Security Assistance Perspectives

Arms Exports in a Post-Soviet Market

By

Peter Almquist
and
Edwin Bacon

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With the collapse of the Soviet Union, a nation that had long competed with the United States for the title of world's leading arms exporter ceased to exist. From 1955 to 1989, the Soviet government exported weapons to 53 countries, including 22 customers in Africa, six in East Asia, three in Latin America, eight in the Middle East, four in South Asia, and even one NATO member (Greece). According to the latest figures from the U.S. Arms Control and Disarmament Agency (ACDA), these sales accounted for roughly 20 percent of the country's exports, totaling $19.6 billion in 1989 and more than $102 billion over the five-year period [1985-1989].

But starting in 1990, the Soviet government consciously attempted to reduce its arms exports. Soviet officials, citing the improved international climate resulting in part from changes in their international policies, promised reductions of 25-65 percent in their export of missiles, tanks and armor, aircraft, and ships, and proposed an international registry of arms sales. Soviet representatives bluntly told even traditional arms clients like Syria and Cuba that key arms requests would not be fulfilled. The Soviet Union also joined the rest of the U.N. Security Council in approving a total arms embargo, and subsequently the use of force, against its largest arms client, Iraq. Combined with the increasing disorganization of the military production system as the Soviet Union neared its last days, these new policies had a dramatic effect on total sales. One Russian estimate placed the 1991 earnings from arms sales at just $4 billion.

Ironically, several of the post-Soviet states are reversing this trend. Although showing a more cooperative, pacific face to the world, these new governments are less interested in limiting arms sales than in continuing arms exports to earn hard currency and preserve their military industries. These governments are mounting aggressive campaigns to regain "market share" lost over the last two years, and to establish new markets for the future. As Russian President Boris Yeltsin said this spring, the arms trade is "an enforced necessity for us today. It is a source of foreign currency, which is currently in extremely short supply. It is also a condition for supporting defense sectors." In May, Mikhail Bazhanov, chairman of the Russian State Commission for Conversion Issues, expressed the hope of bringing arms sales back up to $10 billion in 1992.

SELLING TO STOP BUILDING?

The massive Soviet arms transfers of the past were rarely the source of substantial profits, as most of the deals were financed with Soviet credits or grants, on extremely favorable terms for the buyers. As Bazhanov put it in a February interview, "we were virtually buying the weapons from ourselves." By 1991, according to Russian figures, the Soviets were owed 86 billion rubles for economic and military credits to the Third World.

The driving force behind these sales was political, not economic. Indeed, according to the ACDA figures, from 1985 to 1989, about 60 percent of Soviet arms transfers went to five key countries where the Soviet Union sought to maintain or extend its influence—Iraq, India, Vietnam, Afghanistan, and Cuba.

Nevertheless, key officials in Russia and the other states emerging from the former Soviet Union see continuing arms sales as a potential source of huge hard currency profits—which they hope to use, ironically, in part to help convert their military industries to civilian production. The idea, in effect, is to produce and sell arms now in order to produce fewer arms later.

The idea of large-scale conversion, redirecting some of the vast economic and technical resources being devoted to the military to deal with civilian needs, is a legacy of the Gorbachev era. Despite the confusion and failures that have characterized the conversion effort so far (see *ACT*, December 1990), the leaders of the new states remain committed to conversion. Yeltsin and President Bush, in a joint statement signed at the Washington summit in June, described conversion as "a key challenge of the post Cold War era and essential for building a democratic peace"—though they acknowledged, at the same time, the "hardships" conversion efforts might involve.

As originally conceived, conversion in the Soviet Union was to be accomplished through a planned program. By 1991, however, it was taking place haphazardly and spontaneously. Orders for weapons systems were slashed, with projects canceled with little or no notice in the middle of production runs. From 1988 to 1991, according to top Russian officials, production of strategic missiles was slashed by 58 percent, tanks by 69 percent, infantry combat vehicles by 80 percent, combat aircraft by 47 percent, and ammunition by 44 percent.

In theory, these cuts should have been offset by successful conversion to civilian production, or by some other assistance to the affected enterprises. In most cases, they were not. The Soviet government discovered quickly that converting existing arms development and production organizations was extremely difficult. And there were already those within the military industries who argued that converting from the production of good helicopters to poor ladders, for example, made no sense, when hundreds or thousands of ladders could be bought with the profits from one helicopter sale abroad. Defense managers wanted access to the hard currency their products could bring on the open market.

At the same time, many argued that the military industry was the only world class industry the Soviet Union had managed to create, and that it was critical to find a way to preserve it, rather than shutting it down. Conversion, originally intended to maintain and redirect this technological "jewel in the crown," risked destroying it through sudden and unplanned cuts in military spending, these advocates warned.

Finally, from 1990 on, the republics were demanding greater control over industry on their territory. They, too, wanted a piece of the military industry.

As a result, by early 1992, the states that replaced the Soviet Union, especially Russia, found themselves in control of a vast, sophisticated military industry with a huge appetite but collapsing demand. The head of the Defense Industry Trade Union estimated this spring that one in five military industry factories is currently on the verge of bankruptcy, and that twice that number would soon become unprofitable. And even deeper cuts are now being made in military procurement, which has been cut, according to Russian reports, by at least 60 percent from 1991 to 1992.

The problem of collapsing demand is especially acute in Russia, with 75-80 percent of the Soviet military industry, some 1,500 factories, 900 research and design institutes, and more than five million workers engaged in military or military-related work. With the deep cuts in military acquisition, some Russian industrialists have warned that 1.5 million people could be thrown out of work in the military industries by the end of 1992. Significant military industries are also found in Ukraine (with about 15 percent of the old military industry), Kazakhstan, and Belarus.

In such circumstances, it is not surprising that the political leaderships in these countries have turned to arms sales, both for direct economic gain and to preserve their military industries, which they see as important for security. Public advocates of increased arms sales now include Russian President Boris Yeltsin, Vice Chairman of the Ukrainian Parliament Boris Grinev, and Kazakh President Nursultan Nazarbayev, among other notables.

Yeltsin has promised to fulfill existing Soviet contractual obligations for weapons, and has made clear that the new Russian government will pursue additional arms deals. Responsibility for exports and for the military industry in general now rests with Vice President Aleksander Rutskoi, a hero of the war in Afghanistan who has become a champion of the military industry.

Rutskoi is one of several Russian leaders who have argued that many potential sales and clients have already been lost to other weapons exporters. A common justification for engaging in arms sales is that only competitors benefit if Russia withdraws from the arms market. The Soviet Union may have had a large share in the past, but, as Rutskoi put it, "the remainder was not sold by God descended from the heavens but by real producers, including the chief one—the United States. And only our rivals' lobbyists can push Russia toward a unilateral reduction of the arms trade."

These continuing U.S. arms exports have provided the military industrialists an oft-repeated argument to counter those who favored arms sales restraint. The head of the Russian Defense Industry Trade Union, for example, has claimed that the United States has increased its arms sales by 2.2 times since 1989, largely at the expense of Russia. Deputy Defense Minister Andrei Kokoshin, a long-time liberal who might have favored arms sales restraint, remarked to *The Washington Post* in February that "if other countries would have started reducing arms deliveries, this would have some effect, but it turned out that most democratic countries are not stopping arms sales but increasing them . . . . Naturally, it's very disappointing to our arms producers to see . . . other countries advancing on our markets." Nevertheless, arms sales are unlikely to be completely unrestrained. First, there is a clear consensus against any export of nuclear, chemical or biological weapons, or the technology needed to make them. Moreover, in January, Yeltsin announced his government's intention to abide by and eventually become a formal member of the Missile Technology Control Regime—though his government has since refused to cancel a rocket deal with India, prompting U.S. sanctions against a Russian company (see *ACT*, May 1992), and Russian complaints that the United States was motivated by market—not proliferation—interests. In the same speech, Yeltsin expressed his support for the guidelines on conventional arms sales the major exporters agreed to in London last year, which call for restraining particularly destabilizing transfers (see *ACT*, June 1992). Even General Mikhail Malei, Russian State Counselor for Conversion and one of the most fervent proponents of boosting arms sales, has spoken of barring sales to regions of tension, and of emphasizing the export of "defensive" weapons.

But the struggle over arms sales continues: both the London guidelines and remarks such as Malei's are so vague that virtually any sale could be justified. What weapons will be exported to whom remains very much an open issue, and arms sales proponents appear to have the upper hand. Moreover, in the political and economic disorganization now confronting many of these newly independent states, questions remain as to whether the systems of export regulations only now being set up will be adequate to control all the exports that should be limited—particularly in ambiguous "dual-use" areas, which can require considerable expertise to monitor.

MANAGING ARMS SALES

With the demise of the Soviet Union at the end of last year, the Soviet weapons export system was jettisoned, including the system of grants and credits that financed many of the sales. But just as the end of the Soviet Union led to the birth (or rebirth) of 15 new states, the elimination of one export system led to the need to create several new ones.

Before the collapse of the Soviet Union, arms export decisions were made by the Politburo, approved by the government, and implemented by the Military Industrial Commission (VPK, in its Russian acronym) and the Ministry for Foreign Economic Relations. The military appears to have played little role in arms sales, other than providing training and support through the General Staff's Tenth Main Administration. Production of export weapons was apparently arranged by the Ministry for Foreign Economic Relations, and as a result may have been outside the military's normal monitoring. Most of the income from these "government-to-government" sales went to Soviet government coffers, not to the industrial producers.

After the attempted coup in August 1991, the governments of Russia and the other emerging states claimed control over industries located on their territory, including arms manufacturers, and created new rules for international trade. In an effort to attract hard currency and foreign capital, the Russian government allowed most industries to conduct virtually unregulated trade with foreign partners. Arms trade, however, remained an exception, although several factories and design bureaus in the military sector were already pursuing nonmilitary joint projects and ventures with foreign firms.

Currently, the Russian government is establishing a new mechanism for government monitoring of arms sales. Yeltsin has announced that a special committee has been established to determine the volume, price, and licensing of arms sales. Vice President Rutskoi has described a "triple system" of control: a directorate under the Committee for Conversion Affairs to monitor imports and exports (presumably the committee Yeltsin described); a department of the Foreign Ministry to assess proposed arms sales; and at least one company to market the weapons. There have already been many requests for export licenses, but according to one official, there have been few approvals.

It is not clear what role the Russian parliament will play. Some deputies have demanded a role in approving exports, but there has been little sign that the Yeltsin government plans to meet these demands.

Despite the efforts of the Russian government, the export system is still confused, and it is still not clear who is authorized to sell weapons. At the beginning of this year, the chief designer of the MiG organization, R.A. Belyakov, complained that it has not sold an airplane in two years because there was no one to issue export licenses. "If we were allowed to sell just two MiG-29 fighters," Belyakov told a British journalist, "our plant would be financially secure for a whole year." Three cities have been authorized to market weapons produced locally. And although it has been reported that there is still only one company, "Oboroneksport," authorized to sell weapons abroad, other organizations also claim the right to do so.

One of the reasons for establishing an export system is concern over unsanctioned sales of military hardware, especially by the military or by newly formed "companies." Many of these companies, critics charge, are thinly disguised fronts for military or former Communist Party officials to sell for personal gain what should be state assets. For example, it has been charged that the navy has been writing off ships of the Black Sea Fleet and allowing one company, Nevikon-zyuyd, to sell them. The company was reportedly established by agreement between two vice admirals. *Komsomolskaya Pravda* reprinted an internal report to Yevgeny Shaposhnikov, commander in chief of Commonwealth of Independent States (CIS) armed forces, detailing several cases of the illegal transfer of property from the military to "entrepreneurial structures" made up of serving senior officers. Other republics are also grappling with establishing arms export systems, although the various procedures have yet to become clear or institutionalized.

A BUYERS MARKET

For many years, Soviet military equipment was seen as a bargain: easy to maintain, cheap, and often available on credit. As the new governments enter the world of capitalist arms sales, however, one of the first problems they will face is determining a realistic price for their exports, and ensuring that the price bears some relation to their actual costs. At present, producers appear to be relying on foreign competitors to establish a baseline price, which they then try to beat with discounts on their own versions. There is also a pervasive belief among some in the Russian export community that there is rough "dollar-ruble parity" in military sales, despite the more than 100-to-1 conversion rate that now pertains in most other transactions. In other words, they believe a Russian tank costing 1 million rubles is likely to be comparable to a western tank costing $1 million. The most optimistic believe that they can make $3-4 from arms sales for each ruble invested—a whopping return on investment of 300- or 400-to-one, given current rates of exchange.

In terms of hard currency, Soviet equipment was traditionally cheaper than comparable western products. According to Russian figures, the MiG-29 fighter, much admired by German pilots who inherited them from East Germany, costs from $20-25 million apiece, while a U.S. F-18A Hornet costs $40 million. Soviet tanks such as the T-72 cost from $1 -2 million each, compared with the $3 million price tag on a new Abrams tank.

A notable likely export is the SA-10 (also known by its Soviet designation S-300), an advanced surface-to-air missile system for both air defense and tactical missile defense, billed as superior in many ways to the U.S. Patriot—and, according to the Russians, much cheaper. Since the Gulf War, the Almaz Scientific Production Association and its director Boris Bunkin have been vigorously promoting the system; Bunkin has appeared at air shows all over the world, even suggesting at one point that the system might be sold to Israel. The price for the system has been reported in the Russian press as 1.5 million rubles (in 1991 rubles) for a complex including 12 mobile launchers, each with four missiles, compared to a Patriot price of about $1 million per missile. According to one Russian officer, an unidentified African country is willing to pay $50 million for an SA-10 facility. There have also been suggestions in the Russian press that the United States might even be willing to pay to prevent such technologies from being exported to, for example, Libya.

In general, however, prices and customers in the competitive arms market are seldom discussed officially, because, in the words of one Russian arms sales advocate, "if today I was to name just one specific country to whom we intend to sell weapons, tomorrow we would be selling them at least 15 to 20 percent cheaper to that country and others." In June, however, the Russian military press did report discussions with South Africa on buying Russian aircraft, lasers, and other high-tech products.

Ironically, one of the main selling points of Russian equipment, its comparatively low prices, may be undermined by the desire for hard currency profit. For the MiG-31 aircraft, for example, the Russian press has quoted prices ranging from an expensive $45 million to an astounding $100 million apiece. Latvia has reportedly turned to an unnamed European country for Kalaskhnikov rifles at $180 each; the Russian defense industry had quoted a price of $600. Yeltsin has promised that Russian weapons will not necessarily be the bargains that Soviet weapons once were. An export license "will be granted on the basis of competition, or . . . market prices set at a trade fair. The MiG will never be cheap. Tanks will never be cheap."

WHAT TO DO WITH THE PROFITS?

According to several Russian officials, the Russian government hopes to earn from $15-30 billion per year from arms sales—levels comparable to or greater than Soviet sales in the late 1980s, but without grants and credits to support them. "Weapons are," according to one, "direct dollar earnings."

How this money will be spent is presently unclear. Yeltsin, speaking to a meeting of CIS military officers, promised in January to "earmark the hard currency thus gained to build housing, mainly for the officer corps . . . What is planned is that out of the money thus gained, officers would get $1000 or $2000 or $3000 in order to be able to build a home of their own."

The military would also like to receive some of the profits from the sales of weapons to maintain its technological base. Complaining that in the past the Air Force only received three to seven percent of the sales price of aircraft, one deputy commander argued that a larger fraction of the profits from sales should be invested in aircraft development for the service itself. In March, Air Force Chief Petr Deynekin emphasized that paying for the troops' welfare was not the only motive for arms sales, saying: "We must not only think about providing pilots with housing . . . We must order new aircraft."

The most common recurring theme, however, is the use of arms sales profits to finance the physical conversion of military industries to civilian production. Estimates of the cost of such conversion run as high as $150 billion over the next decade, an amount that, according to Malei, could be obtained through what he calls "economic conversion"—redirecting the military industries to exports. Indeed, he told a group of Arab businessmen that the military industries, rather than cutting back, should be expanding to meet the anticipated demand. Even after using such sales to finance conversion to civilian production, General Malei envisions keeping the most efficient 40 percent of the existing military industry, and devoting it largely to continued arms exports for profit.

At the same time, a number of local governments are laying claim to the profits from arms sales. Three defense-dependent cities (Yekaterinburg [formerly Sverdlovsk], Severodvinsk, and Tula) are allowed to conclude their own agreements for weapons sales with CIS members or other foreign countries. Tula, for example, a major center for firearms production, will be selling weapons to Lithuania in exchange for consumer and construction goods and some hard currency (30 percent of the sale).

Ultimately, however, Russia and the other new countries will have to decide whether they wish to become dependent on arms sales, and whether they will be able to extract themselves from potentially profitable business relationships. If not, they risk undercutting the very conversion effort they claim to be supporting.

MARKET PRESSURES

Another problem for this "economic conversion" concept is that the enormous market for Russian arms these advocates envision may simply not exist. Without the extensive series of grants and credits that financed Soviet arms sales—but prevented them from generating much real profit—few traditional Soviet arms clients are likely to have the wherewithal to be multibillion-dollar customers. And it remains highly uncertain how successful Russia and the other Commonwealth states will be in finding new markets in states that did not traditionally rely on Soviet arms.

According to ACDA's figures, which do not include the growth in arms transfer after the Iraqi invasion of Kuwait, global arms exports are declining, with a fall of more than 25 percent from 1987 to 1989. More recent figures from the Congressional Research Service show that while there was an arms sale surge in 1990 associated with the Gulf War, global transfers to the Third World in 1991 were even lower than in 1989. The market among major traditional Soviet clients appears to have been particularly hard-hit. Iraq, the largest Soviet arms customer, is now out of the picture, as a result of the U.N. embargo. Few of the former Warsaw Pact states are likely to be buying many arms in the near term. Impoverished Cuba is not a particularly promising customer. Syria, unlike many other Arab states, has no oil money, and already owes billions of rubles on past purchases. India is also scaling back its arms imports.

With so many past clients suffering credit problems, the Russians are carefully juggling the demand for hard currency with the desire to keep customers. On the one hand, Russia is working to continue trade relations with the former Soviet republics, Eastern Europe, India, Vietnam, China, and Iran, while seeking new markets in Latin America, the Middle East, and Africa. On the other hand, the Russians have said they will not export weapons to "hot spots" such as Yugoslavia, and that arms sales to countries that have outstanding debts (such as Syria, Libya, and Iraq) or are unable to pay in hard currency (such as Cuba) will be curtailed. Given the almost desperate desire for sales, however, it seems unlikely that the Russians will impose a complete cash-and-carry policy, and sales will probably reflect a combination of cash, credit, and barter (as has already been the case in recent negotiations with India).

Another factor affecting the market is the impressive performance of U.S. equipment in Iraq and the comparatively poor job the Iraqis did with Soviet equipment. But the Iraqi experience may not have as devastating an effect on the demand for Soviet-designed arms as some have suggested. Most likely customers are concerned about a regional threat, and are unlikely to be planning combat with an extraordinarily well-armed U.S.-led coalition. In addition, much of the Soviet equipment in Iraq was old, locally modified (such as the Scud missiles), or, in the case of much of the force, evacuated to Iran. Indeed, Russian military officials have noted the successful participation of the Syrian tank forces in the coalition, to demonstrate the superiority of Russian-made armor.

Ultimately, Russian sales will depend on prices and after-sales service more than on apparent success or failure in Iraq. And the Russians are likely to be especially aggressive competitors.

Already, the news for Russian arms exporters is by no means all bad. Iran continues to be a major buyer, fueled by oil money and regional ambitions. Iran has reportedly ordered $6 billion in arms from the Soviet Union or Russia since 1988, including tanks, aircraft, and three Kilo-class diesel attack submarines. In the last few months, China has also committed to buy 24 Su-27 "Flanker" fighter aircraft, and future purchases are possible. The factory producing the MiG-29 reports more than 100 inquiries about buying its aircraft, and recently ran a half-page ad for it (complete with fax number) in the military newspaper *Krasnaya Zvezda*. And, of course, there will be sales to other members of the CIS: the Ukrainian Ministry of Defense, for example, has indicated that it will continue to buy aircraft from Russia because it can do so at a good price, and pay in rubles.

OTHER COMPETITORS

Though Russia will be by far the largest player in the arms trade, other former republics are interested in arms exports as well. The states most likely to be significant exporters are Ukraine and Kazakhstan, although Belarus has also expressed an interest.

Ukraine has more than 700 factories and design bureaus involved in military production. The major Ukrainian military plants have produced a range of military hardware from missiles and transport aircraft to ships, artillery, and tanks. Like those in Russia, these enterprises are scrambling to find new products and customers. Ukrainian leaders have emphasized that they are anxious to enter the arms export market. While the Ukrainian government has denied it is currently exporting weapons (and has actually refused to sell weapons to Somalia), an agreement has been signed with Czechoslovakia, and there have been reports in the Russian press that the country is quietly selling aircraft and helicopters internationally via German and Greek intermediaries. It has also been suggested that much of the struggle over the Black Sea Fleet is really a struggle over whether the Russians or Ukrainians will be able to sell it off.

The Kazakh government has announced its intention to export weapons as well, as a way to support the defense industry. Kazakhstan is best known as the home of the Semipalatinsk nuclear weapons test site, but it also has at least 38 military factories that are in financial trouble. In January, a group of military industrialists urged President Nazarbayev to promote exports to members of the Commonwealth and other countries. One of Nazarbayev's advisers argued that to not sell weapons abroad "would be simply irrational." Kazakhstan has reportedly already sold 500 heavy machine guns at $15,000 each to Germany. There are also reports that a new company, Paks Alisa, intends to export other weapons, including Su-24 medium-range bombers, for hard currency. Syria was mentioned as a possible customer for the bomber, and Nazarbayev has apparently explored commercial relations with India as well.

Ironically, the most direct competition Russian industry may have for arms sales may not be Ukraine or Kazakhstan, however, but the former Soviet military. With the deep reductions in the size of the military, surplus equipment is building up. Yeltsin has already authorized the Commonwealth air force to sell up to 1,600 surplus aircraft through the Russian Ministry of Foreign Economic Relations, and it seems likely that the military will seek authorization to sell other surplus hardware. In fact, the military may try to sell weapons simply to prevent them from being used in conflicts within the former Soviet Union.

CONCLUSION

Unfortunately, current efforts to control conventional arms transfers are fraught with obstacles and loopholes. The "Big Five" arms export talks, while a useful follow-up to the 1990 Soviet proposal for greater openness in the arms trade, are unlikely to bring more than increased transparency to the arms business. Much of the focus of the talks is on reinforcing the legitimacy of arms transfers that are stabilizing and that support a country's defense requirements, rather than on real restraints. Such notions are inescapably subjective.

The governments of the former Soviet states are reentering the arms bazaar with high hopes, large stocks, and incomplete export controls. The Russian and other governments of the former Soviet Union are under extreme pressure to export weapons in order to protect as much of their military industries as possible, and to earn hard currency. Their leaders argue that there is nothing wrong or immoral in such exports and, finally, that if they don't do it, their competitors will. Unfortunately, that is certainly correct.

ABOUT THE AUTHORS

Peter Almquist, a specialist in Soviet and post-Soviet defense industry, is the author of *Red Forge: Soviet Militry Industry Since 1965*. Edwin Bacon is a research specialist in the Department of Economics, University of Warwick, Coventry, England.