

# Enter Rosoboronexport

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## Coming On Stage

“Rosoboronexport” (ROE) is a tougher tongue-twister than “Yukos” or “Gazprom.” Yet the name is very much a symbol of the interests and motivations driving state-led resource consolidation that has swept Russia under the current Kremlin administration.

In December 2005, ROE made headlines when it seized control of the board of directors of Russia’s largest car-maker *Avtovaz*. ROE’s deputy head Vladimir Artyakov was elected chairman of the board; another high-ranking official became its new chief executive. There were reports that the takeover involved buying 62 percent of *Avtovaz* shares, though the exact terms of ROE’s financial relations with *Avtovaz* are still unclear. Around the same time, Russian media started speculating about ROE’s interest in Russia’s major truck producer *Kamaz* and *VSMPO-Avisma*, a privately-owned titanium producer with billion-dollar orders from Boeing and other major customers worldwide. After ROE officially confirmed its plans to buy at least a blocking share of this highly profitable metallurgical corporation in May 2006, the owners of the company, in reversal of an earlier position, conceded and agreed to sell their shares.

## Background

Who is this newly active player and how does its activity relate to the present phase of Russia’s socioeconomic transformation?

ROE was established in November 2000 to become, as its website declares, “the sole state intermediary agency for Russia’s military exports and imports.” ROE consolidated the functions of several agencies engaged in the military export business and sought to administer the entire flow of weapons and equipment sales to foreign markets. ROE has not succeeded in fully monopolizing military sales abroad: in 2005, about fifteen percent of Russian military exports belonged to some twenty weapons producers holding licenses for the export of end products or spare parts. The remaining 85 percent, however, falls under ROE’s control.

ROE tops the ranks of Russia’s least transparent economic entities. The only widely circulated indicator of its financial activity is the figure for Russia’s annual weapon export sales, announced at the end of each year. In 2003 this figure exceeded the \$5 billion mark, and since then has continued to grow. The accounting chamber, Russia’s supreme auditing body, revealed that in 2001 the state treasury received just four percent of what was due out of ROE’s net profit that year. The auditing report acknowledged that irregularities in ROE’s financial procedures were apparent but that the framework of its activity was so convoluted it defied meaningful control. In such a way, ROE has accumulated enough of what its officials call “saved profits” to start investing into defense R&D projects with solid export prospects. In addition to drawing upon its own assets, ROE has been able to freely attract credit resources from *Vneshtorgbank* and other financial institutions.

### **Patterns of expansion**

In its first five years of existence, ROE focused on profit optimization in its immediate sphere of “military and technical cooperation,” the official designation for Russian defense exports. Under its first director, Andrei Belyaninov, ROE spun a network of agreements with regional governments, defense companies, and federal players to secure its role as gatekeeper to Russian military products and services. Under its current head, Sergei Chemezov, ROE has pursued an aggressive marketing course: it has steadily expanded its markets, supplemented weapons sales with service centers in Greece, India, Malaysia, and Mexico, and run a tight schedule of international armaments fairs and tenders.

At the same time, ROE has become increasingly active on the domestic scene. As part of the defense industry reforms started around 2001, ROE lobbied for a specific model of consolidation that established “managing companies” to control the financial flows of newly integrated corporations. In these managing companies, ROE sought to place individuals closely associated with its own business. It failed to push this scheme through for one of the first “integrated structures,” air defense corporation *Almaz-Antei*, but it was successful, for instance, in the helicopter sector. In 2002, it initiated the consolidation of helicopter plants and design bureaus under a “multisector investment and industrial group,” *Oboronprom*, which eventually absorbed Russia’s two principal helicopter makers Mil and Kamov. Although ROE nominally holds only 31 percent of *Oboronprom* shares, Chemezov chairs the board of directors, and the helicopter

corporation often acts as a proxy for ROE's interests. Through it, ROE runs a joint venture in Jordan and a Russo-Belarusian financial and industrial group that specializes in air defense systems.

ROE has also expanded its activities from marketing and sales into development and production. In cases where future sales are secured by signed contracts, ROE offers credit guarantees or its own investment for the development of designated weapon systems. When investments are involved, ROE's self-proclaimed policy is to control these companies by establishing a presence on their board or by acquiring stock. At present, ROE representatives sit on the boards of practically all major defense producers.

By the start of 2006, signs of the true extent of ROE's ambition emerged. Occasionally snapping up some attractive assets within the defense sector gave way to a takeover spree across the entire economy. In the course of a few months, the media reported not only on the *Avtovaz* episode but also that ROE had considered acquiring *Kamaz* and possibly other truck makers to set up an integrated carmaking corporation; pushed through its advances on *Avisma* and revealed interest in consolidating other metallurgical enterprises; and set out to buy into Russia's two largest shipbuilding companies, at that time working on large export orders, with a view to a similar consolidation of the shipbuilding sector.

## Special features

Every acquisition by ROE has involved administrative pressures characteristic of the *siloviki* (security services)-sponsored takeovers of recent times. ROE is able to wield a wide array of administrative resources to achieve its goals. There are at least two reasons for this: the institutional advantages that result from ROE's original domain of activity, and the personal advantages of ROE's leader, Sergei Chemezov.

### Institutional Advantages

The fact that ROE works in the arms export business provides it with a number of advantages on the operational and political levels. One of these is protected nontransparency. Arms trade conveniently combines concerns of state security with commercial secrecy. This leaves the leadership of ROE a considerable amount of room to keep silent regarding the activities of their organization. Beside the export and import of military goods and services, however, ROE is licensed for a broad scope of operations covering, among other things, natural resources. Whatever activities ROE is engaged in, they are in practical terms exempt from public control.

Though ROE is not strictly one of the Russian "force" (*silovye*) agencies, it is formally under the Defense Ministry, and its director Sergei Chemezov comes from a pool of Putin's KGB friends. Of all the force structures engaged in asset redistribution, ROE probably maintains the most extensive commercial infrastructure, as well as a network of international connections, which serve as an additional resource for maneuverability and influence. ROE is unique in that it represents an already functional economic actor

that is fully incorporated into the present power system. Most other competitors for property and power in the Kremlin administration do not have similar bases.

Furthermore, dealing with Russia's material attributes of power imparts a special status to ROE that can be invoked for both business and political ends. A substratum in the Russian public discourse has propelled the theme of Russian excellence in making weapons into a positive identity marker and a source of national pride. ROE is well positioned to tap into this reservoir of patriotic sentiment, should it see fit. In their public strategy, ROE's leaders never fail to give themselves credit for the supposed acclaim for Russian arms around the world.

### **Personal Advantages**

The characteristic of Sergei Chemezov that is of absolute importance in the present hierarchy of political virtues is his close friendship with President Putin. Putin has been instrumental in Chemezov's career advancement. During an interview, Chemezov appeared to relish the question whether it was true that he belonged to a circle of just three people who can directly access the president any time of day or night. In his own account, the two of them have maintained friendly relations since working together, and even living next to each other, in East Germany on KGB missions in 1985-1988.

In his career, Chemezov has focused on the organization of foreign economic activity, since 1996 on behalf of the Russian government. He held the head position for foreign economic relations in Boris Yeltsin's administration and was the director of Promexport, the defense export state agency that in 2000 became a base for the newly organized Rosoboronexport. From his initial position as deputy head of ROE, and since spring 2004 as director, he has been a principal strategist of ROE's economic and political course.

Analysts in the resurging field of Kremlinology note that Chemezov began to display political ambitions already around 2001 and 2002 when he tried to get appointed either vice prime minister or presidential aide on defense industrial policy. His next surge of activism occurred in 2004 when he put significant effort into trying to change ROE's legal status to gain more freedom of action. In both instances, he had to step back. Two of Chemezov's self-confessed values, however, are self-control and the ability to wait. In his words, the arms business, where initial negotiations and a signed deal may well be separated by some five years, teaches patience and cunning. Observers concur that in 2006 Chemezov may be poised to push once again for greater political influence.

### **Learning a Public Role**

The signs of Chemezov's intent seem clear enough. The most evident is Chemezov's crossover from the inner turf of Kremlin insider games, opaque to most people, into a public policy space. In November 2005, ROE turned the celebration of its fifth anniversary into a sustained media campaign. The main themes were the "glory of Russian arms" and ROE's professionalism in selling them. Chemezov's interviews

appeared in top business and military periodicals. In May 2006, ROE took center stage in inaugurating the year leading up to the 60<sup>th</sup> anniversary of the Kalashnikov rifle, planned as a major “patriotic” propaganda event. A beaming Chemezov, in general’s uniform, posed at the side of 86-year-old arms designer Mikhail Kalashnikov.

In April 2006, Chemezov made a carefully prepared move to gain a foothold in the arena of public policy. He decided to use the Russian Union of Machine Builders, an effectively dormant association created in 2002 by industrialists who had sought to use it as a vehicle to represent the interests of their companies. Chemezov mobilized about fifty large companies to join the union’s original sixteen founders and called a general meeting to elect a new leadership. At the meeting, held on ROE premises, he and his deputy were elected to lead the union, the mission of which was defined as “active lobbying for the interests of the machine-building complex on regional, federal, and international levels.” The revamped association is an effective tool of political influence and also provides its leaders with a base for legislative initiatives.

The range of companies brought together to restart the Union of Machine Builders gives an idea of the sphere of influence already established by ROE in Russian industry. The companies represent effective, export-oriented, and, to a large extent, highly technological areas of production mostly in the defense sector, but also in the metallurgical and carmaking industries. With a view toward this constituency, Chemezov has stressed the superiority of technology-intensive defense exports over the sale of energy resources.

In a parallel effort, Chemezov has launched a new attempt to administratively strengthen ROE’s position. ROE was originally established as a “federal unitary enterprise,” a status which imposes legal constraints on its activities. ROE’s property legally belongs to the state; it needs authorization for any deals over five million rubles (just over \$200,000), and it must pay the greater part of its profits into the state treasury. Although these legalities have been largely manageable for ROE, they have complicated its operations.

To remove these constraints, Chemezov has pushed for the reorganization of ROE as a “state corporation,” which would provide it with greater independence of economic activity. The new status would provide ROE with the right to retain all its revenues and to have full discretion on how it uses its funds for investment and purchases.

The latest push for ROE’s reorganization reveals comprehensive planning and a determination to succeed. Preparatory work was done with the Federation Council and the Duma, as well as with the press. In December 2005, ROE hosted a special session of the parliamentary committee on defense to hold hearings on “improving” the legislation on military and technical cooperation, which resulted in approval for the set of proposals the agency was advancing. The draft legislation on ROE’s new status is now under consideration within the government. Although covert interest struggles between rivaling bureaucratic factions are no less intensive than before, Chemezov has invested his best resources into this legal effort and appears confident of its success.

## Conclusion

ROE has positioned itself for a principal role on the battlefield of corporate redistribution of national property. With its main base in the defense industry, it has stated an intent to expand further into major industrial sectors of the economy. It is building an increasingly visible public profile and probing new channels of political influence. It is not clear whether this new level of activity is driven mainly by the excitement of open opportunities on the Russian economic scene, or whether it is aimed strategically at the power struggle likely to arise with Presidential elections in 2008. In any case, Rosoboronexport is succeeding in bringing its set of comparative advantages into play at a time when the main action is just beginning.

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