



Russia's defense spending and the economic decline



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ABSTRACT

The purpose of this article is to explore the development of Russian military spending in light of weak and negative growth of the Russian economy and to look at the reasons for the economic decline that has developed after the economic crisis in 2009 and is due to long-term internal structural factors that have existed since the mid-2000s. The confidence crisis resulting from Russia's aggression against Ukraine 2014, Western sanctions and falling oil prices has further aggravated these tendencies and the economy is now contracting. The main conclusions are that the share of the defense budget in GDP has risen substantially, but there is still a trade-off between defense and other public spending in the budget. Political reform would be necessary to implement market institutions and revive the economy.

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1. Introduction

Russia's aggression against Ukraine in 2014 and the intensified economic decline that followed have changed the conditions for Russian military spending. For a decade Russia's geopolitical ambitions have been reflected in increased defense spending. Since the economic crisis in 2009, however, Russia has experienced low growth for several years; in 2015 it is facing a substantial contraction of GDP, and growth prospects are weak for the foreseeable future. It follows that continuing to give high priority to defense will become more costly in terms of other public spending. How far is Russia ready to go in giving precedence to defense over other public expenditure under these new circumstances? Will the high level of defense spending be maintained or will it be adapted to the new economic conditions?

Russia's military expenditure became increasingly noteworthy as it rose in the 2000s, and it became even more relevant to study its development as Russia started to challenge the new security order in Europe that had been formed after the end of the Cold War. In his speech to the Federation Council on 25 April 2005, President Vladimir [Putin \(2005\)](#) claimed that "the collapse of the Soviet Union was a major geopolitical disaster of the century". Two years later, in his address to the Munich Conference on Security Policy he described the unipolar world that developed after the Cold War with the US as the only superpower as "unacceptable" ([Putin, 2007](#)). The war with Georgia in 2008 made it clear that Russia's geopolitical ambitions were real and not just slogans for an audience at home.¹ It showed that Russia was ready to use force to protect its "sphere of influence". A military reform was introduced in 2008 aiming at modernizing the Armed Forces and giving them a "New

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¹ When Georgia and Ukraine pursued attempts to join NATO in 2008, this was too provocative for Moscow.

Look”² thereby building contemporary military capability in terms of both advanced technology and professional personnel. The reform signaled that the defense budget would continue to be a priority and also that the leadership was opting for more capability per ruble spent. In support of the reform, a new ten-year state armament program was launched in 2011, which aimed at rearming the Armed Forces with up-to-date arms and support systems up to 2020.³ The armament program led to yearly arms procurement rising as share of GDP, and concerns about cost-efficiency and value for money became more pronounced in the Ministry of Defense’s procurement policy.⁴

The purpose of this article is to explore the development of Russian military spending in light of the changed economic situation and also to look at the reasons for the economic decline that has developed after the economic crisis in 2009. Attempts to modernize the economy have failed, which is due to a number of long-term internal structural factors that have existed since the mid-2000s. The confidence crisis resulting from Russia’s aggression against Ukraine, Western sanctions and falling oil prices has further aggravated these tendencies and the crisis.

The article starts by investigating the economic situation and military expenditure up to 2013 (section 2). In this section the factors behind the rise in the defense budget since 2011 are explored. The third section analyzes the long-term reasons for Russia’s weak economic growth after the economic crisis in 2009. Section 4 discusses Putin’s economic policy after he came back to the presidency in 2012. In section 5 economic policy and defense spending after 2013 are discussed, including the amendments to the original federal budget law for 2015 that were made in early 2015. Finally, the conclusions are drawn in section 6.

2. Military expenditure and economic growth up to 2013

Over the ten-year period starting in 2003, Russia’s military expenditure doubled, and in 2013 Russia was the third largest country in terms of military spending in the world, with annual expenditure of USD 88 billion and a sizable share of GDP – of 4.4 percent (SIPRI, 2014). This was on par with the share of GDP of the USA but high in comparison with the EU (27) countries’ average of about 2 percent (e.g. France has 2.3 percent and the UK, 2.5 percent; SIPRI, 2014). In value terms Russia’s defense spending was now considerably higher than that of France (USD 61 billion) and the UK (USD 58 billion), countries whose military spending was twice as high as Russia’s ten years earlier (SIPRI, 2014). Over just a decade Russia had managed to

substantially enlarge its defense budget, a strategic precondition for developing its military strength, for further reform of the Armed Forces and for pursuing the geopolitical agenda.

Figure 1 shows the GDP shares of military expenditure for Russia and the EU (27) countries in accordance with SIPRI’s data which are based on a common definition, which allows international comparison. It also shows the GDP share of the Russian defense budget which is based on a more narrow definition than SIPRI’s. The defense budget is the magnitude used in the discussions of allocations in the federal budget.

A fundamental condition for the increase in Russia’s military spending was its exceptionally high economic growth during the 2000s. Yearly average growth between 2000 and 2008 was 6.9 percent, a growth rate only challenged by China (10.4 percent) and India (6.7 percent) among the developing and emerging economies (IMF 2014; Kudrin and Gurvich, 2015: 4). During the later period, 2009–2013, including the financial crisis, Russia’s average growth was 1 percent, those of China and India 8.9 and 7.0 percent respectively (IMF 2014). The high growth rate in the first period was due to the economic reforms in the 1990s that led to structural change, productivity increases, integration with Europe and the rise in the oil price from an average of USD 19.60/bbl⁵ in the 1990s to almost USD 150/bbl before the dip in 2008. After that oil prices increased again, but growth did not pick up as expected after 2009–2010; instead it declined gradually.

Taking the 2000s as a whole, the Russian economy grew at an average rate of 6 percent per year, and so did the defense budget, with a fairly stable share of GDP of around 2.7 percent. Russia’s total military expenditure according to SIPRI’s definition amounted to about 4 percent of GDP during this period of high growth.

In 2011, when the military reform was introduced, the defense budget rose to 2.9 percent of GDP and the three-year budget for 2012–2014 anticipated an increase to 3.2 percent of GDP in 2012, to 3.7 in 2013 and to 3.9 percent in 2014 (Oxenstierna & Bergstrand, 2012, 63). The actual result for 2012 was a defense budget of 2.9 percent of GDP, thus lower than planned, and in the three-year budget for 2013–2015, the defense budget’s share of GDP had been lowered to 3.1 of GDP for 2013. The shares of 2014 and 2015 were maintained at high levels of 3.8 and 3.5 percent respectively (Oxenstierna, 2013, p. 116).

2.1. Factors behind the increase in the defense budget

On the cost side several factors have affected the size of the defense budget. The main reason is the state armament program for 2011–2020, the increased personnel costs due to a higher share of contract soldiers is another, and finally the need to modernize the unreformed defense industry represent three major factors. The new armament program caused the yearly state defense orders (*gosudarstvennyi oboronnyi zakaz, GOZ*) to rise steeply, and this presented challenges to the existing procurement system

² “Novyi Oblik”. For an account of the military reform in 2008–2011, see Carlsson and Norberg (2012, pp. 97–111).

³ The state armament program for the period 2011–2020. RUR 19 trillion were to be spent and as a result 70 percent of the armed forces’ arms were to be modern by 2020 (Oxenstierna & Westerlund, 2013, p. 2).

⁴ Over the ten-year period 2000–2010 arms procurement as a percentage of GDP rose from 0.7 to 1 percent. With the new state armament program that share would double to 2 percent up to 2014. Then Defense Minister Anatoly Serdyukov challenged the industry over prices and opened it up for competition from abroad (Oxenstierna & Bergstrand, 2012, pp. 50–51).

⁵ In constant 1999 USD, bbl = barrels of oil.

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