

## Kudrin's Complaint

### DOES RUSSIA FACE A GUNS VS. BUTTER DILEMMA?

PONARS Eurasia Policy Memo No. 254

June 2013

Brian D. Taylor  
*Syracuse University*

Since his removal as Russian Minister of Finance in September 2011, Aleksey Kudrin has repeatedly stated his disagreement with the government's economic policies. Indeed, his objection to state spending priorities was one of the principal reasons for his departure, and it remains one of the central obstacles to his return to government service. Specifically, as Kudrin noted in October 2011, if he determined budget policy he "would increase spending less on military needs than on health care and education." In April 2012 he stated that "budget expenditures on defense and national security of Russia should be lowered ... in favor of road construction, education, and health care." Similarly, in November 2012 he said that money for other needs should be "redistributed from the *siloviki*," and that the military did not need the amount of money which is being spent on them, arguing that the military rearmament program should be stretched out.

This memo investigates Kudrin's claim about Russia's guns vs. butter dilemma. I conclude that Kudrin is basically right. Indeed, the problem is even more acute than a guns vs. butter dilemma—it's a guns vs. guns vs. butter vs. butter dilemma. Russia will have a hard time meeting all its future obligations—external defense, internal security, and a range of domestic social and economic needs, such as health care, education, and pensions—unless Russia returns to the high growth rates that Vladimir Putin enjoyed during his first presidency. It is unlikely that Putin will be that lucky twice; if he can somehow pull it off, he will have earned his reputation as a great manager.

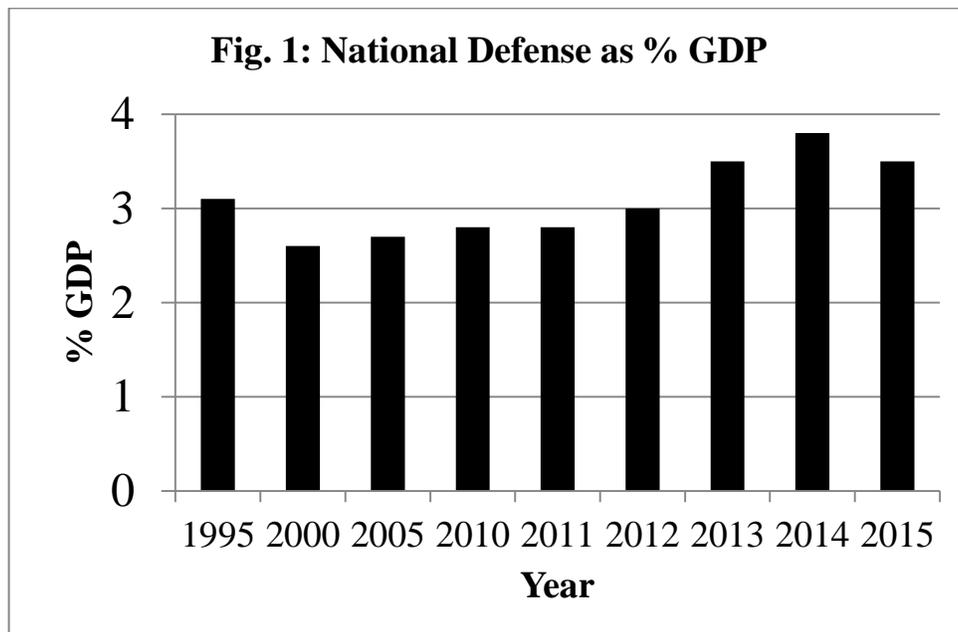
The next section of the memo provides some basic data on Russia's defense burden, which sets up the evaluation of Kudrin's complaint in the final section.

#### **Assessing Russia's Defense Burden**

A country's defense burden is typically measured in one of two ways: either as a percentage of GDP, or as a percentage of the budget. In the Soviet Union it was impossible to measure the defense burden in these two ways because resources were

allocated through centralized planning rather than meaningful currency units. Following the transition to capitalism, however flawed, the defense burden, and thus the opportunity costs of military spending compared to other possible uses, can be measured in a more straightforward manner.

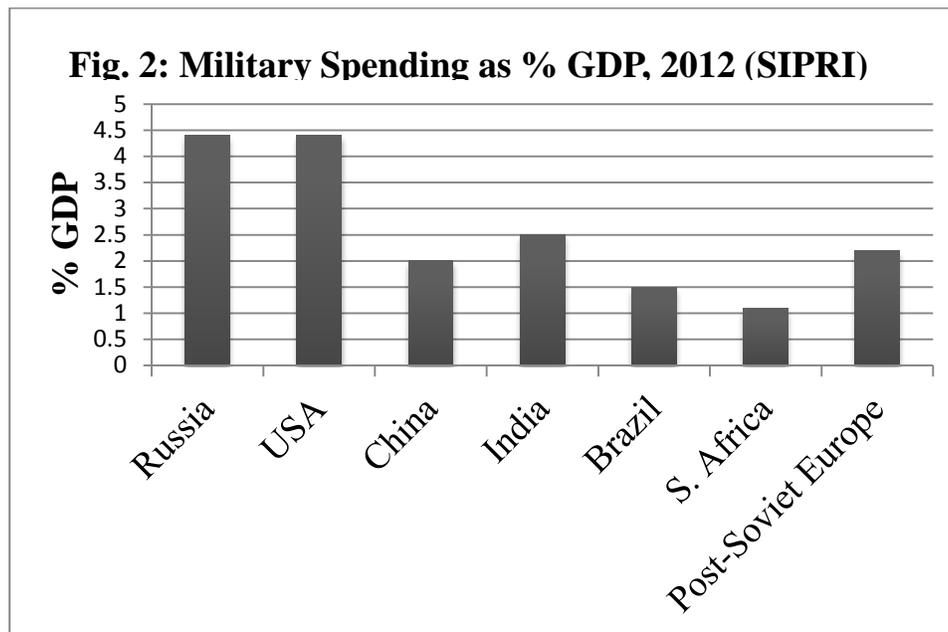
Using military spending—specifically, the “national defense” line of the budget—as a percentage of GDP, we can track the defense burden over the post-Soviet period. **Figure 1** shows that the defense burden on the Russian economy has been relatively constant from the 1990s through 2012, averaging in the range of 2.5-3 percent of GDP. Absolute spending levels more than doubled between 1999 and 2007, from 348 billion rubles to 822 billion rubles in 2007 constant rubles (i.e., adjusted for inflation), but rapid GDP growth over the same period of around seven percent a year meant that large increases in defense spending could be comfortably sustained. In contrast, projected defense budgets going forward are expected to increase to 3.5 percent of GDP or higher.<sup>1</sup>



The main reason the defense burden is supposed to grow is because of the ten year State Armament Program (SAP) announced in 2011 and running until 2020. The SAP commits the state to a 23 trillion ruble defense buildup, counting both the 20 trillion ruble procurement budget and three trillion rubles to be invested in modernizing the defense industry (non-procurement costs will obviously increase the overall defense budget further). The size of the burden as a percentage of GDP also will depend on overall economic growth; at the time the SAP was adopted, it was expected that the economy would grow at over six percent a year throughout the decade. If growth is slower than this, which seems likely, the defense burden will increase.

<sup>1</sup> Figures through 2011 are expenditures, 2012 figures are from the federal budget, and 2013-2015 projections are from the draft federal budget. Data from *The Military Balance 2013*, International Institute for Strategic Studies (IISS).

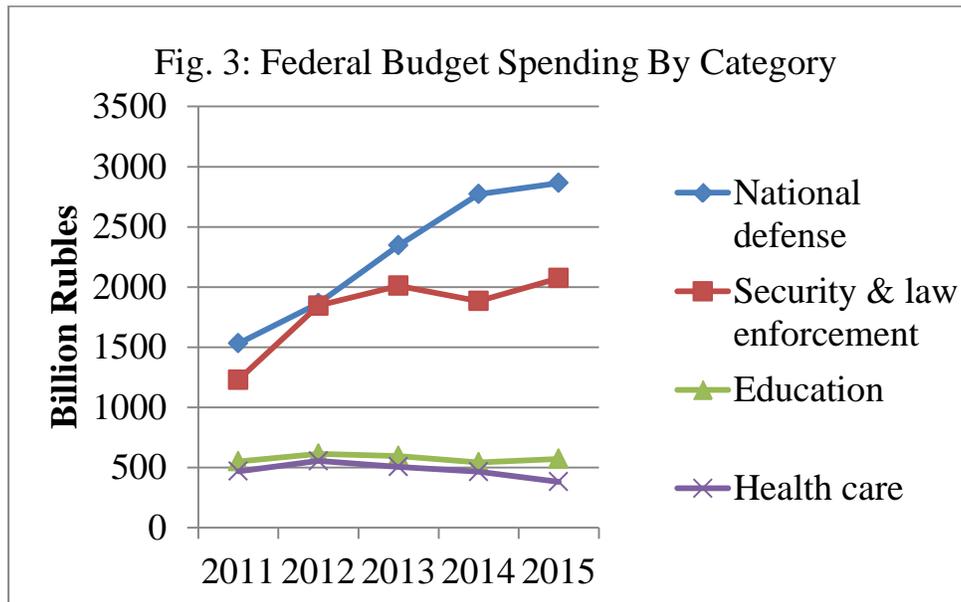
Is a defense burden of 3-3.5 percent of GDP a lot? This question is hard to answer in the abstract and ultimately depends on one's assessment of the severity of threats. To provide some context for the Russian defense burden, **Figure 2** shows military spending as a percentage of GDP for Russia, the United States, the other BRICS, and the average of the other European post-Soviet states (including the Baltic states, excluding the Central Asian states) for 2012.<sup>2</sup> (Note that Russia's military spending as a percentage of GDP is higher in **Figure 2** than in **Figure 1**. This is because **Figure 1** includes only the "national defense" portion of the state budget; SIPRI includes spending for some items, such as paramilitary forces, that are included in other parts of the official Russian budget.) Other international think tanks, such as the International Institute for Strategic Studies, also estimate that the actual defense burden in Russia is closer to five percent than the official 3-3.5 percent. Russia's defense burden is substantially larger than that of the other BRICS states, the second highest in post-Soviet Europe (after Azerbaijan), and on par with that of the United States.



The other way to measure a country's defense burden is as a percentage of the total budget. The defense share of the Russian federal budget is set to increase considerably in coming years, according to the official "Basic Directions of Budget Policy" for the period 2013-2015. The power ministries will claim a growing share of the budget, with big increases for the "national defense" and "national security and law enforcement" portions of the budget. **Figure 3** shows the projected trend from 2011-2015 for those two budget lines compared to two areas singled out by Kudrin, education and health care. The contrast between guns vs. butter is quite clear here. "National defense"

<sup>2</sup> SIPRI Military Expenditure Database, available at: <http://www.sipri.org>. Central Asian states omitted due to a lack of SIPRI data for 2012.

is set to climb from 14 percent of the budget in 2011 to almost 19 percent of the total budget by 2015. “National security and law enforcement” will increase from 11 percent to 13.5 percent of the budget (the big jump in 2012 was caused by the centralization of police funding). In contrast, combined spending on health care and education is set to decline from 9.2 percent of the budget in 2011 to 6.2 percent by 2015.



The trend toward defense spending taking an ever larger share of the total budget will only accelerate over the second half of the SAP, because most of the planned procurement is scheduled to take place between 2016-2020. Prominent Russian defense analysts such as Aleksey Arbatov and Mikhail Barabanov have calculated that, according to current plans, the defense budget will rise from 2.8 trillion rubles in 2015 to six trillion rubles by 2020. If we assume that the overall budget between 2015 and 2020 will grow at the same annual rate as it is supposed to between 2011-2015, a rate just shy of nine percent a year, then by 2020 “national defense” alone will have risen to over 25 percent of the total federal budget, up from 14 percent in 2011. Further, if the economy grows at four percent a year from now until 2020, which both Arbatov and Barabanov note is probably optimistic, defense spending would rise to six percent of GDP. If one makes adjustments like those made by SIPRI or the IISS for defense items not included in the “national defense” category, the defense burden would be even higher.

Two points are worth stressing about Russia’s defense burden. First, for the first two decades after the Soviet collapse, Russia’s defense burden was kept to manageable levels. Defense spending fell radically during the depression of the 1990s and grew during the boom years from 1999-2007, but as a share of the overall economy it has been relatively constant. Although somewhat high compared to many of its peers, arguably the defense burden has not been particularly excessive (unlike in the Soviet period). Second, if the Russian government over the next seven years spends as much on the

military as it has said it will, Russia's defense burden will grow significantly, both as a percentage of the overall economy and as a percentage of the federal budget. If defense spending were to climb to over six percent of GDP, Russia would move into the top ten countries in the world in terms of its defense burden, trailing only behind such big spenders as Iraq (11% of GDP), Afghanistan (11%), Oman (8%), Saudi Arabia (8%), and Israel (8%).<sup>3</sup>

### **Can Russia have Guns and Butter?**

Russia plans to buy a lot more guns by 2020, if the State Armament Program is implemented; for example, over 600 aircraft and over 2,000 tanks by 2020. At the same time, expenditures for key sticks of butter, such as health care, are projected to remain relatively flat in the coming years. The economist Evsei Guvrich notes that health care expenditures at 3.5 percent of GDP are well below the OECD average of 5.8 percent, while categories such as defense and security and pensions (9 percent of GDP vs. the OECD average of 7.5 percent) receive a bigger share of GDP than is typical. The issue of spending on pensions, which Kudrin has also criticized, provides a broader context for Kudrin's complaint. Pensions are 23 percent of the federal budget, and a relatively low retirement age coupled with an aging population means that social security spending will continue to grow unless changes are made in the current system. In terms of opportunity costs, high spending on defense, security, and pensions takes money away from investments in human and physical capital—the roads, health care, and education to which Kudrin referred. Putin and others have argued that a revitalized military-industrial complex (MIC) can be the motor for modernization and economic development, but in general the multiplier effect of defense spending is lower than that of other investment options. The logic of spending on guns and grannies, or bombs and babushkas, seems to be more political, in particular a desire to placate key Putin constituencies such as industrial workers and pensioners, than a strategy for long-term economic development.

How likely is it that Russia will remain committed to high levels of future defense spending, and what will be the consequences? One option is that Russia implements the SAP successfully, spending the projected 23 trillion rubles and gaining a much stronger military with better weapons. This option seems the least likely. Russia has not successfully implemented any of its previous post-Soviet rearmament programs, all of which had to be stretched out and only partially implemented. The current 10-year SAP is based on very optimistic, if not entirely fanciful, projections of the capabilities of Russia's MIC. For example, Barabanov points out that new tanks and armored personnel carriers are supposed to appear in prototype form this year and move into serial production two years later, whereas a more typical development period would be fifteen years. Given the shabby state of the MIC, such breakthroughs seem out of the question. Thus, although even liberal politicians such as Vladimir Milov have stated that

---

<sup>3</sup> See *The Military Balance 2013*. Note the IISS has no estimates for some countries, like North Korea and Cuba.

rearmament is badly needed, Russia will almost certainly fall short of the very ambitious goals it has articulated.

A more likely outcome, then, is that huge resources are devoted to defense spending and procurement, but that much of it is wasted or stolen. This would be the worst outcome from the Russian state's point of view, with all of the costs and only a fraction of the planned benefits. Already there are serious warning signs; in 2011, chief military prosecutor Sergey Fridinskiy estimated that every fifth ruble going to the MIC is "plundered." Not only are the production schedules exceedingly optimistic, the notional prices are also. Defense enterprises already have begun to boost prices significantly—for example, the cost of a BMD-4 light infantry fighting vehicle, designed for the airborne troops, has gone up within the last two years from 61 million rubles per unit to 80 million rubles. The ouster of the former minister of defense, Anatoly Serdyukov, in November 2012 was widely interpreted as a victory for the MIC over the armed forces, which with Serdyukov's support were trying to pressure defense industries to provide better weapons at lower prices, with the threat of foreign acquisition as a substitute hanging over their heads. When Serdyukov was removed, Putin directed the Ministry of Defense to work towards "stable, good partner relations" with industry—in other words, you have to take what they can produce, regardless of its price or quality. Some defense observers, such as Aleksandr Golts, saw a clear political motive here, with Putin concerned that workers at major defense enterprises continue to get defense orders.

A final possibility is that Kudrin's complaint is heard at the highest levels, and that the SAP is stretched out over a longer period of time, with less money spent and fewer weapons acquired. Indeed, the Russian government may turn out to have little choice on this issue, not only because the MIC is not up to the job but because the rate of economic growth may remain lower than anticipated; in May 2013 the Minister of Finance raised the issue of stretching out the SAP, pointing to slow growth rates. Future world energy prices are obviously a key variable here, which will affect both growth rates and the size of the budget, given that fifty percent of state revenues come from hydrocarbons.

Two other more political issues also could have a major influence on how Putin responds to this potential guns vs. butter dilemma, both of them related to how he has chosen to deal with the opposition movement. First, anti-Americanism has become a key feature of Putinist ideology over the last 18 months. Scaling back the defense buildup arguably would be inconsistent with Putin's apparent conviction that Russia faces serious threats from internal and external enemies. Second, and related, Russia faces not only a guns vs. butter dilemma but a guns vs. guns dilemma, or guns vs. nightsticks. As shown above, spending on both internal and external security is set to increase in coming years. Scaling back the numbers or pay of internal law enforcement and security personnel could be perceived as risky if the opposition is able to regain its momentum. A potentially telling indicator is that the Kremlin has decided that the Internal Troops of the Ministry of Internal Affairs should become completely professional by 2016 (perhaps coincidentally the year of the next scheduled round of parliamentary elections).

Prioritizing the professionalization of the 170,000 strong Internal Troops will make it even more difficult for the Ministry of Defense to meet the target established by Putin of 425,000 contractees by 2017 (currently the military has less than 200,000 contractees).

Given these cross-cutting political pressures and existing economic realities, it seems most likely that the planned defense buildup will have to be scaled back substantially, although perhaps not formally abandoned. Putin's dilemma is even more complicated than a guns vs. butter choice. It is also a choice about which guns and which butter—in the case of the latter, pensions or investment in human and physical capital in areas such as education, health care, and infrastructure development. Whether Putin sees these dilemmas acutely at the moment is difficult to say, but Kudrin seems correct in contending that they will have to be faced at some point.

---

Elliott School of  
International Affairs

THE GEORGE WASHINGTON UNIVERSITY

PONARS ● NEW APPROACHES  
E U R A S I A ● TO RESEARCH AND  
● SECURITY IN EURASIA

© PONARS Eurasia 2013. PONARS Eurasia is an international network of academics that advances new policy approaches to research and security in Russia and Eurasia. PONARS Eurasia is based at the [Institute for European, Russian and Eurasian Studies \(IERES\)](#) at George Washington University's Elliott School of International Affairs. The publication was made possible by grants from Carnegie Corporation of New York and the John D. and Catherine T. MacArthur Foundation. [www.ponarseurasia.org](http://www.ponarseurasia.org)