

## Letter of February 2001. RUSSIAN ARMS SALES: ANOTHER REFORM?

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On November 4, 2000, President Putin signed decrees dismissing Alexei Ogarev and Sergei Chemezov, who were Directors-General of *Rosvooruzheniye* and *Promexport*. With another decree the President united two companies into federal state-owned enterprise *Rosoboronexport* headed by Andrei Belyaninov, former Deputy Director-General of *Promexport*.

On December 1, 2000, Vladimir Putin issued Decree No. 1953 "*Problems of Military-Technical Cooperation of the Russian Federation with Foreign States*", which contains the rules regulating Russian arms sales.

According to our estimates, this is seven reform of military-technical cooperation system since 1992, when President Yeltsin first signed a decree establishing Federal State-Owned Unitary Enterprise *Rosoboronexport*. Nearly every change of the cabinet normally leads to redistribution of arms sales revenues. As a result, rumors concerning soon dismissal normally emerge immediately after each appointment. The changes in the leadership of arms exporting company were expected this time as well; backstage fierce battles sometimes reached the press. Outcome of this struggle was not surprising. However, it is of particular importance: this is one of the first reforms of the new President and there are some facts that require detailed coverage and analysis.

Intrigues concerning reshuffles in the system of military-technical cooperation are not only interesting for a narrow military expert community, but may have long-term implications. This is a vivid example of specifics of decision-making and its implementation. Moreover, resumption of military-technical cooperation with Iran (studied below) makes us think that such measures may become typical of other spheres, beside arms sales. They presumably reflect new style of work of Russian leadership.

The recent changes were so dramatic that one can speak about certain revolution, which resulted in sweeping and overwhelming victory of one of the two rival groups: President Putin has formed a new hierarchy which is directly subordinate to him.

Current presidential model of arms export has existed since 1994, when Alexander Kotelkin was appointed head of *Rosvooruzheniye*. He had close ties with Alexander Korzhakov, Yeltsin's security chief, and had a chance to submit some decisions to President Yeltsin in circumvention of bureaucratic machine. Nowadays, arms trade is also under presidential control, although Kotelkin's team is out of business today, whereas Putin's friends and colleagues supervise Russian arms export.

It is noteworthy that Kotelkin, who came to this business from the President's Security Service, was connected with the Main Intelligence Directorate (GRU) and his mates from secret services dominated among top managers of *Rosvooruzheniye*. In the new structure key posts were distributed among former officers of the Foreign Intelligence Service (SVR), while GRU lost its traditional influence in this area, which it had always enjoyed since the Soviet time.

Main goal of Kotelkin's team was to preserve existing military ties (chiefly, arms supplies to China and India under interstate agreements), while Chemezov's group strived to obtain full control over military export. *Promexport* enjoyed strong presidential support and it only needed vivid demonstration of success to launch the campaign for incontestable leadership in this area. 1999 was a year of failures for *Promexport*: large deals fell flat, possible breakthrough with Ethiopia was made null and void after adoption of UN arms embargo.

However, the company finally got a chance to urge for reform in the system of military-technical cooperation. On October 12, 2000, Sergei Chemezov arrived in Novosibirsk to verify fulfillment of a contract between *Promexport* and Algeria. According to the agreement, the *Chkalov* NAPO should repair 22 Su-24 bombers (\$120 million); and such significant deal enabled the company to make public statements and to launch the attack. Sergei Chemezov has first claimed for amalgamation of two arms exporters.

On October 27, the Presidential Commission on Military-Technical Cooperation with Foreign States discussed problem of nominating unified state intermediary for selling specialized equipment. Prime Minister Mikhail Kasyanov chaired the meeting and Sergei Chemezov made a report on the topic. He urged for establishment of the unified authority and proved advisability of consolidating *Rosvooruzheniye* and *Promexport*. Nonetheless, the commission rejected his arguments and found it pointless to unite two companies.

A day before revolutionary decree Alexei Ogarev, who was not suspecting a blow, gave a press conference where he briefed the media about his meeting with President Putin. According to Ogarev, Putin pledged that there would be no consolidation of two exporters. On the contrary, the President spoke about division of powers between two arms dealers (that was actually what Ogarev had asked him for). The newspapers came out with sensational statements by Ogarev and on the next day Vladimir Putin issued a decree with a completely opposite meaning: one state-owned company replaced two arms exporters and buried any concept of *division of labor*.

One can hardly believe that Ogarev misunderstood the President during their meeting. It is even more doubtful that after the talk Vladimir Putin suddenly changed his decision and signed an absolutely different decree. Such documents are normally prepared beforehand and it seems that the President deliberately blunted vigilance of Kotelkin's team. This *smoke screen* facilitated violent change of power in the area of military-technical cooperation, which was sudden for Kotelkin's group and for old Kremlin elite in general.

Andrei Belyaninov, new arms dealer No. 1, convened directors of leading defense enterprises and informed that the President had charged the company with a difficult task: to achieve the same amount of trade as it was in the Soviet Union. Soviet annual arms exports amounted to \$15 billion: according to some estimates, actual Moscow revenues were about \$0.8-1.5 billion, but Putin speaks about absolute amount of sales and that is what he wants from arms dealers. To accomplish this hard mission, Russia has to get rid of its competitors on the world market and reach the level of US arms export. Thus, one may assume that new team has not only a plan of seizing power, but some strategic outline as well.

Such tremendous breakthrough should be performed by Putin's colleagues from the intelligence community - Sergei Chemezov, Andrei Belyaninov, and Mikhail Dmitriev, who all have experience in maintaining military-technical cooperation.

Andrei Belyaninov, Director-General of *Rosoboronexport*, graduated from the *Plekhanov* Institute of National Economy in Moscow in 1978. Until 1998 he served in the SVR and in 1998-1999 he was Chairman of the Board in *Novikombank*. He joined *Promexport* in December 1999 and was Deputy Director-General for Finance.

Sergei Chemezov comes from Irkutsk, where he graduated from the Irkutsk Institute of National Economy. He headed *Promexport* since late 1999 and has been recently appointed First Deputy Director-General of a newly established company. He is one of the most experienced arms dealers among these three figures and besides, he is known for his friendship with Vladimir Putin, with whom he served in East Germany.

Mikhail Dmitriev chairs the MOD's committee on military-technical cooperation. He graduated from the MGIMO in 1970 and until August 2000 he worked in the First Main Directorate of the Soviet KGB and in the SVR. His last post in the Foreign Intelligence Service was Head of the Information and Analysis Department. Then he was appointed Deputy Minister of Industry, Science and Technology and together with Grigory Rapota was in charge of military-technical cooperation with foreign countries.

Three abovementioned officials are the most informed people in arms trade. They will obviously have access to analytical materials and confidential information, which are so important in this delicate business. There is no doubt that having *carte blanche* from the President, they will be able to lobby more efficiently many decisions, which were previously buried in the Ministry of Commerce. This team has only one weak point - human resources.

The company's list of staff and members is nearly completed and obviously, *Promexport* managers take leading positions. *Promexport* strategy has always been aggressive and was based on violent attacks against traditional Soviet markets in detriment to rivals from the FSU states and to *Rosvooruzheniye* as well. *Promexport* did not have to shape any state strategic approach to military-technical cooperation, unlike *Rosvooruzheniye*, which was responsible for implementation of interstate contracts. Nowadays, *Promexport* team has to accomplish a brand new task and it would be reasonable to have some experienced *tutors* or, at least, advisors. However, the majority of knowledgeable

experts from *Rosvooruzheniye* were in this or that manner connected with Kotelkin's group, so temptation to get rid of rivals may be stronger than need for advice.

Pessimists know that after each reshuffle in the state-owned arms trade company the firm needs about half a year to recover. Naturally, this time the situation will be the same: revolutionary changes in arms export system may result in dramatic decline in sales. At the same time, one should bear in mind that deals with two major importers of Russian weapons – China and India – are regulated with intergovernmental agreements. Means to acquire Russian arms are appropriated in beforehand; therefore, revenues of Russian arms dealers will be only slightly affected. Moreover, new team will be able to realize some of its previous ideas.

One of the promising clients is Tehran. Russian leadership has been exploring the opportunity to resume military cooperation with Iran immediately after the Gore-Chernomyrdin memorandum of May 1995, which forced Russia to break military-technical ties with Tehran on December 31, 1999. Iran has been taking the third place among importers of Russian weapons and has always seemed to be Russia's significant economic and political partner in the region. Relations with Iran became strategically important during war in Chechnya and after *Taliban's* victory in Afghanistan. Iran has a developed defense industry and Russia is practically the only state that can offer advanced military technologies to Tehran to balance Iraq. Besides, Moscow is ready to endorse Iranian attitude towards Afghanistan.

After his trip to Iran Defense Minister Igor Sergeyev argued that Russian arms export to Iran might give Russia about \$2 billion in 2001 and up to \$7 billion in the next few years. This may be a *rosy* estimate, but even if Iran restores its former position, Russia's annual revenues will amount to \$300-500 million.

Another lucrative market is Africa, notably Ethiopia and Eritrea. Ethiopia was a trump for *Promexport* until May 2000. Ethiopian generals brought up in Soviet military academies and by Soviet military advisors were actively procuring different Russian weapons – tanks, Su-27 fighters, helicopters and missiles. UN arms embargo imposed in spring 2000 destroyed this *brotherhood in arms*. President Putin signed a special decree banning military cooperation with Ethiopia and Eritrea until May 17, 2001. *Promexport* lost profitable contracts and an opportunity to demonstrate its success in 2000. Anyway now the new company may have a chance to earn \$100-200 million in 2001 and to *show off* this year.

Finally, Russia is still looking for business opportunities in the Middle East. Escalation of Arab-Israeli conflict coincided with Russia's rapprochement with Arab countries. The latter change their perception of Moscow's policy to the better, albeit Russian leadership did not even take any special steps to entice Middle East nations. Islamic world commended Kremlin's struggle against Gussinsky and Berezovsky as a positive sign of eliminating pro-Israel lobby in Yeltsin's and Putin's entourage. Putin's often contacts with competent specialist in Oriental studies Yevgeny Primakov have also been regarded as a symbol of positive change. Reshuffles in *Rosvooruzheniye*, whose leadership was considered to be pro-Israel by some Arab military officials, also contributed to this positive attitude.

Meanwhile, the Middle East is one of the biggest potential markets for Russian arms. Libya, Syria and, in the long run, Iraq may become large Russian partners. If we add the United Arab Emirates, Qatar, Kuwait, and Egypt, which have always preferred to rely on both US and non-US weapons and have paid with *real* money, then fruit of Russian-Arab rapprochement may be even more promising.

It may seem that despite dooms-day predictions, the reform in military-technical cooperation system has not resulted in diminishing sales so far. In late 2000, Alexei Ogarev promised that *Rosvooruzheniye* would gain \$2.95 billion. Official results have not been announced yet, but experts believe that total export will amount to \$2.8 billion. However, this figure demonstrates outcome of old deals, while new contracts will face more problems: some time will be needed to establish personal contacts with old partners and resume interrupted negotiations. Frequent reforms confuse foreign customers, since they no longer understand Russian system of military-technical cooperation. Besides, sometimes instead of meeting appropriate officials, they waste time on talking with black dealers, alleged representatives of enterprises and state-owned companies. As a result, such meetings only exacerbate the situation: clients may lose up to half a year to come to know new details and get in contact with new officials.

Russian system of military-technical cooperation will face a dramatic reduction of the staff: from 3,000 to 2,000 employees. One may presume that these reductions will mostly affect former *Rosvooruzheniye* officials, especially Kotelkin's team. In fact, this is one of the reasons why *Rosvooruzheniye* is reluctant to promote sales: people are more concerned about their future than about interests of the state. Officials of the Ministry of Commerce will be luckier: they will move to the Ministry of Defense.

*Rosvooruzheniye* lost its trademark in one day as if it had no original value. At the same time, one should remember that the Government invested a lot of money in popularizing this trademark and these investments are now lost forever. It is difficult to recall any other country that would so easily and frequently give up such popular trademark.

Now that the system is more centralized chances for arms supplies to belligerents (e.g. for Eritrea and Ethiopia at the same time) are slim. *Rosoboronexport* will be good at working with Ethiopia, thanks to old ties, but Russian-Eritrean deals will be limited to contacts with six enterprises that have independent licenses for arms supplies.

Another risk for monopoly is low interest in small contracts. Ukraine realized this mistake and *Ukrspetsexport* set up a special directorate to negotiate and implement small contracts. And in some cases such agreements become a good start for long-term cooperation.

In June 2000, *Promexport* took up another specialized exporter *Russian Technologies*. Afterwards *Rosvooruzheniye* fell victim of takeover. There is a temptation to repeat this operation with other companies that still enjoy the right to independent work on the market. To ensure legitimacy of such monopolization, there is a notorious pretext about advisability of eliminating competition among Russian arms exporters.

Nonetheless, new reform has some advantages. President Putin started with monopolization and, thus, made the first step to strengthen his power and to restore the military-industrial complex. Presidential allies assumed extreme powers and control over military-technical cooperation. For the first time in modern Russian history arms dealers have a chance to use this *tabula rasa* opportunity and to form the system of arms trade headed by a team of associates not rivals. This team has had a large period of probation, so now it has all chances to realize its ideas and to see the outcome of their implementation.

Freedom of action and presidential trust may substantially contribute to predictability of the system, will help to streamline the structure and to promote growth in production of the military-industrial complex. Lack of competition on the part of conflicting financial groups, which was typical of the system in prior years, may help new managers to focus on conquering world markets instead of fighting for secure *rears*. Time will show how efficient the new system will be.

An appendix to this Arms Control Letter is Presidential Decree No. 1834 of November 4, 2000, pertaining to establishment of the federal state-owned unitary enterprise *Rosoboronexport* (unofficial translation):

“To enhance efficiency of military-technical cooperation of the Russian Federation with foreign states, I decide:

“1. To establish the federal state-owned unitary enterprise *Rosoboronexport* by consolidating federal state-owned unitary enterprises *Rosvooruzheniye* and *Promexport*.

- The federal state-owned unitary enterprise *Rosoboronexport* is a self-sustained economic organization, which is the state intermediary in export/import of military production;
- The federal state-owned unitary enterprise *Rosoboronexport* is legal successor of the state-owned unitary enterprises *Rosvooruzheniye* and *Promexport* and enjoys all property and other rights and liabilities of reorganized federal state-owned unitary enterprises in accordance with the act of transfer;
- The President of the Russian Federation shall approve the Charter of the federal state-owned unitary enterprise *Rosoboronexport* and appoint and dismiss Director-General of this organization.

“2. To charge the Ministry of Defense of the Russian Federation with responsibilities formerly carried out by the Ministry of Industry, Science and Technology of the Russian Federation in the area of regulating military-technical cooperation with foreign states.

“3. The Government of the Russian Federation shall:

- within three months provide for implementation of appropriate activities to transfer to the federal state-owned unitary enterprise *Rosoboronexport* federal property formerly belonging to reorganized federal state-owned unitary enterprises;

- within one month consider and submit proposals, if it deems necessary, to augment the strength of the Armed Forces of the Russian Federation to enable the Ministry of Defense perform its duties pertaining to regulation of military-technical cooperation;
- amend all its acts in conformity with the present decree.

“4. The Director-General of the federal state-owned unitary enterprise *Rosoboronexport* within two months shall submit for approval draft Charter of the aforementioned enterprise.

“5. The Federal Agency of Governmental Communications and Information subordinate to the President of the Russian Federation shall supply the federal state-owned unitary enterprise *Rosoboronexport* with appropriate means of communication, including governmental communications.

“6. The Main State Legal Directorate of the President of the Russian Federation shall within two months submit proposals to bring acts by the President of the Russian Federation in accord with the present decree.

“7. The present decree comes into force on the date of signature.”