

REFORM AND THE REVOLUTION IN RUSSIAN DEFENSE ECONOMICS

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May 19, 1995

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## FOREWORD

As Russia's invasion of Chechnya shows, the Russian armed forces are suffering from tremendous shortages of capable leaders and soldiers. These problems, among others, relate directly to the shortage of funds for the military. Yet Russia cannot afford to spend more than it is now spending on the armed forces. This is the crux of an abiding Russian strategic dilemma, namely the gap between the state's ambitions and objectives and the means of realizing them. Until Russia resolves this dilemma by scaling back its goals, tremendous pressure and impetus to revive a state system in which military spending and the social forces that benefit from a stress on such spending will prevail in politics.

This monograph examines the defense sector's current crisis which has come about due to the collapse of the Soviet Union and of the Russian economy. Should Russia continue to fail to meet the challenge of overcoming an economy excessively geared to defense, prospects for the security of Russia's neighbors and for Russia's democratization remain dim. In the final analysis, the crisis of Russia's defense economy is a vital part of the ongoing crisis of the Russian State.

The Strategic Studies Institute is pleased to offer this report as a contribution to the debate on the ongoing crisis in the Russian economy.

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## BIOGRAPHICAL SKETCH OF THE AUTHOR

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## SUMMARY

An excessively militarized economy was a crucial factor in undermining the foundations of Soviet power. By the same token, fundamental restructuring of that military economy, as well as marketization, is essential if Russia is to become a prosperous, stable, democratic, and even secure state. This study examines the crisis that is challenging the so-called military economy (*Voennaia Ekonomika*) and Russia's ability to put its defense economic policy into some sort of balance.

Unfortunately, the evidence through 1994 indicates a great failure to understand the need for such a reform or to implement it. Although the military economy is in crisis due to greatly reduced production and unpaid government debts in the trillions of rubles, the government still subsidizes many sectors of that economy and shows little or no appreciation of the need to free them from the heavy hand of state tutelage. Although the Soviet command economy is dead and buried, other traditional Russian, and even quasi-Fascist (e.g., Francoist models from Spain) relationships are developing between the state and defense industry.

Instead of reform that really demilitarizes the state, partisans of the military economy are successfully reestablishing a preeminent position and access to the state, and are pursuing an agenda that perceives the West, and especially the United States, as an enemy. They also are using arguments based on the primacy of this threat and on the need to restore the defense economy as a rationale for the reunification of the Commonwealth of Independent States (CIS) from above. Continued success for their advice in the counsels of power will mean a permanent barrier to Russia's democratization, stability, and the demilitarization of Russian thinking and policy on security.

Accordingly, the failures of the military economy and of the defense budget which reflect Russia's inability to afford the kind of armed forces these lobbies demand indicate the crises

in the Russian state's incomplete democratic revolution, and in Russian strategy. An excessively militarized economy distorts the state and obstructs democratization. But the crisis of strategy reflects the continuing disparity between the great ambitions and goals of the state in defense policy, e.g., antagonism to the West, and the means at hand to sustain so grand a policy requirement. As long as this gap is not overcome and the military economy is not reformed, Russia will continue to be in crisis, and it will not even be able to pay for the armed forces it now has. Those forces' performance in Chechnya in 1994-95 illustrates their breakdown precisely because strategic priorities are, to say it euphemistically, misaligned. But if strong action is not taken soon, the result will not be misalignment, but something more like breakdown and those consequences will be unpredictable.

## REFORM AND REVOLUTION IN RUSSIAN DEFENSE ECONOMICS

Russia's specific conditions make any variant of structural policy dependent on the defense sector.

Viktor Chernomyrdin  
Prime Minister of Russia

Unquestionably one reason Soviet power collapsed was its excessive militarization. This is not simply a question of too much military spending. Rather the entire economy operated without regard for real prices or costs; there were no penalties for failure; and, in this economy of soft-budget constraints (i.e., continuing subsidies to industries operating at a loss that reinforced failure), there were no fiscal or economic institutions or markets to impose discipline. In defense spending, far from what we earlier thought about the dominance of the uniformed military and Ministry of Defense (MOD), in reality the MOD and armed forces were no less victimized than other consumers by shoddy equipment that they had to accept.<sup>1</sup> In those cases, however, the equipment, e.g., submarines, often became the military consumers' graves.

This abuse of economic power and of an unrestrained sellers' market in armaments occurred within a context that the Polish socialist Oskar Lange had called "a sui generis war economy." This abuse happened largely because the economy's defining feature was constant organization for war manifested in a permanent readiness for large-scale war and a surge production capacity. Arguably, the planned economy and state ownership that supposedly were the economy's distinguishing marks existed as much to foster this perpetual mobilization capability known as "The Military Economy" (*Voennaia Ekonomika*) as they did to realize a Marxist or totalitarian rationale. Yet, paradoxically, this defense economic system itself became a prime obstacle to the realization of Soviet military and political leaders' strategic vision concerning

the nature of modern war, the state's strategic tasks, and defense policy.

If Russia is to remain a stable, democratic, nonimperial, nonmilitarized state, defense spending and industry must be reined in and subjected to real institutional, legal, and fiscal controls and to a strategic vision commensurate with Russia's real possibilities. Now that Parliament must pass on annual budgets, the budgetary process as well as all aspects of defense economics and strategy can be scrutinized and become important barometers of the success of democratization and demilitarization of the economy and state. Indeed, 1994's budget crisis offers us an opportunity, so to speak, to eavesdrop on the crisis of the military economy and of Russian strategy and to assess prospects for overcoming the past.

The struggle around the military economy is a major part of the larger struggle to convert Russia's economy to a truly civilian system. This means more than merely producing for the civilian market. It also means producing quality goods that people and the armed forces actually want.<sup>2</sup> Two important consequences flow from any successful conversion: that defense industrialists do not have excessive leverage on the state and that the state does not have excessive influence or control over defense industry. Thus defense industry's practical policy guidelines and actual performance must be framed in the context of the real challenges to security.

This is an exceedingly difficult challenge in the best of times and today is certainly not one of those periods. As in the 1920-30s, a revolution in military affairs is sweeping everything before it and the amazing technological potentials and realities of our time pose the most profound challenges before states which would retain a great power military and even economic status. This challenge is very real to Russian elites. After all, in the 1960s Soviet thinkers were among the first to postulate and analyze the implications of what they called the revolution in military affairs or the "scientific-technical revolution" (STR) or, in Russian, *Nauchnaya-Tekhnicheskaya Revoliutsiia* (NTR).<sup>3</sup> Ultimately the consequences of this revolution, especially as developed in the writings of Chief of Staff N.V.

Ogarkov, imposed fundamental challenges upon Soviet grand strategy and the regime's basic economic policies. The regime's inability to meet those challenges is what most observers believe underlaid Gorbachev's calamitous efforts to save Soviet power from itself.

Moreover, the inability of the old order's leaders to achieve a basic strategic reorganization of the system; their incapability to "restructure" (*Perestroit'*) either the military economy or the Soviet system as a whole drove home, for the second time in Soviet history, a fundamental lesson that must be in the minds of those who would respond to the revolution in military affairs. That lesson is that while the revolution may begin with a new vision of warfare based on new technological capabilities, that vision alone is insufficient. For a state or military system to rise to the occasion it must then develop new, viable operational concepts, and new organizational transformations in the armed forces and their supporting industries. These new synergies will then allow those concepts and vision to be realized and tested in practice so that what is misconceived can be jettisoned.<sup>4</sup>

Right up to the end of the Soviet epoch in 1991, Soviet military writers gave profound and innovative accounts of the STR and its impact upon warfare, the missions, and operations of the armed forces. The first studies of OPERATION DESERT STORM showed many analysts seriously trying to come to grips with the fact that the United States realized in practice Soviet operational concepts of the past generation and their future implications.<sup>5</sup> Yet despite postulating that war as the model for future theater warfare, these analysts, and especially their leaders, remained incapable of grasping, let alone undertaking, the organizational restructuring needed to make it possible for the USSR to fulfill its ultimate argument—military competitiveness.<sup>6</sup> The current operations in Chechnya, that began in December 1994, graphically illustrate the Russian Army's shortcomings.

Hence the system perished and a new one is being born amid great travail. Yet the new military leadership continues its effort to keep abreast of modern war, in both theory and practice, to defend a rather expansive view of national

interest.<sup>7</sup> As part of that expansive view of national interests and of the dangers and subsequent threats to it, the military doctrine published in November 1993 calls for a defense economic program oriented towards providing the armed forces with the most contemporary platforms and weapons. It also calls for safeguarding Russia's defense economic independence and association with other CIS members' defense industries in a restructured and effective (if not efficient) market economy with state regulation.<sup>8</sup>

In other words, it is now a matter of high policy that the military economy be restructured to assure Russia's military and technological competitiveness particularly in theater conventional or even nuclear war. But to date this has not happened. Though defense orders and spending have greatly declined from the Soviet period, there is no doubt that defense conversion, an essential precondition for this transition to high-tech and to quality armaments designed for modern war, as defined and practiced since 1988, has been a resounding failure. There are many reasons for this failure, but the lack of a true state understanding of what is needed and of fiscal support for it, and second the industry's lack of faith in it and successful determination to continue the old system of dependence on state subsidies and soft-budget constraints are crucial causes for that outcome.<sup>9</sup> These subsidies helped ignite the massive inflation that accelerated wildly after 1992 and paradoxically contributed to today's situation where the state cannot pay the defense industry for what it has bought and owes just the defense sector at least 4 trillion rubles, if not more. But perhaps the worst aspect of this failed conversion is that the essence of the military economy remains intact. And while that is the case, progress toward a viable and truly new order can only be halting at best.

### **The *Voennaia Ekonomika* (Military Economy).**

The major attribute of this military economy is no longer its disproportionate size or the amount of its military production. Its work force is shrinking rapidly as is the size of weapons procurement and the percentage of its civilian production has steadily risen since 1985. Rather the problem is that as a

perpetual war economy it must operate at mobilization capacity at all times. The defense industry must always maintain enormous stocks of raw materials, semifinished and finished goods, labor, plant space, and so forth, so that it will not have to engage in wartime spurts. Since capacity must be fully engaged at all times, excess production capacity is increasingly diverted to civilian production. But the mobilization stockpiles remain as do state directions that they continue. Ex-Deputy Premier Aleksandr' Shokhin, in late 1993, admitted that the state still obligated the defense industry to maintain mobilization reserves at the 1986 level!<sup>10</sup> This is despite everything that has happened since 1986 and the fact that even some defense industrialists resent this order precisely because it hobbles their ability to compete in a market environment because they bear the cost of these reserves.<sup>11</sup>

The Yeltsin government has greatly subsidized this system, thereby reinforcing failure and stimulating the expectation that it will continue to do so. Therefore, there has been little incentive to undo the status quo. In 1992-93, the industry's expectations that it could not be allowed to fail were rewarded by enormous subsidies, one trillion rubles in 1993 alone. And in August 1994, subsidies resumed. Accordingly, enormous military and defense industry pressure exists to continue this system even though these industries are wholly illogical in economic terms. Raw materials and all its goods and services are irrationally priced and these industries remain, in Vitaly Shlykov's words, "value subtracting industries."<sup>12</sup>

The pressure for continuing this system is tied to the success of those who can get subsidies. Thus it is a paradoxical support because legislation through 1994 has mandated retention of the *Voennaia Ekonomika* but there is no state budget support for it.<sup>13</sup> Accordingly, the pressure for retaining the mobilization system directly depends upon industry's ability to organize as a pressure group and extort subsidies from the regime. From the evidence there is little doubt that the defense industrial sector has effectively constituted itself as a key faction, or lobby, in policymaking.<sup>14</sup> Therefore, when the government began showing signs of

ending subsidies in 1994, this lobby went public, forecasting the collapse of the defense sector and massive unemployment.

Such pressure gains results. Despite several months of tight monetary and fiscal policy, in August 1994, the government caved in to lobbies like agriculture and the military-industrial complex (MIC) and began giving subsidies to them. The inflation rate began to ascend once again. Prominent officials like Deputy Premier Oleg Soskovets keep telling Russia's defense industry that it will be protected.<sup>15</sup> The defense industry has responded by vastly overproducing military goods and demanding credits from the government even during cuts of over two-thirds in procurement from the 1991 baseline. Shlykov recounts that 1992 tank production was 26 times that year's state order.<sup>16</sup>

More generally, Aleksandr Ozhegov reported that defense industrialists began 1992 (when the reforms started) with a skeptical attitude towards expected defense cuts. Since the Ministry of Foreign Economic Relations also believed it could vastly increase arms exports, some producers also accelerated production. Though the government had decided on substantial military cuts in January 1992, only in March did they give the defense industry its orders, leaving it on its own for the first quarter of the year. By then enterprises had produced 20,000 million rubles worth of equipment, three times the 6500 million rubles foreseen in the first quarter's defense budget for 1992.<sup>17</sup> As a result, Russia was awash in military production for which there was no customer. This situation had not changed appreciably into 1994. In March 1994, Acting Finance Minister Sergei Dubinin complained that the MOD had already placed orders for 28 trillion rubles when the federal budget allocated 5 trillion for that purpose for all 1994.<sup>18</sup> Thus the military-industrial complex continues to subvert rational economics and Russia's economic security.

Furthermore, as Aleksandr' Ozhegov observed, conversion of military to civilian production under the same roof and management as before, where managers and owners are legally obligated to assume the entire cost of the mobilization resources, fosters still greater absurdities. Management until 1994 was not allowed to do anything with those mobilization

resources and until a military doctrine was published in 1993, there was apparently no coherent official guideline as to what must be produced.<sup>19</sup> Naturally, too much was produced as a hedge against uncertainty. That is, while procurement was drastically slashed, it is not so clear how much production fell. These irrationalities have to do with conversion and its funding. The federal program for conversion has 14 sub-programs listing the future direction of conversion and investment funds.

By 1995, in the so-called weak sectors: forestry, home building, and roadbuilding, there will be almost no investment, another sign of the traditional priority accorded to development of militarily relevant technologies and industries in Russian planning. As a result, many of the long-standing structural imbalances that plague Russian industry will not be alleviated even if one assumes the government will find the capital to invest in the priority sectors, a very dubious assumption.<sup>20</sup>

A second concern outlined by Ozhegov is that although some of these programs are market oriented, e.g., consumer durables, and some are state-oriented, e.g., environmental and medical production, the government funds them in the same way. "In each case the defense enterprises try to get subsidies or low-interest loans (normally 6 percent annual interest as compared with the commercial banks' 200 percent interest rates)."<sup>21</sup> Whereas the government pays defense enterprises only once in funding consumer durables, in state programs it pays twice, once to advance the subsidy to buy the equipment and a second time to buy the production. "And as the defense enterprises' overheads are very high, due to their obligation to maintain the military production lines (the mobilization capability) [of the military economy-author], not only does the state have to pay doubly for the new products, but the price is very high indeed."<sup>22</sup>

Furthermore this policy has become law for certain kinds of especially important products, thus vesting the *Voennaia Ekonomika* and the subsidy relationship in law. Russia's 1992 law on conversion (Article 8, Paragraph 5) reads as follows,

Provision is made for enterprises undergoing conversion that produce, under conversion programmes, equipment and

machinery for the needs of the agro-industrial complex, to receive compensation for part of the overhead, so as to ensure that the price levels are no higher than those of the world market.<sup>23</sup>

Since this overhead also includes depreciation of equipment in the military shops, the price is already on or close to the world market price although the quality is nowhere near it.<sup>24</sup>

But the system's vagaries do not end here. As Ozhegov also observes, often efforts to fund the customers of finished products directly rather than the military-industrial complex are pocketed by the customer rather than being spent on MIC products. If the Ministry of Agriculture gets funding to support conventional R&D in defense enterprises, it could channel the funds to its institutes instead. Thus, in 1992, it withheld nearly 1000 million rubles from defense enterprises and the design bureaus for work already carried out.<sup>25</sup> And this was not an isolated example.

These episodes offer a sense of how intrinsically dysfunctional and militarily and economically irrational the military economy is. Nevertheless, it is admirably structured for covert raids upon both the state's and society's resources to perpetuate a cozy institutional relationship between formally private and public entities. But the reasons for the strength of these relationships go beyond the opportunities they afford for large concealed subsidies and rents.

We must also consider that many defense industries are company towns with responsibilities for the full range of social amenities that their workers and staffs enjoy. If they crashed due to an explosion of economic rationality, massive unemployment and immediate impoverishment would take place, undermining local governments and Moscow. As one analyst of conversion observes,

Red ink in defense enterprises' balances automatically freezes the financing of critical local social programs, including housing construction, development of economic and social infrastructure, financial assistance to the needy and so on.<sup>26</sup>

Since 1992 both labor unions and defense industrialists have successfully intimidated the government with this specter and threaten to do so again as the government and Parliament face their demands for budget breaking defense expenditures and subsidies.<sup>27</sup>

The armed forces and the government still seem wedded to the old order's mobilization requirements and perspectives. Shokhin's remarks confirm this. In June 1991, Chief of Staff General Mikhail A. Moiseev demanded a mobilization capacity like that of World War II, i.e., 12 million men, showing a complete loss of touch with economic reality.<sup>28</sup> The Russian military still uses the same Soviet estimates of Western mobilization capacity. In addition, Yeltsin decreed retention of that old mobilization system and threatened violators with severe punishment. Third, when the Gaidar Government cut defense procurement by two-thirds in 1992, it increased industry's mobilization capacities, especially tanks. Fourth, as of late 1993, the privatization laws excluded those industries that have mobilization plans.<sup>29</sup> That exception conformed to prior politically-motivated promises to key constituencies that depend on the defense industry that they would not be privatized.<sup>30</sup> Although this law, like all others, is not enforceable, it shows a continuing economic ignorance and the strength of old thinking and economic structures.

The armed forces' viewpoint is no better even though they too are obviously victimized by massive overproduction of useless systems that are irrelevant to future wars and that weaken the economic foundations of the country. They still apparently remain wedded to the mobilization economy even when they espouse the goals of conversion, i.e., a more civilian and more effective economy. Thus Col. A.V. Piskunov writes in *Voennaia Mysl'* (Military Thought), the main journal of the armed forces, that for conversion to succeed, it is not enough to move to those goals. The war fighting capability of the armed forces must not be slighted.

From the military-economic point of view, conversion can be made effective only provided that along with the socio-economic principles [outlined above], the following principles are also realized in its process: an optimum combination of the interests of the

country's social-economic development and the interests of ensuring the requisite condition of the Armed Forces: **preservation of sufficient mobilization readiness of enterprises undergoing conversion and also the development of flexible conversion programs and plans (to carry out possible reconversion projects [i.e., back to war production-author]);** and priority orientation of conversion enterprises towards the socio-economic needs of army servicemen.<sup>31</sup>(author's emphasis)

It never crossed his mind that these two conditions are basically incompatible and thus nullify each other. The same affliction affects Vitaly Tsygichko who, writing in the same issue, advocated the following military-technical policy.

Highly effective weapons and electronic warfare systems; technical command and control, intelligence and communication systems based on a wide use of computing facilities, latest achievements in the sphere of information science and cybernetics, allowing sharply to raise the effectiveness of weapons and troops (forces); as ground and space based infrastructure ensuring command and control, intelligence and communications in peace time and war time; the system of transport facilities and a transport infrastructure enhancing the strategic, operational, and tactical mobility of troops (forces); mobile means and a comprehensive logistic service infrastructure; a mobilizational deployments infrastructure and technical facilities for training troops (forces) and preparing the reserve.<sup>32</sup>

But in discussing the need for a mobilization system and special infrastructure for rapid development of a large army in case of a major war, Tsygichko advocates making the best possible use of the existing infrastructure. He demands that it be saved and become the material foundation for a new mobilization deployment system.<sup>33</sup>

The requirement to preserve this state of affairs, as Deputy Defense Minister Andrei Kokoshin, who oversees military-economic policy, well knows, "distorted" the Soviet program.<sup>34</sup> But not only Kokoshin knows this. At least some naval officers fully grasp the consequences, perhaps due to the disasters afflicting Soviet submarines. Accordingly, Captain First Rank A.N. Zolotov, (Ret.), a well-known naval author, recently wrote a scathing critique of the effort to maintain the navy in constant readiness and mobilization to the

extent that its total operational readiness was at least one order of magnitude if not two or three orders less than that of the U.S. Navy.<sup>35</sup> Under such circumstances parity and combat readiness, or stability, efficiency, and a host of other synonyms for those notions became meaningless.<sup>36</sup> Zolotov concluded by warning that unless a fundamental revision of thinking on readiness, sufficiency, and related concepts takes place, the state-of-the-art navy will be less combat ready than Peter the Great's or Anna Ioanovna's were.<sup>37</sup> But his views apparently do not reflect prevailing trends.

Thus conversion policy has been dogged all along by the struggle of new and old political interests to implement either state control and soft budgets, or alternatively state abdication and letting the industry fend for itself even though that might turn out to be politically unpalatable and unworkable.<sup>38</sup> In addition, as we shall see, in the entire struggle to restructure and reform the defense economy, broader political agendas are in contention. In 1994, Kokoshin had to defend the mobilization system by saying that every state has one. Not only does it preserve and modernize Russia's defense potential, it is also as a component part of national industrial policy.<sup>39</sup>

This defense showed that he accepted the MIC's fundamental idea that this sector is the pinnacle of Russian technology and science and that in particular its science intensive and high-tech capabilities must be protected as "locomotives" for the future recovery of Russian industry.<sup>40</sup> More likely, only 20 percent of this industry can fairly be described this way and the rest are as ineffective as other Soviet firms were.<sup>41</sup> In May 1994, Kokoshin told *Nezavisimaya Gazeta* (The Independent Newspaper) that,

The domestic economy has an acute need for 'growth areas' with an active role of the state and private capital. Such areas can be created primarily by increasing state orders to diversifying enterprises in the defense complex.<sup>42</sup>

He also accepts that closing defense industry's company towns would be profoundly destabilizing. Therefore, other means are needed to convert them to the market, all of which

are subsidies from the state such as tax privileges and special export and import tariffs.<sup>43</sup> Among them is also the fact that the MOD, as before, still subsidizes civilian technology even though that is inherently wasteful.<sup>44</sup> Kokoshin calls for creating and concentrating production in financial-production cartels or associations in an optimal number of specialized enterprises which can produce the weapons of the future high-tech warfare and dual use technologies.<sup>45</sup>

These complexes or, to be frank, vertically integrated cartels, are also the vehicles for articulating a broader political agenda relating to arms sales and the organization of the CIS' defense enterprises as a whole, not just the military budget and Russian defense policy. In Piskunov's terms, these firms should be the core of a new defense complex that is a territorially closed (within Russia or the CIS) technological cycle for producing the most advanced equipment. Defense industry's second tier should then be joint-stock or mixed production firms with mainly contracts for production. The remaining enterprises should be granted full independence to fulfill military orders on a contract basis. Piskunov also wants to integrate defense production in the CIS as a whole based on treaties but with the caution that political complications may cause a break in inter-state (he writes inter-republican—a significant clue to his true goals of restoring the Soviet system of integrated defense economy) relations.<sup>46</sup>

Piskunov's goal is shared throughout the MOD and MIC. Indeed, an important objection to the nationality movements in 1991 by military coup plotters like General Varennikov was precisely that these movements shook the foundations of the union-wide integrated military economy.<sup>47</sup> Today the Deputy Chairman of *Roskomoboronprom* (The Committee of Russian Defense Industries), who oversees all these industries, estimates that, without inputs from the other former Soviet republics, Russia can only produce 17 percent of the finished military systems it requires.<sup>48</sup> Thus, along with the demand for state protection and guidance in a centralized policy of arms sales comes the demand, echoed by leading spokesmen of the arms industry, to reconstitute the CIS as an integrated single military-industrial structure.<sup>49</sup> This demand accords well

with efforts by the leaders of the CIS' joint military staff, like General Ivashov, to reconstitute the union in a CIS military-political union that joins defense, politics, and industry together in a single system.<sup>50</sup>

Tsygichko also favors such programs. He explicitly advocates this military-political union under the Russian nuclear umbrella and asserts the political-military utility of nuclear weapons in this context. He writes that if Russia denuclearized, former Soviet republics would gravitate to Turkey and Iran for security guarantees.<sup>51</sup> More pointedly, "Nuclear weapons appear as an important factor of the Russian state's integrity."<sup>52</sup> They also guarantee that the West will not, as he believes it wants to if it could, split up Russia, because that would lead to nuclear proliferation. Moreover, he openly professes his threat assessment which lies behind his earlier demand for the extensive technological program based on the old system and thus demonstrates that for large sections of the military, the demand for so extensive a military-technical program derives from a presumption of threat that is breathtaking in its implications. Speaking of Russia's nuclear weapons as by their very being posing a serious threat to the West and U.S. leadership, he writes,

Hence the main military-political goal of the United States—to reduce and to finally eliminate this threat—remains invariable. The present situation in the Russian Federation characterized by a prolonged economic crisis and a considerable weakening of the military-industrial complex, assists, in the best way possible, the reaching of this objective toward which the West's economic and especially financial policy is frankly directed. The acceptance of the terms on which Western credits are proposed virtually leaves no chances for the survival of the Russian Federation's military-industrial complex.<sup>53</sup>

Thus the political agenda of those who wish to maintain a large, conservative military technical policy clearly emerges. It comprises a breathtaking anti-Western threat perception to justify the program and the hatred of the IMF and nativist resentment of foreign investment that has become a rallying cry for the political opposition.<sup>54</sup> This is an agenda firmly in favor of the economic-political-military reunification of the old Soviet

empire, even if under a new dispensation. Its proponents also espouse the old infant industry and autarchy arguments that figured so prominently in Stalinist policy, and call for a tightly fused state-industrial management program of subsidies, credits, and the like, either in the form of cartels as Kokoshin espouses and/or retention of the *Voennaia Ekonomika*. As for democracy, that comes second to empire and the ensuing remilitarization, if it comes anywhere. Indeed, the very form of defense industrial organization they and even Kokoshin espouse bears no resemblance to democratic models and is inimical to democracy.

Kokoshin's grand design is admittedly modelled after the South Korean Chaebols, Francoist defense economies and other authoritarian models.<sup>55</sup> It also, probably not accidentally, is heavily indebted to the relationship between Russian defense industry and the state in the era of the Great Reforms under Alexander II, 1855-81, e.g., the relationship between the navy and industry which was not an auspicious one.<sup>56</sup>

And there are several other disturbing current and historical parallels as well. First, the MOD has frequently acted to obstruct privatization plans where civilian production units of defense enterprises would become independent of state control. Now that defense legislation makes the MOD, in theory at least, legally able to determine what should be supplied and procured, it will obviously seek to expand upon its discretion and not let firms out of its purview. This is even more the case when we consider that MOD orders are often financed from the profits from civilian production since the budget allocations cover only a fraction. Thus the MOD, desperate for funds, is unwilling to relinquish such civilian subsidies of military production that it deems vital and vetoes many privatization plans.<sup>57</sup> In St. Petersburg the privatization of Baltiyski Zavod was stalled because the increasingly civilian orientation of the firm would undermine military shipbuilding programs. For 1995 it has no orders to build military and civilian units held together "just in case" as an example of industrial policy.<sup>58</sup>

## **The Political Implications of Military Economic Policy.**

Chernomyrdin's observation, quoted at the beginning of this monograph, underscores the intimate connection among defense policy, reform, and overall economic policy. It also provides a suitable context for thinking about the political and economic implications of the MIC's and Kokoshin's programs. At the macro-strategic level, the demand for the weapons of high-tech and theater war conceals a political assessment of the most likely enemy as the United States and the West.<sup>59</sup> This was as true of the 1993 doctrine as it was of the 1992 unofficial draft doctrine and in both cases suggests a military looking in the wrong direction.

Second, the demand for vigorous arms export programs complete with state subsidies is now almost exclusively couched in terms of saving the defense industry, the "cream of Russian science and technology." Since this industry cannot produce enough for domestic consumption it seeks state support to do so abroad. At the same time the government evidently seeks to create a condominium with the United States in arms sales even as its leaders bitterly decry U.S. competition.<sup>60</sup> This program ultimately would tie Russian defense industry's survival to foreign and state subsidies, factors that are inconstant and at odds with Russia's true security at this stage. For their part, the exponents of cartellization, subsidies and arms exports increasingly reject foreign investment—a cause that unites reform's most vociferous enemies—and advocate support for infant defense industries and import substitution.<sup>61</sup>

Kuznetsov has developed the critique of their programs. First, we know that infant industries tend to remain infantile under such subsidy and tariff walls. Second, he argues that these programs will be captured by interest groups, more precisely branch interests growing from the old Soviet economic branch structure, which will struggle against each other for control of what passes for government.<sup>62</sup> Indeed where four separate agencies claim they should regulate or supervise the MIC, there is no true government, rather endlessly rival bureaucratic oligarchies and only bureaucratic

politics.<sup>63</sup> This pattern is endemic to the government and directly continues Tsarist, if not Soviet ministerial patterns of rivalry. Therefore any industrial policy executed under these conditions would mean only the capture of policy by any one particular bureaucracy.<sup>64</sup> Worse yet are the political implications of this program's becoming policy. Kokoshin's financial-industrial groups are not only the MIC's future, but Russia's. In that case,

There is a risk that such groups may capture the government and follow a Latin American pattern. The problem with this is not that they would produce more arms for export or influence the military doctrine in the direction of increased arms production, but that there would be a continued high rate of inflation and a continued stagnation in the economy, leading to popular unrest. A more favorable development would be an East-Asian variant, i.e., they would develop in response to a weak market infrastructure, substitute for the non-existing capital market, and go for export.<sup>65</sup>

Western analysts express the same concerns. Julian Cooper worries that these financial-industrial enterprises cannot act as "locomotives" of dual-use technology because the Russian domestic market for the latter has collapsed and these firms are not competitive abroad. For several years they can only function as major claimants of state subsidies, thereby locking in the uncompetitive and inward-looking economic structure Kuznetsov outlined.<sup>66</sup> Politically, the model of Hohenzollern Germany, a dirigiste, authoritarian, militarist, and nationalist modernizing regime from the top down may turn out once again to be relevant to Russia and to Europe, as Jack Snyder suggests.<sup>67</sup> A third alternative is a return, conscious or not, to some form of the heavy-handed state tutelage and aversion to true market relationships in the defense industry character of late Tsarism as defined in detail by Peter Gattrell.<sup>68</sup> Here not only was there the state direction we have discussed, but also a commensurate inability to fashion a defense strategy with any sense of Russia's real interests, resources, or priorities. Therefore the government tried to have it all on land and sea and only brought itself to ruin.<sup>69</sup> If, as we suggest, a comparable incoherence and covert political agenda lies behind current defense economic policy that cannot be

sustained, the results could be just as profound, if hopefully not as violent.

Finally there are other alternative outcomes, e.g., those implicit in a recent CIA study that the Yeltsin government cannot stop the sale, smuggling, or transfer of technologies used in weapons of mass destruction or missile technologies that violate the Missile Technology Control Regime.<sup>70</sup> When one includes the fact that there is no true civilian control of the military that is pervasively corrupt, a meaningful and strategically controlled defense economic program becomes virtually impossible. But in all these cases there is no true basis for a liberal, democratic, truly "civilian" state.

### **Current Policy Trends.**

Today the struggle goes on between the forces who want to perpetuate the close state-director-entrepreneur relationship outlined by Kokoshin or revert backwards to one still more closely tied to the past and those who want real progress and the abolition of the old Military Economy. In July 1994, Yeltsin decreed its abolition, but at the same time current trends in military policy point to the logic of policies based on the older series of relationships or Kokoshin's dangerous plans. These trends demanding broad state support for defense industry found expression in the November 1993 *Basic Provisions of the Russian Military Doctrine*. Along with the high-sounding phrases about the need to reform and update the military economy to the demands of the present and future high-tech age and market economics is the requirement to develop defense-industrial potential by a package of measures to be elaborated and implemented "to ensure the mobilization readiness of the economy and the creation of state mobilization reserves."<sup>71</sup> This document also stressed the "priority significance" of restoring mutually advantageous ties with the defense industry and R&D sectors of other CIS states.<sup>72</sup> Conversion is mentioned only in passing and the weight of the section on defense economics falls on devising a rational way to minimize the move to markets. One way is the projected reintegration of the CIS and the other is through the mass sale of arms abroad.<sup>73</sup> What is still more disturbing

in this context is Defense Minister Grachev's reiteration of the Soviet claim that this is a normative document whose recommendations approach juridical law and should therefore be binding on all state organs including the economic ones, a clear sign of an MOD effort to take control over all aspects of policy and further elude civilian control.<sup>74</sup>

Though Kokoshin and Grachev claim that they significantly reduced mobilization assignments in 1992 and will do so again in 1994, it is not clear that this process can succeed over time, which is the only way it can work.<sup>75</sup> After all, the cartellization and subsidy relationship, over time, will grow stronger and more resistant to countervailing trends. Both Shlykov and Dubinin show how colossal overproduction continues.<sup>76</sup>

Unless Yeltsin's recent decree on reducing mobilization capacities and reserves is for real, that situation will continue since many such decrees routinely go unfulfilled.<sup>77</sup> Implementing Yeltsin's decree would mean the government is ready to face the mass unemployment and bankruptcies entailed in such decrees and the socio-political pressure from labor and management. However, the recent decrees on bankruptcy, whose aim is precisely to avoid unemployment and subsidies to unprofitable industries, suggest an opposite conclusion.<sup>78</sup>

Yeltsin's decree of July 13, 1994, called for a new mobilization plan on the basis of a dramatic reduction in the existing one by a "multiple factor in comparison with the existing one." The new plan would also include a narrow range of critical military production, not a comprehensive plan for all output. It would additionally withdraw industries whose output has a lengthy production cycle from the economy's mobilization plan. The government will also establish a procedure for removing previously established tasks to reduce mobilization reserves whose maintenance is inexpedient. New mobilization requirements will be announced to industry as a state order.

The intent here is to subject future production to the actual needs of the armed forces, not producers' wishes. Yeltsin's decree also aims to overcome the Soviet legacy by channelling

state orders to dual-use production and to repudiate the practice by which large defense plants, to amortize their costs, produced all kinds of civilian technology as well, but did so shoddily. Enterprises under the mobilization system's military production plan can now cancel tasks linked with preserving mobilization capacities as the mobilization reserve declines and is changed into a state order. Similarly, those enterprises in the current plan can discontinue holding capabilities for production lines that were terminated in 1991. And they can sell the assets freed as a result of the decline of the reserve to gain capital and free themselves of the cost of maintaining those assets. Finally, after repayment by these firms of bank credits with the proceeds of these sales, the proceeds will go to replenish the defense firms and be credited to the federal budget.<sup>79</sup>

It is too early to tell how this is working since it is only a call for a plan to terminate the old system and switch over to the new guidelines. But while it is laudatory in intention, it is not clear if it can be implemented since the state has defaulted on trillions of rubles it owes to the defense industry already or has resorted to constant sequestration of budgetary funds to avoid paying its obligations. It is of little avail to recast the whole system at a much reduced magnitude and as a state order if the government cannot and will not pay for those orders. Therefore, it is not clear that if enterprises do successfully recapitalize themselves under this guideline, they will then return to defense production or that they can, on the other hand, produce quality dual-use goods for both civilian and defense industries. That would then bring Cooper's concerns, cited above, to realization. Accordingly, even if this decree's implementation is relatively good (a dubious assumption), it is not clear that enterprises will be either sufficiently flexible or capitalized or willing to provide Russia with the defense industry its doctrine calls for. This outcome would, in its own way, underscore the disparity between means and ends that has bedeviled Russian strategy.

Bereft of state funding, defense enterprises will soon face the so-called "brutal" conversion stemming from two sources. These are the reduction in procurement and the fact that the

government does not pay them either allocated budget expenditures or debts for orders such as those Dubinin cited. Nonetheless, since 1992 they have continued producing in excess of orders through the use of these unaccountable and uncalled-for mobilization reserves and through the expectation of credits, bailouts, and the like.<sup>80</sup> Even before this decree, which would terminate subsidies if the government is consistent, there were cries that many firms are collapsing and cannot produce for the state. And while sale of these assets is to be welcomed, it is neither clear that there is a market for them or that firms, once their debts are paid, can then turn around and produce as the government expects. In other words, to be healthy the defense economic program must go beyond reforming the mobilization system to stabilize the budgetary process and a growing market economy. Then and only then can Russia surmount its traditional disparity of too many strategic priorities and enemies and an inadequate resource base. To solve the defense economy's crisis the government must now solve the current budget crisis.

### **The Budget Crisis.**

By mid-1994 the debt problem and the government's inability to spend more on the defense industry lest it retrigger a massive inflation and forfeit IMF support brought the defense industry to a major crisis. Under conditions of stringent deflation to limit state spending and meet foreign targets for low inflation, the government submitted and the lower house of the Parliament passed a tight military budget of 40 trillion rubles in June 1994. The MOD had asked for 87 trillion in its budget request and consistently raised the specter that defense industries will collapse and the armed forces mutiny if this budget goes through. That is because procurement will be further slashed to make way for the armed forces' main budgetary outlays, housing and social spending on the men, including contract recruits. As Pavel Felgengauer writes, the new budget will leave an army of only half-starved conscripts; close down the MIC without any sort of conversion; and means the disintegration of the army, loss of fighting capability, and perhaps, most important, its manageability.<sup>81</sup> In this context,

the disintegrating but ongoing situation in the military economy has added to pressure for outside sources of support, salvation, and, to be frank, corrupt acquisition of foreign currency through arms sales.

Since the government owes defense industry four trillion rubles (at the time of this writing), further spending cuts without subsidies could mean that industry's collapse with the social catastrophes inherent in the breakdown of a vast system of attached labor and industry that can only trigger demands for massive inflationary spending. Thus, Kokoshin recently observed that unless this nonpayment problem is overcome, industrial decline and the decline in government revenues from taxes on industry that go to finance defense cannot be surmounted.<sup>82</sup> But the government cannot spend this money and meet its budget caps that are imposed by the need to fight inflation and comply with the IMF. As Kokoshin noted in March 1994,

For example, a government decision was made previously that the defense state order for 1994 and for the subsequent two years will remain at the 1993 level. But now we have received instructions to make an additional correction, inasmuch as keeping the state order at the 1993 level under conditions of a further drop in the level of the GNP and of industrial production will signify an increase in the proportion of the defense order, which the government cannot undertake. You can imagine what a wave of problems again faces us.<sup>83</sup>

This crisis has galvanized the entire Russian political community, particularly the defense industrial sector. Industry and its spokesmen bitterly decry the previous failures in conversion, the inability to fund it, the maladministration that plagued it and so on. These failures date back to the start of the reform program in 1992 when, according to A. Shulunov, President of the Enterprise Assistance League, 70-80 percent of credits and funds for conversions in 1992-93 came at the end of the year or never reached the enterprises. Essentially these credits went to form and consolidate commercial banks.<sup>84</sup> Likewise, not a single federally targeted conversion program was funded normally.<sup>85</sup> As a result the defense industry was a shambles by 1994. His answer is that the state

must assume responsibility for retooling industries, import substitution, introduction of energy and resource conserving equipment, and transfer of dual-use technologies to the civilian sector.<sup>86</sup>

But given the government's record to date and prevailing economic conditions, this recommendation, like those before it, betrays Russian elites' continuing inability to overcome the shackles of statism and economic utopianism. More prosaically, as well, the continuing struggle and budget crisis both point to the failure to devise a defense program commensurate with Russia's real economic position. This failure pervades modern Russian history, Tsarist and Soviet. But if it remains unchecked, it will lead to a revival of the past tendencies to strategic utopianism regarding Russia's capabilities and statist forms of defense and general economic administration. In that case at the very least the current crisis will be further protracted.

However, that does not deter the utopianists. One of these is Mikhail Maley, a former advisor to Yeltsin and now Chairman of the Security Council's Inter-Departmental Commission for Defense Industry and Scientific Issues. Maley's position obviously makes him an insider on these issues. Previously, Maley bitterly criticized the confusion and incoherence of past policies and strongly advocated state control as embodied in the newly formed *Rosvooruzhenie*, the new state arms sales organization. He acknowledged that only 25 percent of current capacity in the defense industry is needed. But if Russia let the rest of it submit to the market's criteria, an enormous tragedy would occur. Even so, arms will be the second source of hard currency for the state. After the petroleum complex (in which this industry is also heavily involved-author) the defense industry's annual potential is \$8-12 billion in cash. Because it only needs \$6-7 billion of this sum, it could transfer annually \$2-4 billion to the treasury!<sup>87</sup> Meanwhile Maley claims this industry is arming the armed forces and Russia will always outstrip other armies in the quality and quantity of arms--and at no charge to the MOD since it will be at the expense of foreign defense ministries who buy the weapons.<sup>88</sup> He is also a staunch believer in a presidential regime and is not shy about

using outright economic warfare against other CIS republics to reintegrate their defense economies with Russia's.<sup>89</sup>

It is simply unbelievable that such delusions are given wide public support, expression, and credence at this date. For example, a top-secret Foreign Intelligence Service memorandum from 1992 by the FIS' director Nikolai Golushko admitted that Russia's submarine fleet is not combat effective. Thus U.S. SSBNs had and still have tremendous superiority over Soviet/Russian ASW, (anti-submarine warfare) to the degree where they can deliver strikes and remain undetected. In 1992 Golushko observed,

**The seriousness of the matter lies not only in the fact that the Ministry of the Shipbuilding Industry is removing the urgency of struggling for acoustic superiority of our submarines. It is disorienting the levels of authority, reporting the approximate equality of the noise level of our third-and fourth-generation nuclear-powered submarines being built and being designed with U.S. Navy nuclear-powered submarines, and thereby is misleading them about the actual combat capabilities of our maritime strategic nuclear systems.<sup>90</sup>**

This deliberate misinformation or disinformation of the leadership apparently continues as Maley's remarks indicate (who, after all would buy such weapons?). And the editor of *Stolitza*, which ran similar articles, complained that it is impossible for people independent of the MIC to express themselves in "their" military journals and papers.<sup>91</sup> Indeed, Yeltsin's belief that defense exports can save the defense industry and armed forces, which are also competitors in the arms market, led him to rebuke the MOD and Grachev publicly when they complained that defense was not getting sufficient budget authority. Yeltsin rebuffed their warnings of catastrophe and told them to get money from arms sales, from non-budget sources, and cut manpower and procurement.<sup>92</sup> But it remains to be seen who will prevail here, for how long, and how.

The budget issue is not only a question of a trial of strength between the Parliament and the military-industrial complex or between the inflationary forces in Russia and the IMF. Rather it cuts to the heart of the failure to reform the MIC sufficiently. Because Russia can no longer support its military-political and

even imperial pretensions, a fundamental crisis will ensue however this decision is resolved. Inflation has been kept down simply by not paying people's salaries and hoping that they will find their way into privatized employment. Yet even those firms cannot survive confiscatory taxation, rampant corruption, and the breakdown of suppliers' links as production continues to fall. For instance, in education, as of June 1994, the government has only paid for 10 percent of the research expenses for which it has contracted, a situation that resembles that of military procurement discussed above. Either it pays the money to those whom it owes, stimulating a massive inflationary explosion, or the government refuses to grant the money that the military legitimately believes is coming to it. Either alternative risks a total crash. In either fashion the masses will be fundamentally expropriated from above, a not unfamiliar phenomenon in Russian history, and what Vladimir Zhirinovskiy calls the government of swindlers will be exposed for either having run Russia into inflation and depression and/or destroying its military might. This is what is at stake in the struggle over the budget and the perpetuation of the *Voennaia Ekonomika* through the mirage of arms sales, subsidies, and the chronic overproduction at irrationally high costs and prices.

### **The Crisis of Russian Strategy.**

It is not enough to observe that the passage of the budget means that Parliament is not responsive to defense lobbies.<sup>93</sup> Indeed, the defense outlays do not cover the whole of military spending. Rather the issue is what kind of defense industry and establishment can Russia afford if reform is to have a chance? In that context several factors, including defense spending, become apparent. First, this budget is quite unrealistic and cannot be maintained. Second, good reasons exist to believe that substantial hidden military expenditures lie elsewhere in that budget. Third, by any standard, Russia is still excessively militarized. A disproportionate number of people are under arms relative to its population, and its economy still suffers from the old mobilization system. Fourth, the previous three aspects of Russia's budget and defense economic policies strongly suggest that Russia has not yet reconciled its military

aspirations and needs with its economic realities. And fifth, if Russia is unable to balance these two needs, it will mean the obstruction of general reform. In that case the prognosis for democratization and demilitarization also remains guarded at best.

That the budget is unrealistic seems indubitable. The budget resolution obligated the government to keep the deficit to 10 percent of GNP. But the tax revenues collected through March 1994 were only 20 percent of that period's GDP, down from 33.3 percent in 1993. Thus central revenues fell by over a third. Inflation fell in the first half of the year mainly because people, including officers and soldiers as well as workers and the defense industry, were not paid (a classic anti-labor deflationary strategy). This clearly cannot go on. In fact, it had already begun to change in the spring of 1994 when the regime put more monies into the economy, raising the inflation rate and government deficits. This inflation led to counter-responses of excessive interest rates, a lack of confidence which inhibits investment, and rampant tax evasion. Since the commodities market is now dropping and Russian export revenues depend on that, in effect the budget is already based on a series of fictitious premises. And when the Duma passed the budget, the budget target for inflation was already fictional since the deficit was already 11 percent of GDP. Inevitably inflation will soon run upwards again.<sup>94</sup> In fact, it climbed spectacularly in the last four months of 1994 and will keep climbing due to the Chechnya invasion. Therefore, current trends also retard a revival of domestic investment, civilian or military.

Second, despite the MOD's complaints that soldiers will mutiny and that social unrest will grow due to the refusal to spend over 40 trillion rubles in the budget, other sources, including military men, admit that substantial sums are hidden elsewhere in the budget or by non-budgetary appropriations, i.e., they are off the books. Arms sales will or could cover the gap. Therefore the sales will not go for conversion which will be pushed back further, thereby perpetuating (inevitably) the old mobilization system.<sup>95</sup> One analyst who went through the budget clocked up 80 trillion rubles in hidden items that directly

pertain to the military and military industrial sector of the economy, a figure equalling 65 percent of the projected revenue of the state budget (which, as we have seen, cannot be in any way realized).<sup>96</sup> And this figure does not include the upkeep of military commissariats, severance pay for draftees into the army, training at colleges, of reservists who are workers in and trained at defense enterprises, or the income from sales of military property.<sup>97</sup>

It should be noted that some of these critics are themselves officers who conclude that military reform, as it was understood, has not really taken place. Instead the country remains overmilitarized. Yeltsin and the Chief of Staff, Col. General Kolesnikov, have on separate occasions recently calculated 3 or 4 million men currently under arms in all branches of service: Army, Navy, Air Force, Border Troops, Strategic Nuclear Forces, MVD Troops, Railroad troops, etc.<sup>98</sup> This is being supported by a population of 147 million that is shrinking! Yet defense capability is not being enhanced. The usable military force of all these people is probably no more than 250,000 for all of Russia and the CIS as draft rates plummet and shipbuilding has almost totally come to a halt.

For all its military and defense investment, Russia still gets a miserable return in terms of improved military quality or capability. Yet the government apparently sees no way out other than to postpone conversion yet again, maintain crushing expenditure levels, and refrain from truly marketizing its defense industrial sector to produce high-quality goods that civilians and military purchasers alike will want. Although Yeltsin demanded just that of the MOD by telling it to cut procurement and manpower, the fact remains that it cannot even meet the subsequent manpower target of 1.9 million men in the army.<sup>99</sup>

Plainly Russia cannot even afford the reduced military power it now has. Further reform is essential if the society's productive forces are to be optimized to their full potential. And that is the only way economic and political reform will take place. Only when the state is not organized to be the defense industry's cash cow and when it no longer sees itself as obliged constantly to prepare for war, will it overcome this eternal

Russian dilemma. Right now, despite the MOD's complaints, it funds civilian research in technology—an inherently wasteful procedure especially in peacetime.<sup>100</sup> But there is no way out since research funding cannot be found elsewhere.

On the other hand, there is little time to lose. In September 1994 the Moscow electric authorities suspended all power to the national Strategic Nuclear Missile Command for nonpayment of bills, monies the MOD claims it cannot afford to pay.<sup>101</sup> There had been warnings by Kokoshin a month earlier that something along the lines of this farcical and dangerous contingency were imminent, but nothing was done.<sup>102</sup> The incident has given added fervor to the MOD's cries of despair which now include an inability to pay for international disarmament commitments, collapsing defense industries, and further technological decline in defense relative to other states.<sup>103</sup> But while there are signs of increased government sympathy for the MOD and MIC, their appetite shows no sign of slackening.<sup>104</sup> Even though preliminary figures for 1995's budget shows state revenues falling by about a half, Kokoshin proposed a 60 trillion ruble allocation for 1995, 50 percent more than in 1994, to stem this technological decline. Others, like Petr Shirsov, Head of the Upper House (The Federation Committee) of Parliament's Defense Committee, advocated an 80 trillion ruble allocation.<sup>105</sup> Thus, if anything, the interaction between efforts to control the armed forces and defense industry and to create a strategy that balances objectives against real resources will grow more acute. And the consequences of that dual struggle will be more profound.

If the past is a sign for the future, demilitarization of the economy faces a rocky and halting future. In that case, the failed reform of the old mobilization and soft-budget economy will inevitably strengthen the MOD and MIC lobbies. Failure to reform the old system will make them preeminent political forces in Russian society that would have uniquely privileged access to the state's revenues and assets. Those interests will then remain a constant force for expanding the state to the old Soviet borders, another tragic delusion. At the same time this system will not enable Russia to keep up with the revolution in

military affairs; thus it will fail to make Russia militarily competitive, its ultimate rationale. To prevent this outcome tough institutional, fiscal, and legal controls on those sectors must emerge in tandem with an end to the subsidies, credits, and privileges that allow them to extract billions from Russia but return an inferior military machine. The continuance of this state of affairs and of this sector's primacy inevitably distorts the state's preferences, policy, and posture and not in favor of democracy and peace. Four years after Gorbachev, Russia's demilitarization remains a fundamental but unachieved objective and prerequisite of lasting reform. As long as the MIC and the MOD grip the state's imagination, Russia's abiding strategic dilemma of a claim to a role that it cannot sustain will continue. While that remains the case, neither Russians nor their neighbors can claim security or democracy.

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