended budget also does not involve a 'slashing' of welfare spending.

<sup>9</sup> <http://minfin.ru/ru/press-center/?#>, 1 November 2016.

<sup>10</sup> <http://minfin.ru/ru>, 8 July 2016.

<sup>11</sup> Dmitrii Butrin, 'Net deneg - nechegoi schitati', *Kommersant Daily*, 12 April 2016 and Dmitrii Butrin, 'Byudzhet uvodyat v letnii otpusk', *Kommersant Daily*, 20 April 2016.

<sup>12</sup> <http://www.interfax.ru/business/509325>, 20 May 2016, 'Gosduma rasshirila polnomochiya pravitel'stva RF v byudzhetnom protsesse.'

<sup>13</sup> From preliminary MOF report on budget implementation, January-October, <http://minfin.ru/ru/press-center/?>, 15 November 2016, 'Predvaritel'naya otsenka ispolneniya federal'nogo byudzheta za yanvar' - oktyabr' 2016 goda.'

<sup>14</sup> *Poyasnitel'naya zapiska ob osnovnykh parametrakh prognoza sotsial'no-ekonomicheskogo razvitiya Rossiiskoi Federatsii na 2017-2018 gody* (available, [http://asozd2.duma.gov.ru/main.nsf/\(Spravka\)?OpenAgent&RN=](http://asozd2.duma.gov.ru/main.nsf/(Spravka)?OpenAgent&RN=)

3.7 per cent of GDP, compared with the 3 per cent specified in the law of December 2015.<sup>15</sup> Examination of the changes to spending by budget chapter provided no explanation as details were given of open spending only, not classified. It soon became apparent from media comment, informed by the earlier publication on regulation.gov.ru, that the additional spending was mainly under the budget chapter 'national defence'. In the words of the title of one of the first articles on the draft, 'The budget prepares for war'.<sup>16</sup> But the increased defence spending was not related to the current activities of the MOD or the acquisition of new weapons in 2016. As soon emerged, it was debt settlement associated with the state defence order for military R&D and procurement of earlier years.<sup>17</sup> However, media reports lacked clarity on the issue leading to a general sentiment that the needs of the military were taking precedence over welfare, as exemplified by the above-mentioned *The Moscow Times* article. Even former finance minister, Aleksei Kudrin, expressed his 'astonishment' that more spending in the budget had been classified.<sup>18</sup>

A detailed explanation of the issue had in fact been presented earlier by *Vedomosti* under the title, 'The government must pay state banks almost 800 billion roubles in 2017-2018'.<sup>19</sup> From information supplied by unnamed officials, it emerged that the government was faced with a dilemma, how to settle a very large debt that had arisen in the early years of the implementation of the state armament programme to 2020 (GPV-2020). To speed up work on major new development programmes without imposing an additional burden on the budget in the short run, in 2011-2012 a scheme was devised according to which four of the largest state banks (Sberbank, VTB, Gazprombank and Vneshekonombank) would credit enterprises at an interest rate of not more than 10 per cent under budget guarantee. The scheme was modified in 2015 when a system of advance payment was introduced. As might have been expected, interest rates faced by enterprises were often much higher than 10 per cent, programmes overran, the performance of the economy deteriorated and banks were not refunded as envisaged. To make matters worse, under the terms according to which the credits were granted there was no necessity to undertake prior checks on the financial viability of the defence industry enterprises concerned. At the time of the *Vedomosti* article, repayment of the accumulated debts was scheduled to begin in 2017, with 319 bn.r. in that year and approximately 470 bn.r. in 2018, giving a total of almost 790 bn.r. .

With severe pressure on the budget and the MOF determined to limit spending in the three-year budget for 2017-2019, the debt repayment presented a very difficult challenge. In July

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2428-7, 10 October 2016). Note, the new GPD forecast clearly reflects the latest Rosstat revision of the series, replacing the earlier version in the law on the budget of December 2015.

<sup>15</sup> <http://regulation.gov.ru/projects#npa=5504>, 'O vnesenii izmeneneni v Federal'nogo zakon "O federal'nomu byudzhete na 2016 god"', 3 October 2016.

<sup>16</sup> Petr Ntrelba, Elena Malysheva, 'Byudzhet gotovyat k voine', [http://www.gazeta.ru/business/news/2016/10/04/n\\_91800717.shtml](http://www.gazeta.ru/business/news/2016/10/04/n_91800717.shtml), 4 October 2016.

<sup>17</sup> Dmitrii Butrin, Yulia Rotenberger, 'Byudzhet voennykh garantii', *Kommersant Daily*, 4 October 2016.

<sup>18</sup> <http://www.rbc.ru/economics/04/10/2016/57f370989a794767955dfd2e>, 4 October 2016, 'Kudrin vystupil protiv zasekrechivaniya byudzhetsykh raskhodov'.

<sup>19</sup> Aleksandr Prokopenko, Aleksei Nikol'skii, Margarita Panchenkova, 'Pravitel'stvo dolzhno zaplatit' gosbankam pochti 800 mlrd rublei v 2017-2018 godakh', *Vedomosti*, 21 September 2016.

the MOF decided that the MOD would have to find savings of 6 per cent a year in each of the three years but this would clearly be difficult if the debt issue remained unresolved. It appears that at the time of the *Vedomosti* article the MOF was considering debt restructuring or prolongation in order to ease the problem and the issue had been discussed at a meeting with deputy prime minister Dmitrii Rogozin, responsible for defence industry oversight, at the beginning of September but the outcome was not known. It is worth noting that as early as August 2011 the MOF, then under minister Aleksei Kudrin, had been aware of the potential dangers of resort to state guaranteed credits. Concern was expressed that they introduced additional uncertainty and complicated significantly budget planning.<sup>20</sup>

At the time the *Vedomosti* article appeared, the debt issue had not been resolved. It must have been decided soon after that in order to facilitate agreement on the terms of the 2017-2019 budget it would be expedient to clear the debt, or most of it, in advance, even at the price of an increased budget deficit in 2016. The MOF may not have been happy with this solution but by agreeing it may have enhanced its bargaining power in negotiating a tough spending regime for the MOD in 2017 and beyond. Perhaps because for the MOF the solution adopted was a pragmatic, technical, matter, consideration may not have been given to how it would be perceived both within and beyond Russia. At a time of Russian military action in Syria, an unresolved conflict in Ukraine, and a heightened level of tension in Russian-Western relations, it may not have been in Russia's interests to give the impression that defence spending was being increased suddenly by almost twenty-five per cent.

The draft law on the amended 2016 budget was approved by the State Duma on the 9th of November 2016 and by the Soviet of the Federation on the 16th, and was signed into law by President Putin on the 22nd. Provision for military spending was amended in the course of its passage through parliament but not to a significant degree. During the first reading, finance minister Anton Siluanov revealed that the total debt of enterprises to commercial banks associated with credits for the GOZ was more than 1,000 bn.r. of which approximately 800 bn.r. would be repaid under the amended 2016 budget and the remaining 200 bn.r. would have to be settled by 2020. He said that the action had been taken to make it possible for enterprises to engage credits again and also to develop not only their defence work, but also civilian activities.<sup>21</sup> Details of the amended budget are shown in Table 2.

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<sup>20</sup> Ministry of Finance of Russian Federation, *Osnovnye napravleniya gosudarstvennoi dolgovi politiki Rossiiskoi Federatsii na 2012-2014 gg.*, Moscow, August 2011, pp.22-3.

<sup>21</sup> Gosudarstvennaya Duma, 'Stenogram zasedanii 21 Oktyabrya 2016 g.', <http://transcript.duma.gov.ru/node/4530/>

Table 2

Military expenditure in the original and amended 2016 federal budgets (million roubles)

	2016 federal budget law	2016 amended budget, law	Change +/-
<i>'National defence'</i>			
Armed forces of the Russian Federation	2 233 630	2 885 644	+652 014
Ministry of Defence	828 874	899 580	+70 706
Classified residual	1 404 756	1 986 064	+581 308
Mobilisation and ex-forces training	5 428	6 905	+1 477
Mobilisation preparation of economy	3 835	3 589	-246
Nuclear weapons complex	46 014	45 635	-379
International obligations in mil-tech coopn.	9 493	9 408	-85
Applied R&D in field of national defence	314 971	405 505	+90 534
Open spending	18 407	17 676	-732
Classified residual	296 564	387 829	+91 265
Other questions in field of national defence	535 920	538 732	+2 812
Open spending	149 701	166 102	+16 401
Classified residual	386 219	372 630	-13 589
Total 'national defence'	3 149 291	3 895 418	+746 127
Open spending	1 003 983	1 091 697	+87 714
Classified	2 145 308	2 803 721	+658 413
Less payment of debt on past GOZ <sup>1</sup>		3 102 205	-47 086
Arms recycling	14 829	13,174	-1 655
Total 'national defence' less arms recycling & mobilisation preparation of the economy	3 130 627	3 878 655	+748 029
Less payment of debt on past GOZ <sup>1</sup>		3 085 442	-45 185
<i>Other military expenditure</i>			
Other Ministry of Defence expenditure:			
Housing	139	1 139	+1 000
Environment	785	573	-212
Education	77 473	72 254	-5 219
Health	54 377	54 709	+332
Culture and cinematography	2 574	2 360	-214
Physical culture and sport	3 856	4 331	+475
Mass media	1 283	2 318	+1 035
Pensions	330 152	329 433	-719
Social support	138 496	138 027	-469
Fees to international agencies	9	9	-
<i>Paramilitary forces</i>			
Troops of National Guard	115 444	114 668	-776

Open spending	106 375	105 621	-754
Including GOZ	(9 069)	(9 047)	(-22)
Border service of Federal Security Service	123 870	124 255	+385
Support for closed towns of MOD, Rosatom	10 047	10 047	-
Support for Baikonur space centre	1 024	1 004	-20
Total other military expenditure	859 529	855 127	-4 402
Total military expenditure	3 990 156	4 733 782	743 626
Less debt payment for GOZ <sup>1</sup>		3 940 569	-49 587
Total federal budget expenditure	16 098 659	16 402 973	+304 314
Including open spending	13 116 717	12 742 202	-374 515
Classified spending	2 981 942	3 660 771	+678 829
% total spending	18.52	22.32	
'National defence' as % total expenditure	19.56	23.75/18.91	
Total military expenditure as % total exp.	24.79	28.86/24.02	
Gross domestic product (GDP)	78 673 000	82 815 000	
'National defence' as % GDP	4.00	4.70/3.75	
Total military expenditure as % GDP	5.07	5.72/4.76	
Total budget-funded GOZ (approximate)	1 701 320	1 580 680	-120 640
GOZ financed by state guaranteed credits	209 000	209 000	
Total GOZ (budget plus SGCs)	1 910 320	1 789 680	-120 640

1. Dept repayment on past GOZ: 793,213 m.r.(as below).

*Source*

2016 federal budget: [http://www.minfin.ru/common/upload/library/2015/12/main/FZ359-FZ\\_ot\\_141215.pdf](http://www.minfin.ru/common/upload/library/2015/12/main/FZ359-FZ_ot_141215.pdf), federal law No.359-FZ, 14 December 2015.

Amended budget: Federal'nyi zakon ot 22.11.2016 No.397-FZ "O vnesenii izmenenii v Federal'nyi zakon "O federal'nom byudzhete na 2016 god", <http://publication.pravo.gov.ru/Document/View/0001201611240001>, 24 November 2016 and Schetnaya palata Rossiiskoi Federatsii, Operativnye doklad o khode ispolneniya federal'nogo byudzheta za yanvar'-dekabr' 2016 goda, <http://www.ach.gov.ru/activities/audit-of-the-federal-budget/29425/>, 9 February 2017.

It can be seen that under 'national defence' almost all the increased spending is in the two sub-chapters with allocations to fund the state defence order, with an overall increase of more than 746 bn.r.. As revealed by Andrei Makarov, chair of the Duma's budget committee, during the second reading in the State Duma, the total planned debt resettlement amounted to 793,213 million roubles.<sup>22</sup> Allocations to most other sub-chapters were reduced as were most lines of military spending in other chapters of the budget. This means that total military spending in the amended budget, without the debt repayment, was reduced by approximately 50 bn.r., giving a GDP share, using the new revised figure, of 4.8 per cent compared with the 5.1 per cent in the original budget.

<sup>22</sup> Gosudarstvennyi Duma, 'Stennograma zasedanii, 2 Noyabrya 2016 g.', <http://transcript.duma.ru/node/4534>, accessed 21 November 2016.



## The implementation of the 2016 amended federal budget

At the time of writing full details of the implementation of the 2016 federal budget are not yet available but there is sufficient information to analyse military spending. Table 3 shows actual spending in 2015, the amended budget for 2016, and actual spending in 2016.

Table 3

Russian military expenditure in 2015, 2016 and the 2017 federal budget (million current roubles)

	2015 implementation	2016 amended federal budget	2016 provisional implementation
<i>'National defence'</i>			
Armed forces of the Russian Federation	2 432 905	2 885 644	2 936 475
Ministry of Defence	843 355	899 580	911 132
Classified residual <sup>1</sup>	1 589 550	1 986 064	2 025 343
Mobilisation and ex-forces training	6 296	6 905	6 867
Mobilisation preparation of economy	4 020	3 589	3 586
Nuclear weapons complex	44 385	45 635	45 623
International obligations in mil-tech coopn.	10 325	9 408	9 890
Applied R&D in field of national defence	318 521	405 505	471 276
Open spending	26 296	17 676	17 565
Classified residual <sup>1</sup>	292 225	387 829	453 711
Other questions in field of national defence	364 914	538 732	302 499
Open spending	223 456	166 102	154 931
Classified residual	141 458	372 630	147 568
Total 'national defence'	3 181 366	3 895 418	3 776 216
Less payment of debt on past GOZ <sup>2</sup>	-	3 102 205	2 983 003
Arms recycling	17 317	14,810	15 796
Total 'national defence' less arms recycling & mobilisation preparation of the economy	3 160 029	3 877 019	3 756 834
Less payment of debt on past GOZ <sup>2</sup>	-	3 083 806	2 963 621
<i>Other military expenditure</i>			
Other Ministry of Defence expenditure:			
Housing	22 479	1 139	1 338
Environment	211	573	573
Education	66 704	72 254	75 692
Health	56 409	54 709	56 310
Culture and cinematography	3 009	2 360	3 059
Physical culture and sport	4 202	4 331	5 351
Mass media	2 280	2 318	2 318

Pensions	306 311	329 433	328 183
Social support	136 520	138 027	138 238
Fees to international agencies	8	9	22
<i>Paramilitary forces</i>			
Ministry of Interior internal troops	120 525	114 668	116 420
Open spending	112 666	105 621	107 419
Including GOZ	(7,859)	(9 047)	(9 001)
Border service of Federal Security Service	136 709	124 255	130 050
Support for closed towns of MOD, Rosatom	9 987	10 047	10 047
Support for Baikonur space centre	901	1 004	1 004
Total other military expenditure	866 255	855 127	868 605
Total military expenditure	4 026 284	4 732 146	4 625 439
Less debt payment for GOZ <sup>2</sup>	-	3 938 933	3 832 226
Total federal budget expenditure	15 610 901	16 402 973	16 426 799
'National defence' as % total expenditure	20.38	23.75/18.91	23.00/18.16 <sup>3</sup>
Total military expenditure as % total exp.	25.79	28.86/24.02	28.16/23.33 <sup>3</sup>
Gross domestic product (GDP)	83 232 600	82 815 000	85 880 600
'National defence' as % GDP	3.82	4.70/3.75	4.40/3.47 <sup>3</sup>
Total military expenditure as % GDP	4.84	5.72/4.76	5.39/4.46 <sup>3</sup>
Total budget-funded GOZ (approximate)	1 881 775	1 580 680	1 685 841
GOZ financed by state guaranteed credits	8 500	209 000	200 823 <sup>4</sup>
Total GOZ (budget plus SGCs)	1 890 275	1 789 680	1 886 664

1. Residual is almost entirely, or fully, the value of the state defence order.

2. Debt repayment on past GOZ in amended 2016 federal budget: 793,213 m.r. (Source, Gosudarstvennyi Duma, 'Stenogramma zasedanii, 2 Noyabrya 2016 g.', <http://transcript.duma.ru/node/4534>, accessed 21 November 2016. Here it is assumed that the full amount was in fact repaid. Given that this is a classified line of spending it is possible that that actual amount may not be revealed.

3. First figure is the share of defence spending including debt repayment, second excluding, for comparability with earlier years.

4. As law on budget, 19 December 2016, but this forecast of the Ministry of Economic Development used a methodology for estimating GDP since updated by Rosstat so an upward revision likely soon, which is likely to give a GDP share of total military spending of c.3.2 per cent.

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2015 implementation: Law on implementation of 2015 federal budget, 'Federal'nyi zakon ot 31.10.2016 g. No. 377-FZ, 'Ob ispolnenii federal'nogo byudzheta za 2015 god', <http://www.kremlin.ru/acts/bank/41361>, 31 December 2016.

2016 amended budget, as Table 1.

2016 provisional implementation: Ministerstvo finansov Rossiiskoi Federatsii, Predvaritel'naya otsenka ispolneniya federal'nogo byudzheta za yanvar'-dekabr' 2016 goda, 20 January 2017; Federal'noi kaznacheistvo, Otchet ob ispolnenii federal'nogo byudzheta na 01.01.2017, 6 February 2017.

State guaranteed credits, actual: Schetnaya palata Rossiiskoi Federatsii, Analiticheskaya zapiska o khode ispolneniya federal'nogo byudzheta za yanvar' - dekabr' 2016 goda, 9 February 2017, p.239.

2017 budget: Rossiiskaya federatsiya. Federal'nyi zakon ot 19.12.16 No.415-FZ, 'O federa'nom byudzhete na 2017 god i planovyi period 2018 i 2019 godov', [http://minfin.ru/common/upload/library/2016/12/main/FZ415-FZ\\_ot\\_191216.pdf](http://minfin.ru/common/upload/library/2016/12/main/FZ415-FZ_ot_191216.pdf) and Ministerstvo finansov Rossiiskoi Federatsii, Ministerstvo finansov Rossiiskoi Federatsii, Predvaritel'naya otsenka ispolneniya federal'nogo byudzheta za yanvar' 2017 goda, 14 February 2017.

As noted in footnote 2 of the Table, in the absence of official information it can only be assumed that the 793 billion debt repayment was fully disbursed. On this assumption, the amended budget was broadly fulfilled. While total military spending was less than budgeted this was mainly because of the quite large under-spend on the sub-chapter 'other questions in the field of national defence. In the author's view the explanation for this may be that a classified reserve fund, perhaps a contingency fund created to cover spending on the Syria conflict, was not drawn down as fully as initially expected. By the time provisional implementation was revealed, Rosstat had completed yet another revision of the GDP series. As a result, military expenditure as a percentage of GDP fell well below the original level indicated in the budget law and the level of 2015. Thus, excluding debt repayment the share turned out to be 4.46 per cent, compared with 4.76 in the budget law and 4.84 in 2015. Finally, boosted by over 200 billion roubles of state guaranteed credits, the total GOZ was funded to almost the same level as in 2015, i.e. almost 1,900 billion roubles. But this was a fall in the GDP share of the state defence order, from 2.3 per cent in 2015 to 2.2 per cent in 2016.

#### *A new state programme*

In examining future prospects for defence spending it is necessary to consider a new dimension that appeared in 2016, namely the approval by the government of a new state programme for the development of the defence-industrial complex (*oboronno-promyshlennyi kompleks*, OPK). This programme, approved by a government decree of 16 May 2016, incorporates earlier federal targeted programmes plus some new ones, and most of its funding is classified, only one of its sub-programmes being open, a fact that some journalists did not at first appreciate.<sup>23</sup> Only its first sub-programme, 'Stimulating the development of the defence-industrial complex' had open funding to a total of 35 bn. r. for the five years 2016-20. It had ambitious targets. Industrial output of the defence industry was to increase by 75 per cent, 2020 compared with 2014, labour productivity by 137.5 per cent, and the average monthly wage by 77 per cent. Civilian output of the defence industry was forecast to increase by 28 per cent, 2020 compared with 2015. Overall responsibility for its implementation was vested in the Ministry of Industry and Trade. A number of measures were outlined: stimulation by subsidised interest payments, state support to improve the financial stability of enterprises, supplements to pay for personnel contributing exceptionally to the implementation of the GOZ.<sup>24</sup> Deputy prime minister, Dmitrii Rogozin, soon revealed that

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<sup>23</sup> Pravitel'stvo Rossiiskoi Federatsii, Postanovlenie ot 19 Maya 2016 g., No.425-8, 'Ob utverzhdeniya gosudarstvennoi programmy Rossiiskoi Federatsii "Razvitiya oboronno-promyshlennogo kompleksa"', <http://government.ru/docs/23173/>, 25 May 2016.

<sup>24</sup> Ibid.

total budget funding of the programme would be 1,067 bn. r., meaning that the open part is a mere 3 per cent. Given that the programme is scheduled for only five years, this amounts to over 200 bn.r. a year, though probably much less in the first year given the fact of its late approval.<sup>25</sup>

Since the programme was adopted, further details have emerged. It is state programme no.44, with five sub-programmes. The first, is the open one discussed above. The second is the federal targeted programme, 'development of the OPK', which was originally intended to run from 2011 to 2020. The third is devoted to import substitution of technological equipment and components, and presumably incorporates the two programmes adopted in response to the Ukraine crisis, one replacing deliveries of systems and components hitherto obtained from Ukrainian suppliers, the other substitution activities to counter the sanctions on dual use technologies imposed on Russia by NATO and EU member countries.<sup>26</sup> The fourth is another former federal targeted programme, that for the 'development and organisation of production of strategic materials and their semi-fabricates needed for the production of priority types of armaments, military and special equipment'. The fifth is, 'Investigatory (*poiskovye*) scientific research in the interests of the development of industrial technologies for the production of armaments, military and special equipment'. The measures under this sub-programme include a very wide range of research into diverse fields relevant to the creation of weapons, including electronics, lasers, navigation and control systems, nuclear munitions, and materials.<sup>27</sup>

What is not clear from the guidance provided by MOF is which budget chapters the sub-programmes are funded under. By its content, the final programme could well be funded under chapter 1, sub-chapter 10, 'fundamental research', which does indeed have a classified component but this is very modest in scale, only one billion roubles in the 2017 budget, the same amount as in 2015, which suggests that none of the new state programme is being funded from this source. From the 2017-19 budget, discussed below, it is known that the first, open, or perhaps only partly open, sub-programme is funded under 'national defence' and this may probably also applies to the second sub-programme, as the federal targeted programme it replaces used was previously funded under 'other questions of national defence'. However, the sub-programmes concerned with import substitution and strategic materials are probably being funded under chapter 4, 'national economy'. In the 2017 budget there is unusually large classified spending under the sub-chapter 12, 'other questions in the

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<sup>25</sup> 'Rogozin:naprogrammu razvitiya OPK v 2016-2020 godakhbudet napravleno 1,67 trln rublei', <http://tass.ru/armiya+opk/3324256>, 30 May 2016.

<sup>26</sup> See Julian Cooper, *Russia's state armament programme to 2020: a quantitative assessment of implementation 2011-2015*, FOI Report on Russia, FOI-R-4239-SE, March 2016, pp. 35-42 (Swedish Defence Research Agency - FOI), hereafter Cooper, FOI, 2016.

<sup>27</sup> Ministerstvo finansov Rossiiskoi Federatsii, 'O vnesenii izmenenii v Ukazaniya o poryadke premeneniya byudzhenoj klassifikatsii Rossiiskoi Federatsii, utverzhdennye prikazom Ministerstva finansov Rossiiskoi Federatsii ot 1 iyuya 2013 g. No..65n', [http://minfin.ru/common/upload/library/2016/11/main/prikaz\\_minfina\\_Rossii\\_ot\\_12.10..2016\\_N\\_180n.pdf](http://minfin.ru/common/upload/library/2016/11/main/prikaz_minfina_Rossii_ot_12.10..2016_N_180n.pdf), 11 November 2016.

field of the national economy', namely 140.3 billion roubles.<sup>28</sup> At the time of writing the equivalent figure for 2016 is not available, but in 2015 it was much less, 55.1 billion roubles.<sup>29</sup> Thus the adoption of the new state programme could involve a further dispersion of defence-related funding to other chapters of the federal budget.

According to Medvedev, work is now started on a new programme of development of the defence-industrial complex to 2025, presumably an updated extension of the existing state programme to bring it into line with the future GPV-2025, or at least FTsP within it which is scheduled to end in 2020. The prime minister was speaking at a meeting on the development of production capacities of organisations of the defence industry for fulfilling the state programme of armament. This took place in Kirov at the end of January 2017, when he visited the 'Kirovskii mashinostroitel'noe predpriyatie', a completely new facility of the 'Almaz-Antei' concern for the manufacture of air defence systems. Participants in the meeting included Rogozin, Borisov, Siluanov, industry minister Manturov, and a number of leading defence company directors.<sup>30</sup>

On the topic of state programmes it should be noted that another major programme has still not been approved but is still being prepared. This is the planned programme, 'Ensuring the defence capability of the country' which featured in the original list of state programmes approved by the government in 2010 and has been under consideration for a number of years as programme number 31. The MOD is to be the responsible lead executor.<sup>31</sup> Work on the programme appears to have been halted for some time but the Accounts Chamber report on the implementation of the 2016 federal budget simply says that it has not yet been approved, which suggests that that preparation is still being made for its adoption.<sup>32</sup> Just as the state programme for the development of the OPK was introduced in an amendment to the 2016 budget, so the new defence programme may appear as an amendment to the 2017-2019 budget. Before turning attention to this budget it is necessary to consider the central issue determining the future trend of defence spending, namely the next state armament programme.

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<sup>28</sup> Calculated from 2017 budget: Rossiiskaya federatsiya. Federal'nyi zakon ot 19.12.16 No.415-FZ, 'O federa'nom byudzhete na 2017god i planovyi period 2018 i 2019 godov', [http://minfin.ru/common/upload/library/2016/12/main/FZ415-FZ\\_ot\\_191216.pdf](http://minfin.ru/common/upload/library/2016/12/main/FZ415-FZ_ot_191216.pdf) and Ministerstvo finansov Rossiiskoi Federatsii, Ministerstvo finansov Rossiiskoi Federatsii, Predvaritel'naya otsenka ispolneniya federal'nogo byudzheta za yanvar' 2017 goda, 14 February 2017.

<sup>29</sup> Calculated from budget implementation data, <http://www.roskazna.ru/ispolnenie-byudzhetov/federalnyj-byudzhet/>, 2015 god.

<sup>30</sup> 'Soveshchanie o razvitii proizvodstvennykh moshchnosti organizatsii oboronno-promyshlennogo kompleksa dlya vypolneniya gosudarstvennykh programm vvooruzheniya; <http://government.ru/news/26274/>, 31 January 2017.

<sup>31</sup> For the background to the programme see Cooper, FOI (2013), pp. 45-47.

<sup>32</sup> Sctnaya palata Rossiiskoi Federatsii, Analiticheskaya zapiska o khode ispolneniya federal'nogo byudzheta za yanvar' - dekabr' 2016 goda, <http://www.ach.gov.ru/activities/audit-of-the-federal-budget/29425/>, 9 February 2017, pp. 171-2.

## *The next state armaments programme to 2025*

The state armament programme, GPV, is a ten-year document, updated every five years. Thus GPV-2020, approved on the final day of 2010, was scheduled for renewal as GPV-2025 to start at the beginning of 2016. In September 2012 Dmitrii Rogozin noted that in the government work had started on the next programme, GPV-2025, and in January 2013 a timetable for its drafting was discussed by the VPK.<sup>33</sup> At this time Rogozin declared that the scale of funding of the new programme would be comparable with that of GPV-2020, i.e. approximately 20 trillion roubles.<sup>34</sup> The schedule was later approved, with an expectation that a draft would be presented to the President in July 2015 enabling approval by the end of the year.<sup>35</sup>

In September 2014 Putin convened a high-level meeting on the drafting of the new programme. It was here that he announced his decision to take over leadership of the Military-Industrial Commission (*Voенно-promyshlennaya kommissiya -VPK*), with Rogozin as deputy chair and Yurii Borisov, deputy defence minister for armaments, as secretary. He underlined that the new programme must be based on a clear analysis of the security threats facing the country and also on a realistic forecast of the development of the economy.<sup>36</sup>

The next issue to surface was the impact of sanctions and the end of supplies from Ukraine. After a meeting in October on import substitution in the defence industry, deputy chair of the VPK, Oleg Bochkarev, said that the new situation would be taken into account in drafting GPV-2025 and acknowledged that there could be delays in producing some complex new weapons systems in so far as it would take time to organise the domestic production of the required electronic components.<sup>37</sup> However, he did not think this would lead to any reductions in the defence budget and was confident that the new programme would be approved by Putin in December.<sup>38</sup> The MOF was less optimistic. Speaking in the Federation Council, finance minister Siluanov warned that the funding of the new GPV had to be realistic: the budget could not now afford a programme of the scale of the current one. GPV-2020 had been drawn up at a time when economic prospects appeared to be much more optimistic than in 2014. It would be necessary for the MOF and MOD to have discussions to establish a realistic level of funding.<sup>39</sup> This was followed by press speculation that economic

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<sup>33</sup> <http://www.rbc.ru/rbcfreenews/20120907145930.shtml>, 7 September 2012; Oleg Vladykin, 'Vooruzhenie po chetkim pravilam', *Nezavisimaya gazeta*, 31 January 2013.

<sup>34</sup> 'Novuyu Gosprogrammu vooruzhenii utverdyat v dekabre 2015 goda', <https://lenta.ru/news/2014/10/28/rearmament2025/>, 28 October 2014.

<sup>35</sup> <http://vpk-news.ru/articles/16594>, 3 July 2015.

<sup>36</sup> <http://www.kremlin.ru/events/president/news/46589>, 10 September 2014, 'Soveshchanie po voprosu razrabotki proekta gosprogrammy vooruzheniya na 2016-2025 gody.'

<sup>37</sup> Oleg Vladykin, 'Sokratit' voennyi byudzhет ne dadut', *Nezavisimaya gazeta*, 27 October 2014.

<sup>38</sup> 'Novuyu Gosprogrammu vooruzhenii utverdyat v dekabre 2015 goda', <https://lenta.ru/news/2014/10/28/rearmament2025/>, 28 October 2014.

<sup>39</sup> 'Siluanov priznal otsuststvie deneg na krupnye zakupki vooruzhenii', <https://lenta.ru/news/2014/10/07/siluanov>, 7 October 2014.

constraints were beginning to limit the implementation of GPV-2020 and that this could have implications for the new programme.<sup>40</sup>

Before the end of 2014 the expected volume of funding under the new programme began to be clarified. Sergei Shoigu revealed that a total of 55 trillion roubles had been considered but after completing work on rationalising the range of armaments and military hardware to be procured it had proved possible to reduce the sum to 30 trillion roubles.<sup>41</sup> According to Yurii Borisov, deputy minister for procurement, the '*tipazhnost*' (nomenclature of models) of armaments and military hardware has been reduced by 36 per cent.<sup>42</sup> He also revealed that the new GPV would include state capital investment related to preparing infrastructure for the deployment of new armaments and also some costs of developing the production base of enterprises previously covered by Minpromtorg. The latter claim may reflect thinking at a time when the new state programme for the development of the defence industry had not been conceived. He also hinted that cutting costs of servicing hardware was an important consideration in reducing the range of equipment and it can be speculated that this may be linked to the gradual transition to lifetime contracts for new armaments, i.e. contracts covering all stages from the development new systems to their repair and maintenance and eventual withdrawal from service.

The funding of GPV-2025 was discussed at a meeting of the VPK on the 20th January 2015 attended by the top military leadership plus the ministers of finance and the economy. Putin made it clear that, notwithstanding the difficult security situation, the development of the military had to be realistic, in accordance with the economic situation and financial possibilities of the country, and that no new arms race was envisaged.<sup>43</sup> After the meeting, according to *Kommersant*, sources in the government were speaking of 20 trillion roubles being allocated to the new programme, but Rogozin indicated that no final decision had been taken as the macroeconomic situation was so fluid.<sup>44</sup> Only later did it become known that it was at this meeting that a decision was taken to delay the start of the new programme until 2018. The first reference to this came in February, but without any official confirmation.<sup>45</sup> In May the postponement of the new programme's start was finally confirmed by Vasilii Burenok, director of the MOD's 46th TsNII, responsible for drafting the GPV: 'At the present time a new GPV is being elaborated. In connection with the moving of the time period of its action it will be called "GPV for the years 2018-2025"'.<sup>46</sup> It was not until September 2016

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<sup>40</sup> Editorial article, 'Oboronnye raskhody ne obremyat stranu', *Nezavisimaya gazeta*, October 9, 2014.

<sup>41</sup> [http://function.mil.ru/news\\_page/country/more.htm?id=12004148@egNews](http://function.mil.ru/news_page/country/more.htm?id=12004148@egNews), 19 December 2014, *Otchet na rasshirennom zasedanii kollegii Minoborony Rossii ob itogakh deyatelnosti za 2014 g.*, pp.3-4.

<sup>42</sup> 'Pri umen'shenii nomenklatury vooruzheniya na 36% sekonomim 30 trln rublei', *Izvestiya*, 12 January 2015.

<sup>43</sup> 'Zasedanie VoЕННО-promyshlennogo komissii', <http://www.kremlin.ru/events/president/news/47493>, 20 January 2015.

<sup>44</sup> Ivan Safronov, 'Gonki robotov svooruzheniyami', *Kommersant*, 21 January 2015.

<sup>45</sup> Ivan Safronov, Dmitrii Butrin, 'Vooruzheniya vstupil v boi vozrazheniyami', *Kommersant Daily*, 19 February 2015; Oleg Vladykin, 'Voennye soglasyatsya na minimal'nyi sekvestr', *Nezavisimaya gazeta*, 27 February 2015.

<sup>46</sup> Vasilii Burenok, 'Lovushka dlya supergeroya', *VoENNO-promyshlennykur'er*, 2015, no.19, 27 May 2015.

that Putin himself acknowledged that a decision to delay the start of GPV-2025 had been taken in January of the previous year.<sup>47</sup>

It is not difficult to understand why the decision was taken. It has been acknowledged that a major factor was the uncertain state of the economy, making it difficult to produce a dependable forecast to 2025, essential for elaborating a long-term budget strategy.<sup>48</sup> The Ministry of Economic Development (MED) eventually produced a long-term forecast, to 2035, in October 2016, making it possible for MOF to finalise its long-term budget strategy which, as noted below, appeared in November. Another factor was clearly the impact of the Ukraine crisis and the need to implement import substitution policies in relation to both inputs previously supplied by Ukrainian producers and by NATO and EU member countries, with electronic components occupying a significant place in the latter. In addition, as acknowledged by Borisov, the price parameters of the state defence order, 2015-2017 (and presumably the early drafts of GPV-2025) have been rendered inaccurate by the sharp depreciation of the rouble, which has made imported components more expensive.<sup>49</sup> But another factor may have been problems encountered in completing major new development programmes for new systems, including rising costs. The original targets of GPV-2020 have undergone revision, recognising that volume delivery of important new systems will not be possible until after 2020. Examples include the 'Armata' main battle tank, 'Kurganets' and 'Bumerang' armoured vehicles, T-50 fifth generation fighter and, probably, the 'Sarmat' liquid-fuelled heavy ICBM. In other cases priorities were changed, in particular the development of a new advanced strategic bomber took second place to restoration of the production of a modernised variant of the Tu-160 bomber originally built in the 1980s. With volume procurement of genuinely new systems delayed, the state programme was amended to put more emphasis on the delivery of cheaper but still effective 'gap fillers', notably the modernised T-72B3 main battle tank, Su-35S and MiG-35 4++ fighters, and the project 22800 small missile ship armed with the 'Kalibr' cruise missile. It is likely that GPV-2025 will be a continuation of GPV-2020, focused on the volume production of the new systems developed under the latter, but with particular emphasis on high-precision weaponry.<sup>50</sup>

That there could be a delay in the new programme had been recognised as a possibility much earlier. Putin himself, as prime minister, had raised the possibility in 2011 that GPV-2020 could be extended, delaying the adoption of its successor. Speaking in Ekaterinburg, he made it clear that 20 t.r. was to be spent on the GPV and added that the time period over which this fixed sum of money could be spent was flexible, 'to 2020, 2021, may be 2022'.<sup>51</sup>

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<sup>47</sup> Vladimir Putin at meeting of the VPK, September 2016: 'Soveshchanie po osnovnym parametram gosprogrammy vooruzheniya n 2018-2015 gody', <http://www.kremlin.ru/events/president/news/52866>, 9 September 2016.

<sup>48</sup> See, for example, 'Novuyu gosprogrammuy vooruzhenii zapustyat posle stabilizatsii situatsii v ekonomike', [https://lenta.ru/news/2015/08/31/new\\_gpv/](https://lenta.ru/news/2015/08/31/new_gpv/), 31 August 2016.

<sup>49</sup> As f.n. 60. XXXX check For the role of price increases as a factor, see also Sergei Sarkisyants, 'Voina budet ekonomnoi', *Ekspert*, 2015, no.11, 7 March 2015.

<sup>50</sup> See 'Zamestitel' Ministra oborony RF Yurii Borisov provel VI Vserossiiskuyu nauchno-tekhnicheskuyu konferentsiyu po voprosam sozdaniya VTO', [http://function.mil.ru/news\\_page/country/more.htm?id=12104588@egNews](http://function.mil.ru/news_page/country/more.htm?id=12104588@egNews), 23 November 2016.

<sup>51</sup> <http://premier.gov.ru/events/news/1571>, 30 June 2011



In May 2013 Anton Siluanov, finance minister, revealed that Minfin had been in discussion with the MOD about a possible delay of part of the spending under GPV-2020 by from two to four years. This would mean that the serial production of some new models of armaments would begin later than originally envisaged within the framework of GOV-2025. The MOD was apparently willing to consider this option, a source within it acknowledging that some 'super-optimistic' indicators entered into GPV-2020.<sup>52</sup> A particular concern was an unrealistic schedule for new naval ships. At a meeting on the implementation of GPV-2020 for the navy in July 2013 Putin made it clear that he had no objection to the postponement of the handover of some new vessels to a later date, within the framework of GPV-2025.<sup>53</sup> Thus the ground was prepared for a reconsideration of procurement schedules well in advance of early 2015.

After the January 2015 decision it soon emerged that the Military-Industrial Commission was beginning to accept that the new programme would be funded on a more modest scale than hitherto acknowledged. According to an unnamed source in the Commission, achievement of the GPV-2020 target of 70 per cent modern armaments in the armed forces would make it possible to go over to a more modest annual rate of procurement sufficient to maintain that level. This would permit a reduction of defence spending as a percentage of GDP, freeing resources for social and other needs. In the informant's view, it would be adequate to fund the new programme to 70 per cent of GPV-2020, i.e. to no more than 14-15 trillion roubles. He added that the start of the new programme could be delayed to 2018 because of 'insufficient resources in the federal budget'.<sup>54</sup> It was not noted that a reduction of the programme to eight years would mean even less funding, more like 12 trillion roubles. Little more was said about plans for GPV-25 until the autumn of 2016.

In September 2016 Putin chaired a meeting at which the basic parameters of GPV, 2018-25 were discussed. It was attended by all the main interested parties, including the secretary of the Security Council Nikolai Patrushev. Putin confirmed the decision to postpone the start of the new programme had been taken in January the previous year and noted that since then resource provision for the new programme had been discussed by the VPK on several occasions. He called for continuity between the existing and new programmes and declared that, 'All budget obligations adopted earlier and plans in the field of the defence and security of the state must be fulfilled.' He set the goal of completing the generalisation of proposals for the programme by the end of 2016 so that the government could present the draft programme for approval by 1st July 2017.<sup>55</sup> A week later more details of this closed meeting emerged, as described by Ivan Safronov, *Kommersant's* well-informed correspondent. MOF, Siluanov, and MOD, Shoigu, were unable to agree an acceptable volume of funding for GPV-2025 and the issue was unresolved at the end of the meeting with serious disagreement

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<sup>52</sup> Ivan Safronov, 'Gosprogramma vooruzhenii ostaetsya na sverkhstrochnuyu', *Kommersant Daily*, 23 May 2013.

<sup>53</sup> Aleksei Nikol'skii, 'Ekonomiya po-flotski', *Vedomosti*, 30 July 2013.

<sup>54</sup> 'V VPK predlozili vdvoe sokratit' zapros voennykh na novoe oruzhie', [https://lenta.ru/news/2015/02/25/no\\_money\\_for\\_army\\_men/](https://lenta.ru/news/2015/02/25/no_money_for_army_men/), 25 February 2015.

<sup>55</sup> 'Soveshchanie po osnovnym parametram gosprogrammy vooruzheniya n 2018-2015 gody', <http://www.kremlin.ru/events/president/news/52866>, 9 September 2016.

remaining. According to a source in the financial bloc of the government, after an opening report by Rogozin discussion between the parties developed 'in raised tones'. Siluanov stood out for total funding of 12 trillion roubles; Shoigu for 22 trillion, which clearly represented a retreat from the 30 trillion that the MOD had been seeking earlier. Not surprisingly, Siluanov stressed the state of the economy and the fact that increased defence spending would have a negative impact on the realisation of other priorities, including social commitments. The military focused on the need to ensure the country's national security but also invoked the 70 per cent modern hardware target embodied in one of Putin's May 2012 edicts. Clearly a compromise would have to be found, with the end of the year as the deadline if GPV-2025 were to be ready for approval by 1st July 2017.<sup>56</sup>

The MOD appears to have been aiming for funding in nominal terms in excess of the 20 trillion for GPV-2020, even though the new programme would run for eight years, not ten. A halfway compromise of 17 trillion roubles, over 2.1 trillion a year, if extended to ten years would still be more than the funding for GPV-2020 and, as such, probably unacceptable to MOF, suggesting a possible final compromise of 15 trillion, which if extended to ten years would amount to just under the 19 trillion allocated to the MOD in the preceding programme. As noted above, this was a figure apparently acceptable to the VPK.<sup>57</sup>

The day before the meeting on GPV-2025 Putin spoke in Tula on the production of high-technology civilian and dual-use goods by defence industry companies. This theme has come to the fore with increasing prominence since first raised by Putin in 2013 as a future priority task. It was in the formal assignments following his December 2013 state of the nation speech that he instructed the VPK to begin to prepare for the time after the completion of the 2020 state defence order, including transition in an operational manner to the production of high-technology goods finding demand on both domestic and foreign markets.<sup>58</sup> It was in response to this that the Minpromtorg elaborated the sub-programme of the new state programme for the development of the OPK on the stimulation of the defence industry, with measures to promote the organisation of new civilian production.<sup>59</sup> In April 2016 Putin spoke at the Congress of the Union of Machine builders and addressed the issue directly. Preparation has to be made, because 'the peak load of the defence-industrial complex in the limits of the state defence order will come next year and then will gradually decrease. I hope that defence enterprises will use their accumulated potential for conversion, diversification of production, and will start to produce competitive and, I emphasise, high-technology civilian goods. This is something you need to begin to think about today, and take the necessary measures.'<sup>60</sup>

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<sup>56</sup> Ivan Safronov, 'Esli ne skhod, to razval', <http://www.kommersant.ru/doc/3092628>, 17 September 2016.

<sup>57</sup> According to the well-informed *Vedomosti* journalist Aleksei Nikol'skii, an informant had indicated that the end figure would be very close to the MOF's preference, 'Polgoda na soglasovanie', *Vedomosti*, 11 January 2017, p.3.

<sup>58</sup> 'Perechen' poruchenii po realizatsii Poslaniya Federal'nomu Sobraniyu', <http://www.kremlin.ru/acts/assignments/orders/20004>, 27 December 2013.

<sup>59</sup> Denis Zhurenkov, 'Razvitie OPK: Novye zadachi diversifikatsii', <http://www.rosinform.ru/mic/493132-razvitie-opk-novye-zadachi-diversifikatsii/>, 17 August 2016.

<sup>60</sup> 'S"ezd Soyuzha mashinostroitelei Rossii', <http://www.kremlin.ru/events/president/news/51746>, 19 April 2016.

In Tula he began by underlining the progress being made in re-equipping the armed forces: by the end of 2016 the share of modern arms had to reach at least 50 per cent and by 2020 80 per cent, effectively completing the task.<sup>61</sup> The peak of deliveries under the state defence order will then have been passed. The forces would still require improvement but this would take place on a planned basis, with supplementation as necessary to replace old equipment and work on new-generation systems, but this would not keep the capacities of the defence industry fully occupied. Diversification would be needed and work had to start now on increasing the output of civil and dual-use goods in order to maintain employment and the financial stability of enterprises. Alluding to the 'conversion' of the Gorbachev years, a bitter memory for many in the defence industry, Putin made it clear that this time the advanced equipment and skills would not be employed in making basic consumer goods such as sauce pans, but in meeting the needs of the health service, energy sector, IT and communications, and space business for high technology equipment. According to the then economics minister, Aleksei Ulyukaev, the goal was to achieve 50/50 military and civil shares of the output of the defence industry by 2025, compared with the current 16 per cent civil share.<sup>62</sup>

Later in September this theme featured once again at a meeting addressed by Putin at the 'Kalashnikov' concern in Izhevsk. But this time the principal issue was GPV-2025 and its funding. Putin was clearly intent on warning the military and the defence industry that the days of generous funding were nearing an end. 'Naturally, there are always issues between the capabilities of the state, budget options and the needs of the armed forces. Here we must find the golden mean so that our defence spending does not crowd out other needs linked with social issues, social welfare, pensions, healthcare and education - many areas for which the state and federal budget are responsible. This is why we must find this golden mean. However, as I have already said and would like to repeat once again: at all meetings with heads of defence enterprises we have made the point that the peak of equipping our army and navy with modern hardware should come somewhere at the threshold of 2021-2022. The armed forces must continue to be supplied with new hardware but on a planned basis. We will climb this mountain of the greatest volume of funding and then it will be reduced. By that time it is absolutely vital to make sure that the scale of civilian production is sufficient to utilise fully the production capacities acquired today so as to retain workers and increase their salaries. This is not an easy task for any defence plant.'<sup>63</sup>

This was echoed soon after by deputy defence minister, Yurii Borisov. Speaking in Saratov he said that within five to seven years, presumably having in mind 2021-23, the volume of the defence order would begin to fall gradually, the required level of modernisation of the equipment of the armed forces having been achieved. Addressing the directors of radio

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<sup>61</sup> 'Soveshchanie po voprosam ispol'zovaniya potentsiala OPK v proizvodstve vysokotekhnologichnoi produktsii grazhdanskogo naznacheniya', <http://www.kremlin.ru/events/president/news/52852>, 8 September 2016.

<sup>62</sup> Ibid.

<sup>63</sup> 'Vstrecha s rabochimi kontserna "Kalashnikov"', <http://www.kremlin.ru/events/president/news/52921>, 20 September 2016.

industry enterprises present at the meeting he warned them that those who did not make a reorientation in time to new markets, whether civilian or export, faced very serious financial difficulties. He added that the government intended to develop support mechanisms for defence industry companies to facilitate the processes of change.<sup>64</sup> This is an issue that has been concerning Vladimir Gutenev, president of the Association 'League in Support of Defence Industry Enterprises' and first vice-president of the Union of Machine builder. Elected in September 2016 to the State Duma as a 'United Russia' deputy, he became first deputy chair of its Committee for Economic Policy, Industry, Innovation and Entrepreneurship and head of its commission for legislative provision for defence industry enterprises. He has made it clear that the issue of diversification of the industry will be a central concern, ensuring that it will be properly prepared, the aim being to secure 50 per cent civil output.<sup>65</sup> Gutenev has been very firm that this time, unlike the earlier conversion and diversification, there will be no question of missile factories ending up making saucepans.<sup>66</sup>

From these statements by Putin, Borisov, Gutenev and others in 2016 it is clear that preparation is being made for a time when the volume of the state defence order will begin to diminish. However, it remains uncertain when that will happen. In April it appeared to be from 2018, but in September after 2020 or even, in the case of Borisov, 2023. This divergence of view may well reflect a debate underway and not finally resolved in the corridors of power. Another indication of intentions may be provided by budget plans for the three years 2017 to 2019.

#### *The federal budget for 2017 and the plan years 2018 and 2019*

Because of highly uncertain economic prospects, in September 2015 a law was adopted permitting the return to a traditional one-year budget for 2016. With some signs of stabilisation, it was decided in spring 2016 that the federal budget for 2017 would revert to a three-year format.<sup>67</sup> It soon became apparent that MOF was aiming for a tough budget designed to consolidate federal finances in response to a much lower oil price and a diminishing Reserve Fund. In early July the government approved its proposal that there should be a strict spending limit of 15.78 trillion roubles in all three years.<sup>68</sup> A few days later there was a meeting of Putin with the leaders of all the main 'power' ministries plus Siluanov, Putin's economic advisor Andrei Belousov and the head of the Accounts Chamber, Tatiana

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<sup>64</sup> 'Minoborony Rossii: ob"emy gosoboronzakaza cherez 5-7let nachnut snizhat'sya', [https://ria.ru/defense\\_safety/20160929/1478147589.html](https://ria.ru/defense_safety/20160929/1478147589.html), 29 September 2016.

<sup>65</sup> 'ER planiruet obsudit' v GD diversifikatsiyu voenno-promyshlennogo kompleksa', [https://ria.ru/defense\\_safety/20161002/1478327675.html](https://ria.ru/defense_safety/20161002/1478327675.html), 2 October 2016.

<sup>66</sup> Evgeniya Avramenko, "Kastryli vmesto tankov na zavodakh OPK bol'she delat'ne budem", <https://riafan.ru/548154-deputat-gutenev-kastryuli-vmesto-tankov-na-zavodah-opk-bolshe-delat-ne-budem>, 22 August 2016 (interview with Vladimir Gutenev).

<sup>67</sup> Dmitrii Butrin and Denis Skorobogat'ko, 'Novaya byudzhelnaya normal'nost', *Kommersant Daily*, 16 March 2016.

<sup>68</sup> Mikhail Sergeev, 'Rossiya vpervye rezhnet gosbyudzhnet', *Nezavisimaya gazeta*, 7 July 2016.

Golikova, to consider their future funding.<sup>69</sup> It must have adopted a tough line as shortly after MOF issued a methodological letter to all budget holders on spending limits and how they should prepare their budget claims for the three years. This included a specific clause on the MOD: it was to reduce spending by 6 per cent in each year.<sup>70</sup> A week later a meeting was held at the government level to discuss funding in the budget for the defence industry, with the participation of Medvedev, Siluanov, Ulyukaev, Rogozin, Borisov and others. Unfortunately, apart from a brief opening statement by Medvedev in which he emphasised that while proposals had come forward for spending additional money reserves for this were extremely meagre, no information emerged on the meeting's conclusions.<sup>71</sup>

Over the summer while MOF was working on the draft budget awareness that military spending could be subject to limitations, perhaps of a serious nature, began to enter the public domain. Open opposition emerged, expressed most vividly in the weekly *Voennopromyshlennyi kur'ier*, often a platform for authors of a nationalistic and at times militaristic disposition. In the last issue of August one of its leading journalists Oleg Falichev, launched an attack on the 'anaconda' of the Ministry of Finance, intent on squeezing to a minimum funding on GPV-2025. He noted MOF's wish to devote 12 trillion roubles to the programme, not the '24 trillion' requested by MOD, although as noted above the sum actually requested was 22 trillion. In his view the bureaucrats of MOF were guilty of voluntarism, taking no account of the real national security imperatives facing Russia. 'Russia de facto lives in the conditions of an armed camp', he asserted. President Putin was clearly expected to resolve the matter in favour of the military.<sup>72</sup> In the same issue there was a more authoritative article on the same theme by no less than Vasilii Burenok, the director of the MOD's 46th Central Research Institute, responsible for drawing up the GPV and establishing the methodology of its compilation. Under the heading, 'State programme of disarmament', he openly acknowledged that work on the programme was being delayed by a clash of opinion between the economic and 'power' blocs of the government. He attempted to demonstrate that analysis of the equipment needs of the armed forces, above all the MOD, was a scientific process which revealed what was essential to ensure the country's national security. The funding requested by the MOD for the GPV was not an arbitrary (*sluchaino*) figure but firmly substantiated, and to question it was to put the country's security at risk. Perhaps aware that his argument had been unconvincingly technocratic, Burenok then went on to underline the importance of the work of the defence industry for the development of the economy. He concluded, '...the GPV is not only a document aimed at ensuring the defence capability of Russia, but also in its own way a locomotive of the development of industry and the scientific

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<sup>69</sup> 'Soveshchanie po voprosam formirovaniya byudzheta silovykh struktur' , <http://www.kremlin.ru/events/president/news/52498>, 12 July 2016.

<sup>70</sup> Pis'mo Minfina Rossii ot 21.07.2016 No16-01-08/42065 "Predstavlenie glavnymi rasporyaditelyami sredstv federal'nogo byudzheta proedlozhenii po raspredeleniyu byudzhethnykh assignovaniy na 2017 god i na planovyyi period 2018 i 2019 godov, [http://minfin.ru/ru/performance/budget/federal\\_budget/budgeti/11-16/index.php#](http://minfin.ru/ru/performance/budget/federal_budget/budgeti/11-16/index.php#), 21 July 2016. The 6 per cent clearly applies to the nominal value of spending in the prices of each year.

<sup>71</sup> 'O raskhodakh federal'nogo byudzheta na 2017-2019 godii v chasti razvitya oboronnoi promyshlennosti', <http://government.ru/news/24039/>, 28 July 2016.

<sup>72</sup> Oleg Falichev, 'Anakonda Minfina', *Voennopromyshlennyi kur'ier*, no.33, 31 August 2016, <http://vpk-news.ru/articles/32069>.

potential of the country. Reduction of the volume of financing relative to the substantiated level will bring about the most negative consequences both for national security and for the industrial development of the country. This cannot be permitted.' <sup>73</sup> These interventions of Falichev and Burenok probably give a flavour of arguments that were then being conducted in the corridors of power.

It is possible that military spending was discussed at a meeting on the draft budget chaired by Putin at the end of September but no details were released on the participants (although Medvedev, Siluanov, Ulyukaev and other ministers are visible in the photograph on the Presidential website) or the discussion. <sup>74</sup> A few days later MOF published its 'Basic Directions of Budget Policy', for the first time setting out its thinking and providing an indication of spending plans over the three years. <sup>75</sup> It confirmed that spending on 'national defence' was to be held at almost the same level in nominal terms over all three years, with a steadily declining share of GDP. Although the figures in the final draft budget were slightly different, Table 4 shows the trend.

Table 4

The federal budget for 2016 and 2017-19 according to the MOF's 'Basic Directions of Budget Policy', October 2016 (billion roubles)

	2016 amended budget	2017 as 'Basic directions'	2018 as 'Basic directions'	2019 as 'Basic directions'
GDP	82 815	87391	92 850	98 816
Rate of growth, %	-0.6	0.6	1.7	2.1
Oil price, Urals,\$ p.b.	41	40	40	40
<i>Federal budget</i>				
Revenue	13 369	13 492	13 955	14 823
Expenditure	16 403	16 160	15 951	15 962
Deficit	3 034	2 668	1 996	1 139
As % GDP	3.66	3.05	2.15	1.15
'National defence'	3889/3096 <sup>1</sup>	2 840	2 728	2 816
As % budget exp.	23.7/18.9	17.6	17.1	17.6

<sup>73</sup> Vasilii Burenok, 'Gosprogramma razorozheniya.Finansovoe vedomstvo ekonomit na natsional'noi bezopasnosti', *Voенно-promyshlennyi kur'er*, no.33, 31 August 2016, <http://vpk-news.ru/articles/32056>. This is an argument often advanced by the MOD deputy for financial matter, Tat'ana Shevtsova. See, e.g. her article 'Tat'ana Shevtsova:"Za schet optimizatsii raskhodov, pyatiprotsentnogo sekvestra byudzheta my dazhe ne pochustvuem', *Natsional'naua oborona*, 2016, no.3, <http://www.nationaldefense.ru/includes/periodics/authors/2016/0323/183818109/detail.shtml>

<sup>74</sup> 'Soveshchaniye po vopsrosam formirovaniya byudzheta', <http://www.kremlin.ru/events/president/news/52978>, 28 September 2016.

<sup>75</sup> Ministerstvo Finansov Rossiiskoi Federatsii, *Osnovnye napravleniya byudzhethoi politiki na 2017 god i naplanovyi period 2018 i2019 godov*, Moscow, 2016 (available: <http://www.komitet-bn.km.duma.gov.ru/site.xp/053053049124052049050048.html>, 6 October 2016).

As % GDP	4.67/3.74	3.25	2.94	2.85
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1. Excluding dept repayment, as Table 2.

*Source*

Ministerstvo finansov Rossiikoi Federatsii, *Osnovnye napravleniya byudzhethnoi politiki na 2017 god i na planovyi period 2018 i 2019 godov*, Moscow, October 2016, pp. 27, 58 and 62

2015A: actual spending, author's analysis based on 2015 actual provisional spending:

<http://www.roskazna.ru/ispolnenie-byudzhetov/federalnyj-byudzheth/1020/>, 9 February 2016; latest GDP data of Rosstat; oil price MEP data.

This was soon followed by MOF's draft federal budget for 2017 and the plan years 2018 and 2019, transmitted by the government to the State Duma on 28th October 2016. This was broadly similar to the intentions set out in the Basic Directions document.<sup>76</sup> It passed through the Duma with virtually no changes in planned military spending and in the Duma discussion during all three readings hardly any mention at all was made of the topic. It was probably understood by all that the volumes of spending set out in the draft budget had been agreed by the President, MOD and MOF and were not subject to amendment. The budget passed through its third reading on the 9th of December 2016 and was signed into law by Putin on the 19th. As now usual, apart from showing total budget expenditure for each year the budget law revealed only open spending, with not even total spending by budget chapter and sub-chapter. Budget spending by chapter only became available with the publication by MOF of the so-called 'Budget for Citizens', a document summarising in an accessible manner the principal features of the budget. This means that at the time of writing details of the structure of spending on 'national defence' can only be analysed by supplementing the budget law by some data on the draft budget. Fortunately, as can be seen from Table 5, total spending on 'national defence' in the years 2018 and 2019 differed hardly at all from the draft and for 2017 was identical.

Table 5

Military expenditure in 2016 and the budget for 2017-19 (million roubles)

	2016 actual	2017 budget	2018 budget	2019 budget
<i>'National defence'</i>				
Armed forces of the Russian Federation	2 936 475	2 150 386	2 169 772	2 180 492
Ministry of Defence	911 132	867 596	792 984	792 869
Classified residual	2 025 343	1 282 790	1 376 788	1 387 623
Mobilisation and ex-forces training	6 867	5 322	5 322	5 322
Mobilisation preparation of economy	3 586	3 373	3 268	3 198
Nuclear weapons complex	45 623	45 220	45 220	45 220

<sup>76</sup> [http://asozd2.duma.gov.ru/main.nsf/\(Spravka\)?OpenAgent&RN=15455-7](http://asozd2.duma.gov.ru/main.nsf/(Spravka)?OpenAgent&RN=15455-7), 28 October 2016.

Internl obligations in mil-tech coopn.	9 890	10 073	10 234	10 556
Applied R&D in field of national defence	471 276	346 937	213 913	176 352
Open spending	17 565	15 566	13 482	11 571
Classified residual	453 711	331 371	200 431	164 781
Other questions in field of nat. def.	302 499	274 481	280 579	394 888
Open spending	154 931	129 310	134 712	129 599
Classified residual	147 568	145 171	145 867	265 289
Total 'national defence'	3 776 216	2 835 792	2 728 308	2 816 028
'National defence' less past debt payment	2 983 003			
'National defence' as budget law, 2017-19 <sup>1</sup>		2 835 800	2 729 200	2 815 800
Arms recycling	15 796	10 138	8 125	2 753
Total 'nat def' less arms recycling & mobilisation preparation of the economy	3 756 834	2 822 281	2 716 915	2 810 077
Less payment of debt on past GOZ	2 963 621			
<i>Other military expenditure</i>				
Other Ministry of Defence expenditure:				
Housing	1 338	4 188	136	141
Environment	573	1 484	1 488	1 492
Education	75 692	72 961	73 017	73 070
Health	56 310	51 842	51 943	52 060
Culture and cinematography	3 059	3 262	3 337	3 406
Physical culture and sport	5 351	3 543	3 601	3 654
Mass media	2 318	2 308	2 308	2 309
Pensions	328 183	335 785	(334 000) <sup>2</sup>	(336 000) <sup>2</sup>
Social support	138 238	144 996	145 278	145 465
Fees to international agencies	22	9	9	10
<i>Paramilitary forces</i>				
Ministry of Interior internal troops/Rosgv	116 420	209 256	207 969	206 691
Open spending	107 419	196 923	195 812	194 817
Including state defence order (GOZ)	(9 001)	(12 333)	(12 065)	(11 783)
Border service of Federal Security Service	130 050	123 057	121 646	119 086
Support, closed towns of MOD, Rosatom	10 047	9 449	9 151	8 952
Support for Baikonur space centre	1 004	1 224	1 024	1 024
Total other military expenditure	868 605	961 480	954 953	953 397
Total military expenditure	4 625 439	3 783 761	3 671 868	3 763 474
Less debt payment for GOZ	3 832 226			
Total budget expenditure	16 426 799	13 478 526	13 371 829	13 269 498
'National defence' as % total expenditure	23.00/18.16 <sup>3</sup>	17.46	17.01	17.58
Total military expenditure as % total exp.	28.16/23.33 <sup>3</sup>	23.30	22.89	23.54
Gross domestic product (GDP)	85 880 600	86 806 000	92 296 000	98 860 000
'National defence' as % GDP	4.40/3.47 <sup>3</sup>	3.27	2.96	2.85
Total military expenditure as % GDP	5.39/4.46 <sup>3</sup>	4.36	3.98	3.81
Total budget-funded GOZ, approx	1 685 841	1 610 981	1 576 990	1 552 178



GOZ financed by state guaranteed credits	200 823 <sup>4</sup>	-	-	-
Total GOZ (budget plus SGCs)	1 886 664	1 610 981	1 576 990	1 552 178

1. Total spending on 'national defence' as law on budget as opposed to total shown in draft law.
2. Estimate, as draft budgets never show pensions for the military more than a year ahead.

*Source*

2016 provisional budget implementation: as Table 2.

2017-19 federal budget: open spending and GDP forecast, budget law, Federal'nyi zakon ot 19.12.16 No.415-FZ, "O federal'nom byudzhete na 2016 god i planovyi period 2018 i 2019 godov", [http://minfin.ru/ru/fed\\_budget/](http://minfin.ru/ru/fed_budget/)

Sub-chapter total spending, including classified, as draft budget, Raskhody federal'nogo byudzheta po razdelam i podrazdelamklassifikatsii raskhodov byudzhetrov na 2017 god i na planovyi period 2018 i 2019 godov, Prilozhenie No.6 k poyasnitel'noi zapiske k proektu federal'nogozakona"O federal'nom byudzhete na 2016 god i planovyi period 2018 i 2019 godov". [http://asozd2.duma.gov.ru/main.nsf/\(Spravka\)?OpenAgent&RN=15455-7](http://asozd2.duma.gov.ru/main.nsf/(Spravka)?OpenAgent&RN=15455-7), accessed 12 January 2017.

Total 'national defence' as budget law: Ministerstvo finansov Rossiiskoi Federatsii, *Byudzhets dlya grazhdank federal'nomu zakonu o federal'nom byudzhete na 2017 gog i na planovyi period 2018 i 2019 godov*, Moscow, 2016, p.13, [http://minfin.ru/ru/performance/reforms/budgte/budget\\_citizen/#ixzz4XcCGLhMT](http://minfin.ru/ru/performance/reforms/budgte/budget_citizen/#ixzz4XcCGLhMT), 21 December 2016.

As noted above, in the 2016 amended budget there was no change to the 209 billion rouble state guaranteed credits for the state defence order in the original budget for the year. In the 2017-19 budget there are no credits for the state defence order, and in 2017 only 43,725 million roubles for State Programme 'Development of the defence-industrial complex'.

Some features of the budget are worth noting. As the MOF guidance required, total spending on 'national defence' was held at approximately the same level over the years 2016 to 2019. However, this appears to have been achieved by holding spending constant by sub-chapter except for two cases, R&D and 'other questions'. Spending on R&D declines and this may be because new projects are on hold pending the drafting and approval of GPV from 2018 to 2025. Perhaps to counter-balance this trend and retain an overall stable level of funding, the allocation to 'other questions' increases sharply, without explanation, in 2019. The extra spending is classified and may well take the form of a reserve fund. It will be seen that the budget-funded state defence order appears to decline gradually over the period and with account of the additional funding in the form of credits there is a more significant contraction in 2017 compared with 2015. However, it should be noted that in the absence of evidence to the contrary it has been assumed that all the classified funding under the subchapters 'armed force of the Russian Federation' and 'applied R&D in the field of national defence' is devoted the GOZ. That this may no longer be true is suggested by deputy defence minister Yurii Borisov, who has said that in 2017 the GOZ will be 'more than 1.4 trillion roubles', 65 per cent of which was for the procurement of new armaments and other military equipment.<sup>77</sup> Unfortunately, this issue is unlikely to be clarified so long as the Russian authorities insist on classifying such a large proportion of the country's defence spending. Most lines of military

<sup>77</sup> Ivan Petrov, 'Ruzhpark', *Rossiiskaya gazeta*, 22 February 2017 (interview with Borisov).

spending in other chapters of the budget have also been held at an approximately stable level but one shows a marked increase compared with 2016, namely the allocation to internal troops. In 2016 this was for the troops of the Ministry of the Interior, but in 2017 there is transition to budget funding of the National Guard of the Russian Federation, which has taken over the responsibility.<sup>78</sup> However, the National Guard has non-military functions and personnel as well but it is not yet possible to determine the proportion of its budget allocation that is genuinely of a military, or paramilitary, character. Thus the allocation shown to some extent overstates this component of other military spending.

If the budget for 2017 to 2019 were to be implemented as it stands it would mean a quite significant fall in military spending in real terms. However, spending intentions signalled for the second and third years of a three-year budget are always highly provisional and should be treated with caution. Nevertheless, as shown in Table 6, deflating spending on 'national defence' by the GDP deflator, by 2019 the annual volume could be more than 22 per cent smaller in real terms than in the peak year of 2015 and only 11 per cent larger than the level of 2012. However, by 2019 GDP could still be little more than that of 2012. Clearly, the actual outcome will depend to a considerable extent on the performance of the economy during the next three years and this will be influenced by the price of oil. The budget for 2017, based on an oil price of \$40 per barrel, could turn out to be more favourable than envisaged when it was drafted, with an average oil price (Urals) in January of more than \$53 per barrel. Economic growth could turn out to be higher than indicated by Minekon's conservative 'basic' forecast on which the budget was based. A new forecast is likely to appear within the next few months, based on Rosstat's latest estimation of GDP, and this will may provide a better view of future prospects.

Table 6

Spending on 'national defence' in real terms, 2012 to 2019 (million roubles)

Year	GDP	GDP change, %	GDP Deflator	'National defence'	% real change	Index 2012=100	ND% GDP	GDP 2012=100
2019F	98 860 000	102.1	104.5	2 815 800	98.7	111	2.85	103
2018F	92 296 000	101.7	104.1	2 729 200	92.5	113	2.96	101
2017F	86 806 000	100.6	104.6	2 835 792	94.5	122	3.27	100
2016	85 880 600	99.8	103.4	2 983 003 <sup>1</sup>	90.7	129	3.47	99
2015	83 232 600	97.2	108.2	3 181 366	118.6	143	3.82	99
2014	79 199 700	100.7	108.9	2 479 074	108.2	120	3.13	102
2013	71 067 000	101.3	104.7	2 103 579	110.9	111	2.96	101
2012	66 927 900	103.5	108.3	1 812 386	110.4	100	2.71	100

1. Excluding debt repayment for past GOZ

Source

<sup>78</sup> The Federal Service of National Guard Troops has a new budget code number, 180, but in the functional presentation of the federal budget has taken over sub-chapter 03-03 formerly devoted to the MVD Internal Troops.

Calculated by author on the basis of Rosstat, Ministry of Finance and laws on budget implementation. GDP 2014-16 as revised by Rosstat, 1 February 2017.

### *Introducing more flexibility*

While the 2017-19 draft budget was being considered by the State Duma the MOF submitted another draft amending the budget code. This contained a number of measures including one of potential significance for military spending. It permits some changes to lines of spending in the budget in the course of its implementation without requiring submission to the Duma of an amended federal budget. Within a limit of ten per cent the allocations to main budget holders, i.e. ministries, government departments or other agencies with budget holding rights, under the 2017-19 budget listing can be changed, but not budget allocations under the state armament programme. This new provision applies only to federal organs of executive power in the fields of defence, internal affairs, the Russian National Guard, the Federal Protection Service (FSO) and intelligence agencies. It also applies to agencies in the sphere of mobilisation preparation and mobilisation, plus 'state administration in the field of ensuring the security' of the country, which presumably means such bodies as the Security Council or the Military-Industrial Commission. However, any changes made under this provision cannot be for increasing pay of personnel. The MOF must refer any proposed changes under this provision to the Duma's Commission for examining expenditures of the federal budget directed to providing for national defence, national security and the state defence order, the special commission of parliament for handling classified expenditure. The commission must give its agreement, or disagreement, within one working day. If it fails to do so within the specific time limit the MOF can implement the proposed change regardless. This amendment to the budget code was adopted by the State Duma on 18th November 2016.<sup>79</sup> It is likely that any changes arising from this new provision will become apparent only when the Federal Treasury publishes its monthly report on budget implementation, which normally shows the latest version of the budget listing.

### *More evidence on prospects*

Since the 2017-19 budget was submitted to the Duma for approval there have been further developments relating to prospects for military expenditure. In late October Dmitrii Rogozin addressed the issue of the future work of the defence industry. He noted that he had at one time studied the documents on Soviet defence industry conversion held by the USSR Council of Ministers. The documentation was fine but the execution another matter. High technology production facilities had been used to manufacture casseroles, irons and the like, which had brought not only physical but also moral harm to the defence industry. He went on, 'Why do I recall this? Because we are now passing through the peak of fulfilment of the state defence order. The largest outlays on this are for the years 2016 - 2017. Later, to the extent that we reach the plank of 70 per cent of modern armaments, it will be necessary for us to spend and

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<sup>79</sup> O vnesenii izmenenii v Byudzhetnyi kodeks Rossiiskoi Federatsii i priznaniu utrativshimi silu otdel'nykh polozenii zakonodatel'nykh aktov Rossiiskoi Federatsii, clause 12, amendment to article 217, available, [http://asozd2.duma.gov.ru/main.nsf/\(SpravkaNew\)?OpenAgent&RN=4313-7&02](http://asozd2.duma.gov.ru/main.nsf/(SpravkaNew)?OpenAgent&RN=4313-7&02)

make just as much as will firmly maintain this 70 per cent. If we spend less, then we shall once again begin degradation of the armed forces, moreover to the point of collapse. If we do more, than this will impose an enormous load on the budget to the harm of social programmes and we cannot permit this. All have fathers, grandfathers, mothers, children, grandchildren - they study in schools, go to polyclinics. Everything has to be very judiciously calculated.'<sup>80</sup>

In November 2016, while preparations were being made for the Duma's first reading of the draft 1917-19 budget, Putin held one of his now regular series of meetings in Sochi on defence-related issues. At a session with the leadership of the MOD on the basic directions of development of the armed forces and longer-term issues, Putin ended his introduction by restating his view on the necessity of finding a balanced solution to resource provision of the military: '.... our military development and equipment modernisation work must proceed in strict accordance with the principle of reasonable sufficiency and in accordance with the state's economic possibilities. At the same time we must maintain all our plans for securing the necessary rates of economic growth, the development of civilian branches of production and, of course, guaranteeing fulfilment of the social obligations of the state towards citizens. There must be no contradictions here. All of these different areas must be in natural coordination and must complement each other'.<sup>81</sup>

This theme also featured at a meeting chaired by Putin in late November of the Council for Strategic Development and Priority Projects. Putin recalled the September (?) meeting in Tula and the fact that the time of very large orders from the MOD was coming to an end and noted that after the meeting the Ministry of Industry and Trade had been charged with bringing forward proposals for increasing exports of civilian goods manufactured by defence industry enterprises. In his contribution, industry minister Denis Manturov noted that the output of civilian and dual use goods by the defence industry would grow at an annual rate of five percent<sup>82</sup>

Until late 2016 discussion of military spending intentions had been a matter mainly for specialist discussion and it is likely that there was little public awareness of the issue. This changed in December with Putin's 'state of the nation' address on and then his annual televised dialogue with the nation. In the former he spoke of success in modernising the defence industry and the new task of targeting it on the production of modern, competitive, civil goods. By 2025 30 per cent of the industry's output would be civilian, rising to at least half by 2030.<sup>83</sup> In the latter he set out the future trajectory of defence spending. In 2011 2.7 per cent of GDP went to 'national defence', rising to a peak of 4.7 per cent (including debt

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<sup>80</sup> Dmitrii Rogozin, 'V bitve tekhnologii pobezhdaet dal'novidnyi', *Rossiiskaya gazeta*, 30 October 2016 (<https://rg.ru/2016/10/30/dmitrij-rogozin-v-bitve-tehnologij-pobezhdaet-dalnovidnyj.html>).

<sup>81</sup> 'Soveshchanie s rukovodstvom Ministerstva oborony', <http://kremlin.ru/events/president/news/53262>, 16 November 2016.

<sup>82</sup> 'Zasedanie Sovets po strategicheskomu razvitiyu i prioritnym proektam', <http://www.kremlin.ru/events/president/news/53333>, 25 November 2016.

<sup>83</sup> 'Poslanie Prezidenta Federal'nomu Sobraniyu', <http://www.kremlin.ru/events/president/transcripts/messages/53379>, 1 December 2016.

repayment) in 2016, but the share would fall to 2.8 per cent in 2019 and then be held at that level for 'several years'. He added that this would not affect plans for strengthening the country's defence capability as sufficient resources had been devoted to the task in the preceding five years. 'But I would like to stress that this is also very important for our domestic consumption, for domestic policy. We will never be dragged into an arms race to spend more than we can afford'.<sup>84</sup>

It is notable that since these November and December events visits by Rogozin, Borisov and other leading officials to defence companies are invariably occasions when questions of preparation to develop and manufacture high-technology civil goods are raised. Thus in early February Borisov visited the cluster of four companies in Tambov oblast' producing radio and electronic warfare equipment for the armed forces. He was not at all pleased to find that capacities were being used to only 30 per cent but the enterprises were working only on military orders. Borisov drew attention of all present, including representatives of ministries, to the reality that one-sided focus on the GOZ was 'very dangerous': civilian production had to be developed.<sup>85</sup> The civilian activities of defence companies are now receiving more publicity, with emphasis on the high-technology character of some of their products, but also on the fact that many are not well-prepared for a decline in military orders.<sup>86</sup>

At the end of February 2017 defence industry diversification was the theme of round table at the 'Sochi-2017' investment forum, with particular emphasis on the regional dimension. Opening the event, Medvedev underlined the importance of the topic, drew parallels with earlier Soviet experience, and noted that the situation today is different in so far as many new developments in technology originate in the civilian sector of the economy, not the defence industry. The task was thus to promote civil-military interactions with a modern business model for the defence industry that would promote this and secure its profitability.<sup>87</sup> This was echoed by Rogozin, the main speaker, who also introduced a dimension not hitherto addressed, namely diversification and the system of mobilisation preparation. The elaborate Soviet mobilisation system and its evolution in post-communist Russia has been discussed by the author elsewhere.<sup>88</sup> In the late Soviet period when defence enterprises reduced military production the freed capacities had to be retained in case they would be needed again in the event of war or other major national emergency. This mobilisation requirement greatly complicated defence industry conversion and added to its cost.<sup>89</sup> In recent years the

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<sup>84</sup> 'Bol'shaya press-konferentsiya Vladimira Putina', [http://www.kremlin.ru/events/president/transcripts/press\\_conferences/53573](http://www.kremlin.ru/events/president/transcripts/press_conferences/53573), 22 December 2016.

<sup>85</sup> Yurii Avdeev, 'V labirinte rentabel'nosti', *Kransnaya zvezda*, 13 February, 2017.

<sup>86</sup> Two examples in February 2017, Aleksandr Volobuev, 'Ot samovara doteleskop', [http://lenta.ru/articles/2017/02/17/oboronka\\_dlya\\_grazhdanki/](http://lenta.ru/articles/2017/02/17/oboronka_dlya_grazhdanki/), 17 February 2017 and 'Uzhi na Putinskoi "skovorodke": soscokhit li oboronka Tatarstana s igly voennykh zakazov?', *BIZNES Online* (Kazan), <http://www.business-gazeta.ru/article/336485>, 7 February 2017, a very detailed account of the civilian production of defence companies of Tatarstan.

<sup>87</sup> 'Dmitrii Medvedev prinyal uchastie v rabote kruglogo stola "Diversifikatsiya oboronno-promyshlennogo kompleksa i regional'noe razvitiye -strategiya peremen"', <http://government.ru/news/26568>, 27 February 2017.

<sup>88</sup> See Julian Cooper, *If War Comes Tomorrow. How Russia Prepares for Possible Armed Aggression*, Royal United Services Institute, Whitehall Report 4-16, August 2016.

<sup>89</sup> *Op. cit.*, p.8.

mobilisation system has been modernised and reduced in scope.<sup>90</sup> At the Sochi round table Rogozin made it clear that in present-day conditions mobilisation possibilities had to be considered but would not be allowed to obstruct the development of civilian and dual use manufacture.

*Looking ahead, economic prospects... but are they decisive?*

In July 2014 Putin signed the long-awaited law, 'On strategic planning of the Russian Federation'.<sup>91</sup> This set out a hierarchy of long- and medium-term documents to be prepared on a scheduled basis for aiding government decision making on the future path of development of the country. Because of the uncertain economic situation when it was adopted it was decided by an amendment of the law in June 2016 to postpone the adoption of some of the basic documents to the beginning of 2017 and full implementation until 2019.<sup>92</sup> However, some documents still had to be prepared before these dates, notably a long-term strategic forecast, to be drafted by MED, and then, on its basis, a long-term budgetary strategy, by MOF. These documents were also considered important in taking decisions on the scale of funding under GPV-2025. As part of this process, in October 2016 MED transmitted to the government a draft forecast to the year 2035. At the time of writing it has not been published, but some details were leaked to the press and then featured in the MOF's long-term budget forecast, as shown below. The forecast was not optimistic. According to the basic variant, the one usually chosen for budgetary purposes, GDP growth was to average only 2 per cent over the almost twenty-year period, rising to 2.2 per cent in 2025, then reaching a maximum of 2.6 per cent but falling to 1.7 per cent by 2035.<sup>93</sup>

In submitting the 2017 draft budget to the Duma MOF also completed a long-term budget forecast to 2034. This was a rather insubstantial document of nine pages: in the words of one commentary, MOF 'evidently did not spend much effort on the few pages'.<sup>94</sup> It outlined a tough policy according to which all budget expenditure as a share of GDP will decline from over 37 per cent in 2016, to 32.9 per cent in 2020 and 30.5 per cent in 2034. An overall deficit of the budget system will be retained throughout the period, falling from -4.0% in 2016 to -0.7 per cent in 2034. The MED forecast on which it is based is shown in Table 7.

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<sup>90</sup> *Op.cit.*, pp.18-23.

<sup>91</sup> For the background to this law see Julian Cooper, *Reviewing Russian Strategic Planning: The Emergence of Strategy 2020*, NATO Defense College, Rome, June 2012, available: <http://www.ndc.nato.int/research/research.php?icode=0>

<sup>92</sup> Amendments published *Rossiiskaya gazeta*, 28 June 2016.

<sup>93</sup> Ol'ga Kushinova, Aleksandr Prokopenko, 'Eshche 20 let stagnatsii prognoziruuet Minekonomrazvitiya', <http://www.vedomosti.ru/economics/articles/2016/10/20/661689-20-let-stagnatsii>, 20 October 2016; Petr Netroba, 'Zastoi prodlitsya 20 let', <http://www.gazeta.ru/business/2016/10/19/10259831.shtml>, 19 October 2016.

<sup>94</sup> Dmitrii Butrin, Denis Skorobogat'ko, Vadim Visloguzov, 'Byudzhnet mirnogo bremeni', *Kommersant Daily*, 27 October 2016.

Table 7

The economic forecast on which MOF's budget forecast to 2034 is based

	2017-20	2021-25	2026-30	3031-35
Growth of GDP (annual average,% )	1.6	2.1	2.0	1.8
Investment (annual average, %)	1.2	3.2	3.0	2.7
Inflation (Dec-Dec, %)	4.0	3.9	3.4	3.2
Oil price (Urals), \$ per barrel	40.2	43.3	47.8	52.8

*Source*

Ministerstvo finansov Rossiiskoi Federatsii, Byudzhetni prognoz Rossiiskoi Federatsii na period do 2034 goda (proekt), October 2016, p.6.

This scenario, if approved, will severely constrain the growth of military expenditure in the years ahead. Taking the known MED forecast to 2019 and then projecting forward to 2025 using a GDP deflator of 4 per cent a year it can be estimated that with an annual state defence order of 1.5 per cent of GDP (the level of the early years of GPV-2020) between 2018 and 2025 the total under GPV-2025 would be approximately 15 trillion roubles. Using the proportions of recent years, this would give a share of GDP spent on 'national defence' of approximately 3 per cent, which would appear to be feasible for Russia looking to the future. This forecast was prepared before Rosstat's latest revision of GDP according to the new methodology. If this had been used in the forecast the GDP share of defence would have been lower or, if the c.3 per cent had been retained, the volume of funding for defence would have been larger. But the former would be compatible the 2.8 per cent proposed by Putin, as discussed above. It is clearly very difficult for both MED and MOF to produce credible forecasts at a time of economic uncertainty. In addition, since MED presented its forecast to 2035 a new minister has been appointed, Maksim Oreshkin, formerly in charge of forecasting in the MOF. This could lead to changes in the approach and methods used by MED in its endeavours to look to the future.

Before closing it is worth considering briefly the current state of the Russian economy and prospects as they appear in early 2017. The State Statistical Service, Rosstat, has been making a stage-by-stage transition from System of National Accounts (SNA)-1993 to SNA-2008. This is a complex and time consuming process, still incomplete. According to this new methodology, as adopted to date, Russia's GDP fell by 0.2 per cent in 2016, compared with a decline of 2.8 per cent in 2015. In early 2017 the economy showed signs of revival and with a higher price of oil following Russia's decision to support OPEC's cap on output, growth in 2017 could well be higher than the 0.6 per cent basic forecast of MED in November 2016.<sup>95</sup> At that time MEP also put forward a somewhat more favourable, 'basic +', forecast of 1.1 per

<sup>95</sup> In February 2017 the World Bank forecast an average price of \$55 roubles per barrel in 2017 compared with the \$40 price on which the budget for the year was based, <http://pubdocs.worldbank.org/en/869191487348237935/Feb2017-Russia-Monthly-Economic-Developments-final.pdf>

cent and an optimistic, 'target', forecast of 1.8 per cent.<sup>96</sup> These forecasts can be compared to the 1.1 per cent of the IMF (February 2017) and 1.5 per cent of the World Bank (November 2016), the latter perhaps at the time of writing a possibility.<sup>97</sup>

In his 'state of the nation' speech at the beginning of December 2016 President Putin said that he wanted a rate of growth above the world average by 2019-20 and charged the government with preparing a plan of action to 2025 by May in order to achieve this goal. Business associations were also to be involved.<sup>98</sup> This was a challenging goal as according to the IMF's latest forecast over the period 2017-19 the world economy will grow at an average annual rate of 3.7 per cent. Putin's instruction appeared to supplement two other initiatives then underway. First, the work of the Centre for Strategic Development headed by former finance minister Aleksei Kudrin, asked by Putin to elaborate a programme of reform to boost the performance of the economy and, second, the parallel effort by the 'Stolypin Club' headed by business ombudsman Boris Titov, to draft a 'Strategy of Growth'.<sup>99</sup> There is evidently an expectation that the government's programme will incorporate proposals of both groups.<sup>100</sup> It remains to be seen what measures will be proposed and whether they will be implemented quickly and effectively by the government. Future growth prospects will be more favourable if the price of oil remains fairly high, at least over \$50 per barrel, financial sanctions are eased, and growth becomes more vigorous in the economies of Russia's main trade partners, above all the European Union, which in 2016 accounted for 43 per cent of the country's trade turnover, compared with the 30 per cent share of Asia-Pacific countries, including 14 per cent, China.<sup>101</sup>

In discussion of Russian military spending there is a tendency to assume that the more vigorously the economy is growing the larger will be the resource commitment to defence, as if the regime's urge to strengthen the military capability of the country is constrained only by economic possibilities. In the author's view this is a one-sided interpretation of policy in Russia and unable to provide a sound guide to future military spending intentions. The performance of the economy is clearly an important factor and if it is unsatisfactory then there may also be a question of the preparedness of the country's leadership to prioritise defence over other claims on limited resources, including economic and social spending.<sup>102</sup>

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<sup>96</sup> Prognoz sotsial'no-ekonomicheskogo razvitiya Rossiiskoi Federatsii na 2017 god i na planovyi period 2018 i 2019 godov', <http://economy.gov.ru/minec/activity/sections/macro/2016241101>, 24 November 2016.

<sup>97</sup> <http://www.imf.org/external/country/RUS/index.htm> and <http://www.worldbank.org/en/country/russia/publication/rer>, 9 November 2016.

<sup>98</sup> 'Poslanie Prezidenta k Federal'nomu Sobraniyu', <http://www.kremlin.ru/events/president/news/53379>, 1 December 2016.

<sup>99</sup> For details of their work see Centre for Strategic Development, <http://csr.ru/> and Stolypin Club, <http://stolypinsky.club/>.

<sup>100</sup> See Aleksandr Prokopenko and Margarita Papchenkova, 'Putin poruchil obognat' mirovuyu ekonomiku', *Vedomosti*, 2 December 2016.

<sup>101</sup> [http://www.customs.ru/index2.php?option=com\\_content&view=article&id=24785&Itemid=1976](http://www.customs.ru/index2.php?option=com_content&view=article&id=24785&Itemid=1976), 9 February 2017.

<sup>102</sup> As argued in Gudrun Persson (ed.), *Russian Military Capability in a Ten-Year Perspective -2016*, Swedish Defence Research Agency, FOI-R-4326-SE, December 2015, pp.145-148, where, looking forward to the next decade, Susanne Oxenstierna, considers two basic variables, economic growth prospects and the 'political will to give priority to defence over other items of public spending.'



But there is a third consideration, the leadership's perception of the adequacy of the country's military capability. If considered adequate in overall terms then defence spending can be held at a share of GDP considered sufficient to permit the maintenance and steady enhancement of that capability over time. Developments in Russia suggest that, following a number of years of prioritisation of military spending, even at a time of economic difficulties, the country's leadership now believes that transition can be made to a reduced level of resource commitment to defence. The public declarations of Putin, government and military leaders, together with the actual trend of budget spending, support this interpretation. Of course, developments in Russia and the wider world have the potential to upset this scenario, but at the time of writing there is a possibility that economic development could be boosted by a more modest resource commitment to defence. At the same time some of the country's high-technology development and manufacturing capabilities, for historical reasons heavily concentrated in the defence industry, could be harnessed to civil purposes, enhancing Russia's competitiveness in advanced goods for both domestic and export markets. It will be interesting to see the extent to which the new government economic programme and reform initiatives likely to emerge soon incorporate this understanding.

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