

## **Chapter 7**

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### **Russia: The Second Putin Administration's Stance toward China and Focus on Asia**



In the elections to the State Duma (the lower house of the Federal Assembly of Russia) held in December 2011, ruling party United Russia suffered a loss in the number of seats, and this was followed by nationwide protests against Vladimir Putin. Nonetheless, in the presidential election held in the following March, Putin was reelected to the post of president with more than 60 percent of the vote. Putin's political base in this second presidency, however, is not as rock-solid as it had been, and this may lead to a change in his style of governance. On the diplomatic front in 2012, the Putin administration hosted a summit meeting of the Asia-Pacific Economic Cooperation (APEC) member economies in Vladivostok with the aim of promoting the development of East Siberia and the Russian Far East region, and showed its willingness for security cooperation with Japan.

The Russian economy held comparatively firm during the first half of 2012, but signs of a slowdown were seen in the second half of the year, due to the prolonged fiscal and monetary instability in Europe. This development has highlighted the structural fragility of the Russian economy, which is overly dependent on exports of natural resources to Europe. On the financial front, spending on social measures has been held down, whereas defense spending has grown rapidly, and the administration has placed priority on technological innovation policies that take advantage of the country's strong defense industry and technology infrastructure. As demand for Russian energy exports in the European market is currently sluggish, the Putin administration has begun to prioritize the country's further involvement in the East Asian markets, particularly China. However, as energy supply-and-demand trends in East Asia are uncertain, the Russian government is being forced to craft a strategic approach.

Turning to the Putin administration's military policies, despite the ongoing challenges in adequately procuring the latest weaponry and effectively buttressing Russia's defense industry, the military reforms instituted over a period of roughly four years during the tenure of Anatoliy Serdyukov as Defense Minister of Russia appear to have been reasonably successful in improving the capabilities of the Russian military, and the country has actively engaged in joint military exercises with the goal of strengthening international cooperation in the defense sphere. In November 2012, Governor of Moscow Oblast Sergey Shoygu took over from Serdyukov as defense minister, but no change has been observed in the basic direction of the military reform policy. While Russia has been pursuing military

cooperation with China, including through their Maritime Cooperation 2012 joint naval exercise, it also appears to harbor suspicions regarding China's military intentions, as is suggested by Russia's plans to strengthen its naval presence in the Arctic and the Far Eastern region. Russian arms exports continue to expand thanks to efforts to develop the new market for weaponry, and the nature of Russia's military technological cooperation with other countries is changing.

## **1. The Commencement of the Second Putin Presidency, and Focal Issues**

### **(1) The Aftereffects of the State Duma and Presidential Elections, and the Groundswell of Anti-Putin Protests**

The ruling United Russia party failed to gain a majority of the votes cast in the elections to the State Duma held on December 4, 2011, and lost seventy-seven seats from the 315 it had held before the elections, for 238 seats out of a total of 450. This meant that the party no longer possessed the absolute majority of 300 seats required to pass amendments to the Constitution. Conversely, major gains were made in the elections by the leftwing Communist Party of the Russian Federation, the center-left Just Russia party, the rightwing Liberal Democratic Party of Russia, and other parties.

The ruling party's loss of seats in the State Duma comes against the backdrop of rising public dissatisfaction with the rule of the country by United Russia's de facto leader, Vladimir Putin. In September 2011 Putin announced his candidature for the post of president in the upcoming election, and it was revealed that then premier Putin and then president Dmitry Medvedev planned to swap posts. From that point onward, a wave of opposition arose to this plan to change administrations without seeking the approval of the electorate, against the background of a widening feeling that the country's political system had been stagnating over the past few years under Putin's leadership, which has continued since the year 2000. The noted blogger Alexey Navalny, who is also a lawyer, has used the social media to lambaste United Russia as "a party of crooks and thieves," thereby helping to fan the flames of anti-Putin sentiment throughout Russia.

The share of the vote won by United Russia was only around 30 percent in St. Petersburg, which is the place of birth of both Putin and Medvedev, and the party sustained sharp losses in vote share in the rural areas of central Russia, in the

**Table 7.1. Results of the December 4, 2011 elections to the State Duma**

Party	Votes received			Seats gained		
	Number of votes	Share of vote	Gain/loss (%)	Seats	Gain/loss	Share of total seats (%)
United Russia	32,379,135	49.32%	-14.98	238	-77	52.88
Communist Party of the Russian Federation	12,599,507	19.19%	+7.63	92	+35	20.46
Just Russia	8,695,522	13.24%	+5.50	64	+26	14.21
Liberal Democratic Party of Russia	7,664,570	11.67%	+3.54	56	+16	12.45
Yabloko	2,252,403	3.43%	+1.84	0	0	0
Patriots of Russia	639,119	0.97%	+0.08	0	0	0
Right Cause	392,507	0.60%	new party	0	0	0

Note: Full proportional representation system. Seats are distributed only among parties receiving 7 percent or more of the total vote.

Source: Compiled by the author from the website of the Central Election Commission of the Russian Federation.

industrial cities of the Urals and Siberia, and in the Far Eastern Federal District. In some regions, United Russia ceded the position of leading political party to the Communist Party. Nevertheless, United Russia barely managed to retain a majority in the State Duma, due to the very high voting shares of 80–90 percent that the party achieved in regions such as the North Caucasus, over which Moscow exerts strong political control. As such, Putin's political authority seems to have been dealt a severe blow by the ruling party's electoral defeats in many parts of the country where ethnic Russians form the majority.

Subsequent to the elections, widespread public perception of electoral irregularities sparked dissatisfaction with the political domination of Vladimir Putin, leading to large-scale antigovernment protests. These protests continued right up until just after Putin's inauguration as president in May 2012. Nevertheless, although these various protests may be seen to share a common "anti-Putin" stance, many of the young people who took part in them appear to have been spontaneously motivated by the social media, and the protest movement as a whole lacked leadership. There have been no indications that the anti-Putin protests threaten to develop into a radical movement aimed at toppling the existing regime, such as has been seen in the Arab Spring, and the scale of political protests has declined since Putin's inauguration. While this kind of antigovernment protest

movement occurred before in Russia, the recent round of protests exhibit the following unique features.

Firstly, the recent round of protests have been the largest such since the start of President Putin's first presidency in 2000, and they have taken place not only in Russia's major cities, but all over the country. Consequently, the government has been unable to adequately rein in the protests, whose scale was larger than projected. The number of participants in the demonstrations held in Moscow on December 24, 2011, was 130,000 according to the organizers, although the authorities claim a participation of 30,000.

Additionally, hundreds of people were arrested on the day after the State Duma elections and the day before Putin's inauguration as president. In response, the government tightened legal restrictions on antigovernment activities. In June 2012, legislation was passed to sharply raise the fines imposed for engaging in unauthorized demonstrations or exceeding the bounds of authorized ones, and in October an amendment to the Russian criminal code was adopted, which was aimed at expanding the range of activities classified as treason.

Secondly, whereas antigovernment activities in the past had been mainly led by pensioners, low-wage-earning laborers, trade unions, and opposition political parties including the Communist Party, the majority of the recent protesters have been from the middle-class, i.e., well-educated, reasonably well-off residents of Russia's major cities. Compared with ten years ago, the number of impoverished citizens has halved, and consequently a new middle class is coming into being. Moreover, as a result of the accession to the presidency of Dmitry Medvedev, who has been viewed as comparatively liberal, the hopes of middle class citizens for political reform had been raised. As they regarded the return of Putin as retrogression of political reform, he personally bore the brunt of middle-class criticism.

Thirdly, whereas up until recently antigovernment demonstrations were held mainly to protest against economy-related grievances such as inflation, unemployment, and low wage levels, the recent protests have focused on political issues such as perceived irregularities in the election process, and corruption among the country's officials. Within Russian society, there has been a tacit understanding that if the public wished to enjoy the political stability and economic growth made possible by Putin's leadership, it would be better not to question the ways in which he used his authority. Ironically, this very political

stability and economic growth has raised the political consciousness of ordinary middle-class citizens to the point where they no longer feel obliged to overlook such political issues as vote fraud and bureaucratic corruption.

Amid this rising tide of anti-Putin sentiment, the presidential election was held on March 4, 2012. Initially, it had been predicted that Putin's share of the vote would fall short of a majority, leading to a runoff between the top two candidates, but a voter survey conducted immediately prior to the election revealed that support for Putin was rising, and in the event, he received 63.60 percent of the vote in the first round. While this result fell short of the 71 percent vote share garnered by Vladimir Putin in the 2004 election, it appears that even allowing for the possibility of voter fraud having inflated his share by several percent, Putin would have emerged the clear winner in this election.

In this connection, Gennadiy Zyuganov of the Communist Party gained only 17.18 percent of the vote, roughly the same as in the 2008 election. This shows that the Communists, who have been the main opposition to United Russia, did not benefit from the anti-Putin vote. Billionaire businessman Mikhail Prokhorov, who had hoped to gain the support of anti-Putin groups, received only a small share of the vote and was unable to undermine Putin's electoral support.

Four factors are believed to lie behind Putin's electoral victory. The first is campaign pledges of massive pork-barrel spending such as wage increases and a promise to freeze the planned raising of the pension eligibility age. The second is the absence of any effective rival to Putin, due to the inability of the opposition parties to unite under a single anti-Putin banner. The third is the low share of the votes gained by opposition party candidates due to the fact that a certain

**Table 7.2. Results of the March 4, 2012 presidential election**

Candidates	Political party	Votes received	Share of vote (%)
Vladimir Putin	United Russia	45,602,075	63.60
Gennadiy Zyuganov	Communist Party of the Russian Federation	12,318,353	17.18
Mikhail Prokhorov	Unaffiliated	5,722,508	7.98
Vladimir Zhirinovskiy	Liberal Democratic Party of Russia	4,458,103	6.22
Sergey Mironov	Just Russia	2,763,935	3.85

Source: Compiled by the author from the website of the Central Election Commission of the Russian Federation.

percentage of the middle-class citizens who had taken part in the anti-Putin protests abstained from voting in the election, thereby increasing Putin's share of the total vote. And the fourth is the perceived effectiveness of the ruling party's election campaign message—that without Vladimir Putin as the head of state, the stability of the nation could not be assured. This campaign message, which reminded the public of Putin's record of restoring stability to the Russian political scene in a few short years, appears to have resonated well with the electorate. Putin gave a tearful victory speech immediately following the election, from which many observers conclude that this election was the most difficult political fight of Putin's career to date.

## **(2) The Ongoing Decline in Putin's Ability to Govern Effectively**

The Russian government's basic national strategy up to the year 2020 had already been set out in the *Russian Development Strategy through to 2020*, announced in February 2008, and the *National Security Strategy through to 2020*, published in May 2009. Thus, the start of Putin's second presidency did not involve any significant change in either domestic or foreign policy. Nonetheless, the new administration will be forced to respond sensitively to changes in public opinion, and there is a possibility that they will appeal to nationalistic sentiments among the citizenry and adopt populist policies to counter the groundswell of anti-Putin feeling.

Having won the election, in his report to the State Duma on government activities, made on April 11, Putin claimed success in addressing four issues during

his four years as prime minister—

(1) encouraging a recovery in population growth, (2) successfully dealing with the global economic crisis, (3) achieving a rise in wage levels, and (4) increasing agricultural production. In addition, Putin called for the tackling of three tasks as national issues: (1) raising the gross domestic product (GDP) to No. 5 in the world within the next few years, (2) improving Russia's



investment environment, and (3) reducing the gap between the rich and the poor. To make these goals possible, he proposed four priority initiatives: (1) solving the demography problem, (2) realizing further development of East Siberia and the Russian Far East, (3) creating new jobs, and (4) strengthening Russia's economic competitiveness.

After his inauguration as president on May 7, Putin nominated Dmitry Medvedev as Prime Minister of Russia to the State Duma, which confirmed the choice by majority vote the following day. Putin excused himself from attendance at the G-8 Summit held at Camp David in the United States on May 18–19, giving as reason the time required to form a new cabinet, and Prime Minister Medvedev represented him at the summit meeting. The new Medvedev cabinet was announced on May 21, with approximately two-thirds of the members rotated or replaced. The majority of the former members of Prime Minister Putin's Cabinet were appointed to posts in the Executive Office of the President. Whereas it was a precondition of the previous presidency of Dmitry Medvedev that Putin would serve as prime minister, it was not necessarily taken for granted that, in return, Medvedev would become the prime minister when Putin returned to the president's office. In this sense, it appears that the Putin-Medvedev "tandem" political structure has served its purpose, and that Russia has returned to the original Putin-led system.

A notable feature of the new cabinet is the establishment of a new ministry in charge of overseeing the development of the Far East region. Victor Ishaev, who has served as presidential plenipotentiary envoy in the Far Eastern Federal District of Russia, was appointed to the additional post of Minister for Russian Far East Development. This move results from President Putin's strong concerns over the state of East Siberia and the Far East region, where economic development lags behind and the population is declining. However, the powers of this new ministry are limited. This is because the jurisdiction over resources in these regions that has been held by the Ministry of Regional Development and the Ministry of Economic Development has not been transferred to the Ministry for Development of Russian Far East, and the initial plans to transfer the local branches of federal ministries within the Far Eastern Federal District to the jurisdiction of the new ministry have met with setbacks.

Moreover, the scale of the Ministry for Development of Russian Far East is small, with only five vice ministers, seven departments, and a total of 250 staff,

and the ministry's head office is not in Moscow, the seat of Russian political power, but in Khabarovsk in the Far East. It is thus unclear whether the ministry will be able to operate effectively. In addition, the establishment of a state corporation to develop East Siberia and the Far East, reporting directly to the president, has been proposed, but no concrete plans have been drawn up as yet. Since 2008 Putin has paid more than thirty visits to East Siberia and the Russian Far East, and an APEC summit meeting was held in Vladivostok in September 2012. This record indicates how eager Putin is to further the cause of economic development in these regions, but major barriers lie in his way, including massive and entrenched bureaucratic structures, as well as local vested interests.

Vladimir Putin had been the *de facto* leader of Russia even before his return to the post of president, and from here onward the Presidential Executive Office is expected to lead the way in drafting national policies on important issues. The government headed by Dmitry Medvedev will possess no real power to take decisions, and the cabinet will have no choice but to faithfully implement measures as directed by the Presidential Executive Office. In fact, two-thirds of the cabinet members are former bureaucrats, many of whom have been promoted from the position of vice minister, and their average age is around the same as forty-seven-year-old Medvedev. In short, they are lightweights compared with the staff of the Presidential Executive Office. On May 7, the day of his inauguration as president, Putin signed eleven decrees relating to governmental organization, the economy, education and science, social policy, population issues, housing, health services, inter-ethnic relations, military service, the modernization of the armed forces and the defense industry, and foreign relations.

Diplomatic and security concerns fall within the exclusive competency of the president of Russia. The Ministry of Foreign Affairs, the Ministry of Defense, and the Federal Security Service (FSB) are directly controlled by the president. Other organizations involved with the economy, society, and other matters are controlled by the prime minister. The recent spate of presidential decrees covered almost the entire range of areas within the government's jurisdiction, and have presented specific administrative policies directly from the president himself to all the national administrative organizations.

The drafts of these were prepared by the Security Council, headed by Secretary of the Council Nikolay Patrushev. The Security Council, which reports directly to the president, is a deliberative body that is provided by the Russian Constitution

to conduct preparatory work for presidential decisions on matters of importance to national strategy. It functions both as a secretariat for drawing up national strategy proposals, and as a board for making decisions. It holds meetings almost every week in the Kremlin, and includes the ministers of foreign affairs and defense among its standing members. Despite the formation of a new administration, the majority of the standing members of the Security Council have remained in their posts, and decisions on important issues of national strategy are made via the Council, under the leadership of the president.

Patrushev, who had been the director of the FSB, and is a very close confidante of President Putin, was appointed to the post of secretary of the Security Council when Putin handed over the post of president to Medvedev in 2008. This step is thought to have been taken to ensure that even after relinquishing the reins of presidential power, Putin would still exert a certain degree of influence within the Presidential Executive Office. The regulations governing the Security Council were revised in May 2011, increasing its policy-proposal functions with respect to national strategy and giving the council regulatory powers over the federal subjects of the Russian Federation, the armed forces, and other security-related organs. This move is part of a trend toward giving the Security Council authority above other organs of state power.

Despite winning the presidential election by a large margin, Putin's political base in this second presidency is not as solid as it used to be. As the Russian economy continues to grow, the number of middle-class citizens who are dissatisfied with the current political setup will grow in parallel, and potential antigovernment sentiment is likely to gain momentum rather than dying down. Putin is therefore expected to face difficulties in controlling the Russian society during this second presidency. Putin has already lost the aura of an unchallengeable leader that he formerly wore, and there is no longer any taboo on public opposition to Putin's authority. This structural change in Russian society is starting to exert a major influence on the style of governance for which Putin has been known for so long. In spite of enjoying a share of more than 60 percent of the vote in the presidential election, we can infer from the poor performance of United Russia in the State Duma elections that Putin's base of support among the electorate includes a significant proportion of citizens who voted for him not out of conviction, but simply for lack of a reasonable alternative.

Putin's political base includes the Federal Assembly of Russia, the social elites

in Russia's regions, and the *siloviki* (the political elite from the military or security services). There may have been a relative weakening of the political groups that give Putin their unstinting support, and the possibility has emerged that some of these groups may begin to distance themselves from Putin or attempt to take advantage of his relative weakness. Such a development would undermine Putin's political base as a whole.

For example, the ministers for regional development, for labor and social security, and for education and science, were recently reprimanded for their failure to follow Putin's decrees with respect to the compilation of the budget. Of these three, Minister of Regional Development Oleg Govorun was dismissed from his post in October 2012 for failure to perform his duties by reason of illness, and in November a case of embezzlement involving the sale of Ministry of Defense assets came to light, as a result of which Minister Anatoliy Serdyukov was forced out of office, despite having enjoyed the confidence of Putin in his role as the champion of military reform. In such ways, we have begun to see a fair amount of discord within the Putin administration.

On November 1, 2012, the business daily *Vedomosti*, quoting a number of sources within the Kremlin, reported that President Putin was cutting back on the number of his overseas trips due to pain he was suffering from an old back injury. This report sparked concern about the state of the president's health. Following his sixtieth birthday on October 7, Putin postponed a number of planned inspection trips within Russia as well as overseas trips, in addition to the usual year-end TV interview, and spent an increasingly large amount of time shut away in his official residence in the Moscow suburbs instead of going to his office in the Kremlin.

At the APEC summit in September, Putin was observed to be limping, and when he failed to attend an official awards ceremony in November, sending a cabinet member in his stead, the Internet was filled with rumors that he was suffering from a serious illness. Since the days of the Soviet Union, the Kremlin has traditionally kept a tight lid on information about ailments of the country's top leaders, as such reports could trigger political instability. The fact that this time, unprecedentedly, information regarding the president's health was leaked to the media, has led some observers to speculate that Putin's control over the reins of government is weakening.

### **(3) The Russian Government's Response to Structural Challenges Confronting the Economy**

The Russian economy remained comparatively solid in the first half of 2012, in a continuation of the trend in 2011, despite the stagnation of the global economy against the background of the prolonged fiscal and monetary uncertainty in Europe, among other factors. During this period, the main driver of Russia's economic growth was domestic consumption. In April the unemployment rate improved below the 6 percent mark, reaching a historic low of 5.2 percent in August. Supported by this stable employment situation, wage levels rose, and as the inflation rate did not exceed 7 percent, domestic consumption posted growth. Against the backdrop of this economic growth, Russia's trade surplus increased further thanks to the high level of international oil prices. The consequent increase in energy-related revenue afforded the government the leeway to pursue energetic economic measures, while the country's foreign currency reserves grew and trading on the domestic market was active.

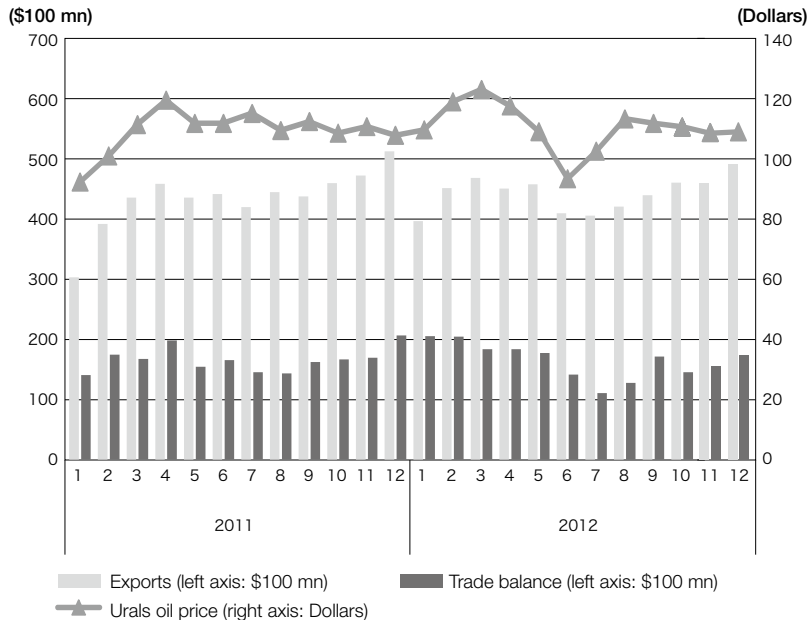
In the second half of 2012, however, high food prices on the global market and higher utility charges began to impact the Russian economy. Domestic consumption, which had hitherto served as the main engine of economic growth, started to decline. On the investment front, too, there was a pause in the inventory buildup that had accompanied the economy's recovery, and in the absence of new, alternative investment targets, a sharp downward trend was seen in total investment activity. The volume of the country's exports other than oil and gas also declined amid a worldwide slowdown in economic activity. As a result, Russia's economic growth rate for 2012 came to a mere 3.4 percent, the lowest level since 1999 apart from the global recession of 2009. This low growth rate trend is seen likely to persist in 2013.

Despite this, the slowdown in Russian economic growth is expected to be of only a limited extent. The fact that Russia has been able to maintain a higher growth rate than the 1.4 percent average recorded by OECD member countries is due to the high level of oil prices. But this highlights a major structural problem for Russia's economy. The economy is supported by energy exports, and if the global economy fails to improve and prices fall in international energy markets, there are risks that the Russian economy will suffer the same sort of sharp slowdown that was seen during the global financial crisis and subsequent recession in 2008–2009. Moreover, the Russian workforce is shrinking due to population

decline and aging, and unless this is halted, companies will have a hard time increasing employment. Additionally, a low level of capital investment will cause poor labor productivity, meaning that companies will find it difficult to take advantage of new businesses opportunities, and they are unlikely to lead to economic growth.

In view of these factors, the main issues confronting the Russian economy are: (1) the need to hold down rises in retail prices over the short term to stabilize the economy; (2) the need to increase the government's room for maneuver in the field of fiscal and monetary measures by strengthening financial sector supervision and bolstering the Reserve Fund so as to ameliorate the impact of the global economic slowdown, and; (3) the need to boost the economy's growth potential over the medium-to-long term. To raise the potential growth rate it will be necessary to engage in long-term initiatives such as improving productivity, strengthening competitiveness, and achieving economic diversification, and these

**Figure 7.1. International crude oil prices and Russia's trade balance**



Sources: Compiled by the author from materials released by the Central Bank of Russia.

measures require a better investment climate. It is also critical for Russia to develop new export markets in view of the weakness of the European market, which has hitherto been the main destination for Russian exports.

The Putin administration is aware of all these structural challenges facing the economy, and is making preparations for fully fledged economic measures. In the presidential election campaign promises issued by then Prime Minister Putin in January 2012, he pledged to reform the structure of the economy to end its excessive dependence on energy exports, and to realize economic growth driven by technological innovation by taking steps to improve Russia's investment climate. In November 2011 the Eurasian Economic Commission was set up to serve as a permanent organ for the transformation of the existing Customs Union of Russia, Kazakhstan and Belarus into the Eurasian Economic Union. In January 2012, a further step was taken toward the realization of this "Common Economic Space" with the appointment of former Industry and Trade Minister Viktor Khristenko as director-general of the commission.

The purpose of the Eurasian Economic Union, as articulated at the APEC summit in September, is to connect the European market with the markets of the Asia-Pacific region. It is not intended to become an exclusive economic bloc. In March 2012 the Russian government unveiled its *Strategy 2020: Russia's Social and Economic Development Strategy through to 2020*. This document contains a wide range of proposals, including the reduction of state controls on economic activities and the achievement of a healthy fiscal structure over the long term through reform of the pension system. The Executive Order on Long-Term State Economic Policy, released immediately following Putin's inauguration as president in May, called for steps to expand investment and raise labor productivity, principally through the creation of highly productive jobs for 25 million people by the year 2020, as well as measures to raise the proportion of high-tech, knowledge-intensive industries.

In June, Prime Minister Medvedev approved a plan for the privatization of state-run enterprises, thereby confirming the government's policy of bolstering the economy by realizing effective levels of competitiveness. In line with this, at the St. Petersburg International Economic Forum held in the same month, President Putin stressed the necessity of decisive steps to implement a variety of economic reforms so as to expand investment from other countries and reduce the economy's dependence on energy exports.

Meanwhile, to reinforce government control over the energy sector, which is expected to serve as the major growth engine for the Russian economy for the time being, the Presidential Commission for Strategic Development of the Fuel and Energy Sector and Environmental Security was established in June. President Putin assumed the chairmanship of the commission, and Igor Sechin was appointed as its executive secretary. Sechin had resigned the post of Deputy Prime Minister in May, and had just assumed the post of President of the state-run oil company Rosneft. In July the commission's powers were strengthened, enabling it to make decisions from a strategic perspective regarding the approval of privatization of energy sector enterprises originally owned by the government.

Russia had long set its sights on membership of the World Trade Organization (WTO), and in July 2012 the ratification procedure for Russia's accession to WTO membership was completed, and it became the 156th member of the WTO in August after nineteen years of negotiations. During the transition period over the next two to three years, import duties will be reduced in stages from the current average of 9.5 percent to around 6 percent. However, since the Russian economy showed signs of slowing down as a result of the deterioration in the global economy, Moscow was forced to take new steps to cushion the impact of membership.

Firstly, in October 2012 a meeting was held to debate the situations of around 300 severely affected single-industry towns. At this meeting, it was announced that a policy would be adopted involving the expenditure of 400 billion rubles to maintain adequate employment levels. Then, in November an expanded format meeting of the Security Council was held to reconfirm the strategic benefits expected from WTO membership and the anticipated economic development effects, and to draw up policies for new measures to deal with the potential security risks concomitant on WTO membership.

#### **(4) Boosting Defense Spending to Revitalize the Russian Defense Industry**

Turning to fiscal issues, in June President Putin signed the 2013–2015 Budget Address, in which he set out his future economic policies, including measures to maintain fiscal health in the face of a deteriorating world economy, to increase the Reserve Fund, to implement budget measures more effectively, and to facilitate diversification of the economy. On this basis, and following new rules



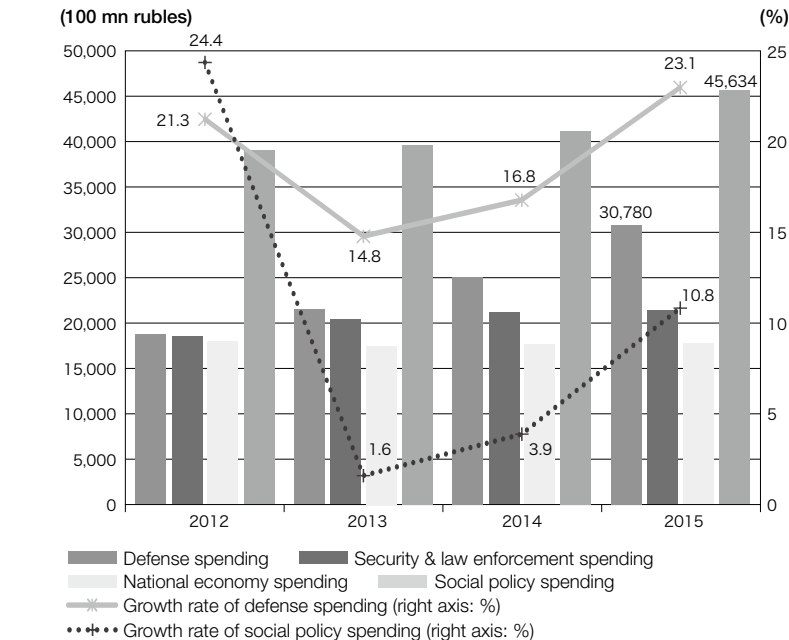
aimed at realizing stricter fiscal discipline, the Finance Ministry in July drew up the draft budget for 2013 as well as the budget plans for 2014 and 2015. In September, the government budget bill was approved by the Cabinet and subsequently by the Federal Assembly, and was signed into law by President Putin on December 5, 2012.

This law on three-year budget, which was drawn up under new rules, is aimed at ensuring the steady implementation of all types of programs provided for in the budget with the goal of realizing long-term economic policies regardless of fluctuations in international oil prices. At the same time, it aims to achieve an approximate balance between fiscal revenue and expenditure by 2015. For this purpose, it seeks to contain expenses by changing the benchmark of a basic indicator for budget formulation—oil and gas revenue (which accounts for roughly 45 percent of total revenue) is now calculated according to the average of actual prices for the past five years, instead of estimated prices, as had been done hitherto. At the same time, it specifies that Reserve Fund is to be used to make up any differences between the actual price and the predetermined price. As a result of this, the Reserve Fund used for emergency public spending will be increased from 811.5 billion rubles in 2011 to 4,722.7 billion rubles in 2015, equivalent to 5.7 percent of Russia's GDP. The National Wealth Fund, which is to enable future increases in social security expenditures, is expected to be maintained at the fiscal 2012 level of 2,800 billion rubles.

In this way, the Putin administration is taking steps to tighten fiscal discipline. The year-on-year growth in spending on social policies is projected to be held down to only 1.6 percent 2013, and to 3.9 percent in 2014, with the value hovering around the 4 trillion ruble mark. Defense expenditure, meanwhile, is scheduled to grow year on year by 14.8 percent in 2013, by 16.8 percent in 2014, and by 23.1 percent in 2015. In absolute value terms, it will increase from 1,864.8 billion rubles in 2012 (or 3 percent of GDP) to 3,078 billion rubles in 2015 (3.7 percent of GDP), for an increase of more than one trillion rubles. Expenditure on security and law enforcement in the 2013–2015 period is projected to rise by 9.9 percent, 4.0 percent, and 0.9 percent, respectively. For 2013, 2,029.8 billion rubles will be allocated to security and law enforcement.

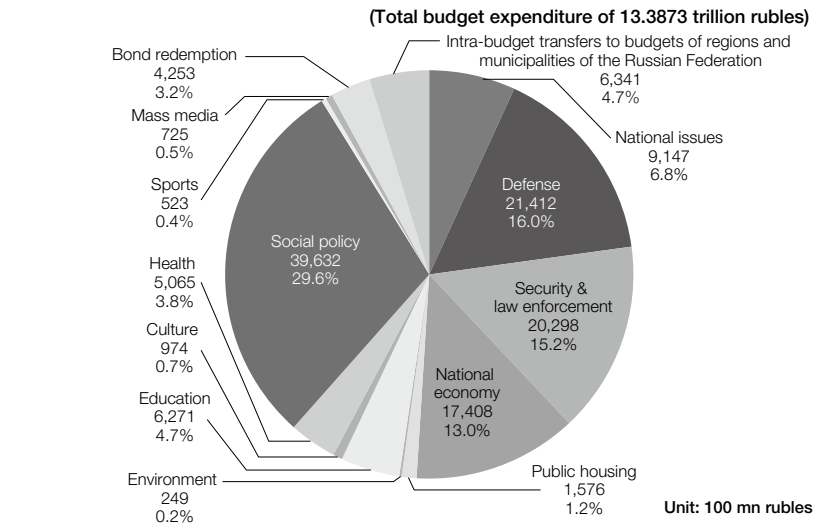
It is believed that in the background to this planned growth in defense spending lies not only the direct motivation of a desire to maintain and enhance Russian military capabilities through modernization, but also the aim of revitalizing the

Figure 7.2. Growth of Russia's defense spending



Sources: Compiled by the author from materials released by the State Duma.

Figure 7.3. Breakdown of Russian Federation budget for 2013



Sources: Compiled by the author from materials released by the State Duma.

national defense industry—which possesses advanced technological expertise—to promote technological innovation throughout the economy as a whole, and in addition to help address social and economic issues by enabling the defense industry to support the economies of various regions of Russia.

A draft of the government's action plan was discussed at a Cabinet meeting on December 7, 2012, including plans to disburse 500 billion rubles from the federal budget up to 2020 to provide support for top-priority industries. This figure of 500 billion rubles appears to be financed from the three trillion rubles earmarked for the modernization of the defense industry as a whole within the twenty-three trillion rubles budgeted for the *State Weapons Program for 2011-2020*. President Putin, in his annual Presidential Address to the Federal Assembly delivered on December 12, insisted on the necessity of utilizing the budget for defense procurement and modernization of the defense industry to the maximum extent in order to modernize Russian industry as a whole and to further the progress of science and technology.

There are also signs of other policies being consistently pursued with the aim of promoting the modernization of the economy through the driving force of the defense industry. Firstly, a large amount of funds have been budgeted for the aerospace and shipbuilding sectors, on which the authorities are pinning their hopes for a knock-on effect on the economy as a whole through research and development into cutting-edge technologies applicable in both the military and civilian fields. In June and July President Putin held separate meetings for each type of technology to discuss equipment procurement plans for the armed forces. Whereas spending of 4,000 billion rubles has been earmarked for aircraft technology and 4,440 billion rubles for naval vessel technology, only 2,600 billion rubles has been budgeted for ground forces and airborne troop units.

In this connection, at an expanded meeting of the Security Council of Russia in August, Putin pointed out that Russia's defense industry comprises 1,353 enterprises and organizations located in sixty-four regions and employing more than two million people, it possesses much of the country's leading-edge technology, and over 30 percent of the products manufactured by this industry are, in fact, for civilian use. For these reasons, he unveiled a policy of encouraging growth in the economy as a whole through the modernization of the defense industry.

In addition, with respect to cooperation in the military technology field between Russia and other countries, Putin stated that as part of an overall defense industry

modernization program for which three trillion rubles will be earmarked, he aims to encourage the acquisition of foreign technologies through technical cooperation agreements as a means of both meeting Russian demand for military materiel and to develop the export competitiveness of the Russian defense industry. Moreover, it was also revealed that plans were under examination for nurturing a stronger defense industry base, in which Deputy Prime Minister Dmitry Rogozin will play a central role. These plans involve an integrated approach in which the issues are being examined from perspectives hitherto neglected, and include such concepts as encouraging the participation of private-sector companies and the transfer of military technologies to the private sector. In addition to the technology aspect, the plans also involve the securing and training of capable managers with expertise in competitive markets.

## **2. Russian Diplomatic Focuses on Asia**

### **(1) Demand for Energy in East Asia, and Russia's Foreign Policy**

#### **(a) The background to Moscow's focus on East Asia**

The export of oil and gas constitutes an important element in Russian foreign policy. These energy exports not only account for nearly 70 percent of total Russian exports, but oil and gas revenues also account for almost 50 percent of the revenue in the federal budget. These export earnings have until recently made it possible to hold down prices of oil and gas on the domestic market, and the entire Russian economy can be said to depend heavily on exports of oil and gas.

With regard to Russia's production and export of oil and gas, as the majority of the reserves are located in inland areas, well away from usable ports, they necessitate massive amounts of investment in the construction of production facilities as well as the transportation infrastructure for exporting such products, such as pipelines. It is therefore rather difficult for Russia to switch from one export destination to another, and the country needs to draw up and implement a comprehensive policy from a long-range standpoint. For this reason, regarding Russia's relationships with the countries to which it exports or wishes to export oil and gas, Russia must firstly nurture stable relationships with countries to which it already exports in order to maintain such exports over the long term. Secondly, if Russia wishes to develop new customers, it must accurately assess those countries' long-term energy demand trends. Furthermore, when signing an energy export

agreement with a new customer nation, it is desirable that Russia ensure that the contract terms are fixed, and for a long period, and that steps are taken to ensure a stable relationship between the two sides through such measures as joint ownership of the assets involved.

In addition, to localize the adverse effects of unforeseen developments in trading-partner countries, Russia must diversify its export destinations, and for this purpose the use of oil tankers and the export of natural gas in the form of LNG is an effective method.

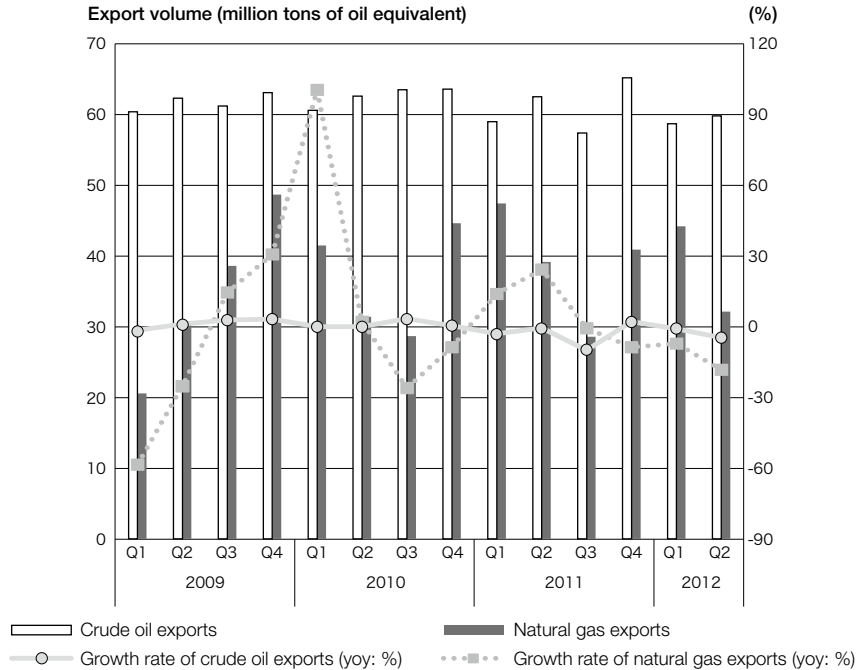
At the moment, over 60 percent of Russia's exports of oil and gas in value terms goes to the European Union, while Europe as a whole accounts for just under 80 percent. Looked at from the EU standpoint, imports from outside the EU accounted for 76 percent of its oil usage in 2010, of which Russia accounted for 34 percent. Similarly, imports accounted for 62 percent of gas used, of which 32 percent came from Russia. It is estimated that the EU will rely on imports for 90 percent of its oil and 85 percent of its gas up to 2035.

From the middle of the first decade of this century, the EU has been taking steps to limit its dependence on imports of gas from Russia, as part of its energy security policy, and a policy of diversifying energy sources was unveiled in October 2007. In response, Russia has been endeavoring to maintain its position and reputation for trustworthiness in the European market, which is its leading export target, including construction of new gas pipelines and the involvement of European capital in gas field development projects as a way of ensuring reliable supplies over the long term.

Demand for gas in Europe plunged during the financial crisis and accompanying recession in 2008–2009. The uncertainty of the European market was then exacerbated by the prolongation of the economic stagnation due to the European sovereign debt crisis starting from the end of 2010, as well as the shale gas revolution in the United States. European gas import companies made strong demands on state-owned gas company Gazprom for the renegotiation of contracts. Gazprom reluctantly placed priority on maintaining its long-term stable trading relationships with its European customers, and renegotiated its contracts with its main partners at the end of 2012. As a result, Russia's flow of revenue from exports to Europe is very likely to contract over the medium term.

Against the backdrop of growing uncertainties in the European market, Russia is endeavoring to secure a reliable flow of revenue from energy—its principal

**Figure 7.4. Trends in Russian oil and gas exports**



Sources: Compiled by the author from materials released by the Central Bank of Russia.

earner—not only by working to stabilize its trading relationship with Europe, but also by pursuing initiatives to expand the market for exports to East Asia. However, as the energy supply-and-demand situation in East Asia is volatile, Russia will need to adopt a strategic approach.

**(b) Russian energy policy toward new markets in East Asia**

To diversify the risks involved in exporting to the European market, the Russian authorities are focusing their attention on East Asia as an alternative market for oil and gas. In September 2007 the government approved the Eastern Gas Program, under which Gazprom will take the lead in developing gas fields in East Siberia and the Russian Far East with the objective of exporting the gas to East Asian countries. To ensure that the Sakhalin II project, which had been underway since the 1990s with financing from outside Russia, would play a leading role in

this program, Gazprom had already joined the Sakhalin II project in April 2007, acquiring an equity share of over 50 percent. Gazprom subsequently commenced LNG exports in February 2009.

In response to the increased uncertainty of the European market, due to the global financial crisis of 2008–2009, in November 2009 the Russian government adopted the *Energy Strategy of Russia for the Period up to 2030*, in which it unveiled a number of specific targets, including raising the ratio of gas exports to East Asia to 20 percent by 2030.

The government has conducted estimates of Russia's energy export capacity and the demand of each East Asian country, and on this basis is pursuing individualized strategies for each potential importing country. With regard to oil, production volume is projected to shrink slowly over the long term, and the government is therefore putting priority on securing the volume of exports to Europe. As for the development of new oilfields, it aims to put a system in place making it possible to export to both the European and East Asian markets. Work is also proceeding with the construction of a pipeline network that will provide flexibility in the choice of export destinations. Regarding Russia's gas reserves, which amount to 20 percent of the world total, the country's export capacity is expected to grow strongly alongside the increasing production volume. Consequently, the government is focusing its efforts on developing the East Asian market while maintaining a stable level of exports to the European market. It is pursuing individualized strategies outlined below, each tailored to the particular unique features of the different countries of East Asia.

Since China and South Korea are linked to Russia by land and are increasing their energy imports from Russia, Moscow is planning to export gas to these countries both by pipeline and by sea in the form of LNG. Japan being an island nation, while there is no large increase in imports, the volume of imports is considerable and the Japanese are interested in imports from Russia both to diversify suppliers and to lower energy import costs, and Russia therefore plans to expand exports of LNG to Japan. India and the countries of Southeast Asia share no land borders with Russia and they are quite distant, but nonetheless demand for gas is growing in these markets, and Russia is making efforts to obtain opportunities in these countries to expand operating revenue through capital participation in upstream operations. They have already established a foothold in Southeast Asia with the signing in November 2006 of a cooperation agreement

between Gazprom and PetroVietnam, the Vietnamese government-owned oil and gas corporation. Further efforts are ongoing to strengthen ties with Vietnam in this field, including the signing in 2012 of an agreement on gas field development in the South China Sea.

### **(c) Energy exports to China, and challenges faced**

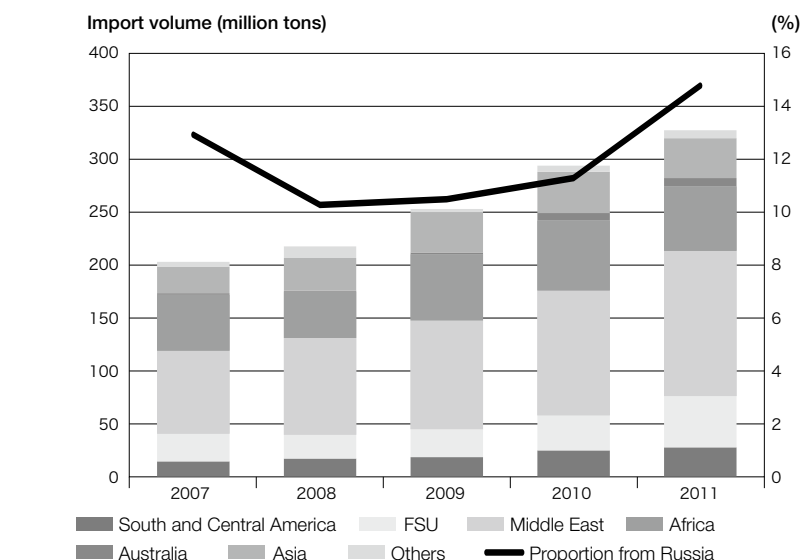
Among the nations of East Asia, demand for energy is highest in China, and the Russian side shows tremendous interest in long-term projections of the energy supply-and-demand situation in that country. In the past, China depended on coal for roughly 70 percent of its energy supply, but in recent years it has been raising the percentage of oil and gas with the twin goals of achieving higher fuel efficiency and reducing the burden on the environment.

The growth in demand for oil in China in the period 2010–2035 is projected to account for about half of the world oil demand growth during that period, increasing from nine million barrels per day (bpd) in 2010 to fifteen million bpd in 2035. Demand for natural gas in China is also forecast to grow steeply. For this reason, China's dependence on imported oil is expected to rise from 56 percent in 2010 to 84 percent in 2035, while its dependence on imported natural gas may rise from 10 percent in 2010 to 42 percent in 2035, although this will depend partly on production of unconventional forms of natural gas (shale gas and others) within China.

For China, whose energy import volume is growing rapidly, the top-priority issue is to secure sufficient sources. In 2011 China procured 42 percent of its oil imports from the Middle East, 19 percent from Africa, 14 percent from the countries of the former Soviet Union (FSU), 13 percent from Asia and Oceania, and 8 percent from Latin America (see Figure 7.5). Of these, the countries and regions that best promise to meet China's sharply growing demand by maintaining or even increasing their supply capacities are the Middle East, the FSU, and Latin America. Supply of oil to China from the FSU overtook that from the Asia-Oceania region in 2011. This was due to the start of operation in January 2011 of a branch-line to Daqing (in China's northeastern Heilongjiang Province) of the Eastern Siberia-Pacific Ocean (ESPO) trunk pipeline, marking the start of exports to China of oil produced in East Siberia.

From now to 2030, current plans call for the export of 300,000 bpd of Russian oil to China, and with the completion in November 2012 of the extension to the



**Figure 7.5. China's crude oil procurement sources**

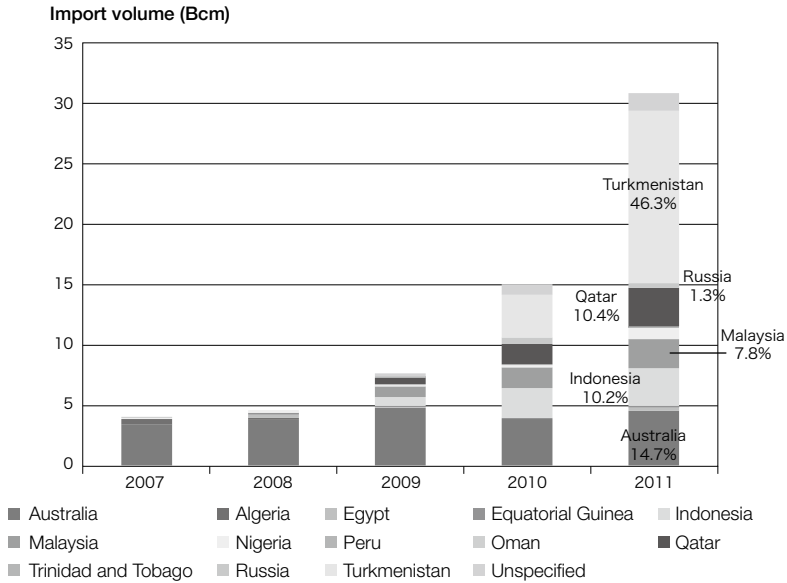
Sources: Compiled by the author from BP, *Statistical Review of World Energy*, various years.

ESPO pipeline to Vladivostok, Russia's export capacity has been increased still further. It is thus likely that the export volume will increase to the 600,000 bpd level well before 2030. In view of these factors, Russia is an important oil supplier for China, capable of meeting the country's fast-growing demand for oil. Moreover, the increased reliance on Russian oil will contribute to China's energy security by helping reduce its excessive dependence on the Middle East.

As for natural gas, in 2011, 46 percent of China's gas imports came from Turkmenistan via pipeline, with the balance arriving via LNG tankers from Australia (16%), Qatar (10%), Indonesia (9%), and several other sources. Gas imports from Russia in LNG form accounted for a mere 1 percent (see Figure 7.6).

Be that as it may, out of the current list of China's sources of supply of natural gas, the only promising candidates capable of maintaining or increasing their supply capacity and thereby meeting a larger share of China's gas import needs, which are expected to grow much faster than those of oil, are Russia and the Caspian region, notably Turkmenistan. Although Australia and other LNG-exporting countries will undoubtedly increase their production, their transportation capabilities will not match those of countries able to utilize pipelines. For this

**Figure 7.6. China's natural gas procurement sources**



Sources: Compiled by the author from International Energy Agency, *Natural Gas Information*, 2011 and 2012 editions.

reason, the International Energy Agency (IEA) estimates that by 2035 China will import 42 percent of its gas (210 billion cubic meters), of which Russia will account for 35 percent (75 billion cubic meters, or 15 percent of total consumption volume).

To enable the supply of this massive amount of gas, Russia will have to develop new gas fields in East Siberia as well as construct the necessary transmission infrastructure. This will necessitate large-scale investment, and Russia should be required to secure gas demand from China to recoup its own investment. For these reasons, what is desirable is long-term, fixed-price contracts. For the Chinese, under a resurgence in the global LNG market as a result of the shale gas revolution, the affordability has emerged that they will be able to secure additional gas imports at relatively low prices from countries other than Russia, as shown in Figure 7.6.

Moreover, if it becomes feasible to commercially produce gas from unconventional gas reserves within China, this will enable the Chinese to reduce their total import volume, and they will be in a stronger position to negotiate favorable prices with the Russians. At the moment, China has no burning incentive

to conclude a contract with Russia on fixed terms. However, if the situation remains as it is for some time, with no progress being made in the development of the East Siberian gas fields, and if China decides to abandon or postpone plans for domestic production of gas and to import large volumes of gas, competition will intensify to acquire gas resources in the Asia-Oceania region, whose gas supply capacity is relatively limited. This scenario could lead to instability in the region.

#### **(d) Dealing with issues involving plans to export gas to China**

Amid this unclear market environment, the second meeting of the Presidential Commission for Strategic Development of the Fuel and Energy Sector and Environmental Security was held in October 2012, at which the commission analyzed developments in the gas market and examined proposals for strengthening Russia's position in the market. President Putin, acting as the chairman of the commission, indicated his intention to expand Russia's exports to the fast-growing East Asian market, and directed Gazprom to conduct an analysis of the overall impact on the LNG market of the expanding commercial production of shale gas and present a report to the commission on its basic gas export policy.

Russia's energy strategy will undergo revision on the basis of this report. Looking at recent progress in bilateral cooperation in the energy sector between Russia and China, at talks between Russian and Chinese leaders held in Beijing in early June of 2012 in conjuncture with the summit meeting of the Shanghai Cooperation Organisation (SCO), the participants discussed cooperation in the energy sector and the expansion of investment. Although the two sides reached agreement on measures to secure the supply of oil, they were forced to put off a decision on natural gas prices. Subsequently, talks have been held between Gazprom and the China National Petroleum Corporation (CNPC), but no final agreement has been reached.

Meanwhile, at the 2012 APEC Energy Ministerial Meeting held in late June in St. Petersburg, the "St. Petersburg Declaration" was adopted, in which the parties agreed to promote expanded use of natural gas and investment in LNG-related facilities, and stated their agreement on the importance of evaluating the impact on both the market and the environment of the development and production of unconventional gas. Then, in early September 2012, in the APEC 2012 Leaders' Declaration adopted at the APEC summit in Vladivostok, the participants confirmed their consensus on the need to promote investment, and increase

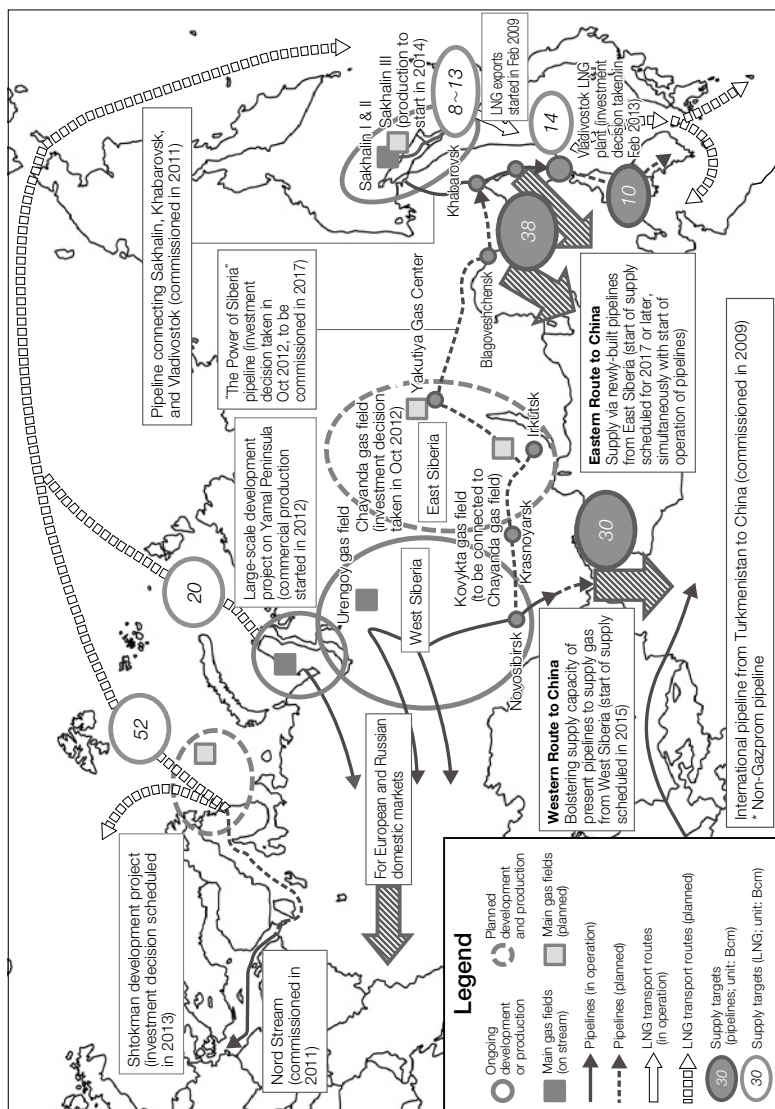
opportunities for mutual capital participation to guarantee investment in the region, and at the same time released an annex document entitled “Strengthening APEC Energy Security,” in which they called for further investment in energy-related infrastructure.

Against the background described above, in which gas pipeline negotiations with China have stalled, these developments can be seen as the result of Russia’s attempts to guarantee investment in gas development with a view to production, while securing demand from the East Asian market as an effective means of promoting the development of energy resources in East Siberia. In this light, agreements made recently involving the Korean Peninsula, India, and Japan are noteworthy. Firstly, Gazprom has held a series of discussions with the Korea Gas Corporation (Kogas) regarding natural gas deliveries to South Korea via pipeline. This pipeline concept involves extending the SKV Pipeline, which was completed in 2011 and links Sakhalin, Khabarovsk, and Vladivostok, with South Korea via North Korea. The Indian project consist of the signing in October 2012 of an LNG purchase and sale contract between Gazprom and the Indian gas company GAIL, stimulating the supply of 2.5 million tons of LNG annually over twenty years.

The progress in the energy cooperation between Russia and Japan is as follows: in April Chikahito Harada, Japanese ambassador to Russia, visited the Gazprom headquarters to discuss with Gazprom executives the importance of the supply of LNG from the Sakhalin II project to meet Japan’s growing demand for gas. At that time, Ambassador Harada was also able to confirm the progress being made in the Russo-Japanese joint project to construct an LNG plant in Vladivostok. Then, in June, Seiji Maehara, who was then Policy Research Council Chairman of the Democratic Party of Japan, also paid a visit to Gazprom and received confirmation that LNG from the Sakhalin II project would be delivered to Japan, and that progress was continuing in the Vladivostok LNG project.

Additionally, in conjunction with the APEC Energy Ministerial meeting held at the end of the same month, representatives of Japan’s Ministry of Economy, Trade and Industry and the Russian Ministry of Energy signed a memorandum relating to cooperation in the energy sector, principally regarding the Vladivostok LNG project. As can be seen, the main focus of this series of discussions and agreements between Japan and Russia has been the Vladivostok LNG project. Russia places great importance on Vladivostok as its center for economic development in the Russian Far East. Local gas demand is inevitably growing, and at the same time

Figure 7.7. Gazprom's scenario for gas exports to the East Asian markets



Sources: Compiled by the author from materials available on the Gazprom and Gazprom Export websites.

the city will play a vital role as a port for the export of gas produced in East Siberia. If this project is successful, all parties concerned will be assured of exports of LNG via from Vladivostok, and this will virtually ensure sufficient investment in the development of natural gas fields in East Siberia.

On October 30, 2012, Gazprom announced a decision to develop the Chayanda gas field in East Siberia and to invest in the construction of a pipeline to link the Yakutiya Gas Center with the city of Khabarovsk (via public subscription in December 2012, the project to be dubbed “The Power of Siberia”). The pipeline will connect the Chayanda field to Khabarovsk, where it will be further connected to the existing SKV pipeline, enabling gas deliveries to Vladivostok. The annual gas throughput volume envisaged is 61 billion cubic meters, and operation is scheduled to commence in 2017.

When we consider that this decision was made against the background of the above-described negotiations on gas exports to countries other than China, as well as the progress being made in the Vladivostok project, it appears possible that the East Asia gas export scenario drawn up by Gazprom may indeed be realized (see Figure 7.7). In fact, in December 2012, in its overview of developments in 2012, Gazprom clearly stated that the commencement of development of the Chayanda field and the start of construction of the pipeline has put it in an advantageous position in negotiations with the Chinese. However, in early December the US Department of Energy published the results of research it had commissioned, and which validated the economic rationality of gas exports. This seems to open the way for participation by American companies in the gas export market, and it thus seems that the future direction of the East Asian gas market is as much a matter for conjecture as ever.

## **(2) Unequal Partnership of Russia and China**

In his thesis on Russian foreign relations, published just before the presidential election, Putin expressed his view that the relative importance of the Asia-Pacific region to international relations was rising, and that his policy would be to encourage active participation by Russia in the currently ongoing dynamic process of integration between the countries of Asia. Moscow is also advocating the development of multilateral frameworks in Asia similar to those used in Europe to resolve international issues, would play a leading role in creating a multilateral framework to resolve international issues not only in Europe but also

in Asia. Russia, having participated in past rounds of the Six-Party Talks on North Korea and being a member of the SCO, formally joined the East Asia Summit in 2011 alongside the United States, and in September 2012 Russia hosted the APEC summit in Vladivostok at a considerable expense.

Asia is not assigned the highest priority within Russia's overall foreign policy, but nonetheless, Moscow's strategic focus is showing a comparative shift from Europe toward Asia. Two major reasons for this can be adduced. Firstly, as explained above, Russia needs to boost its exports of natural resources to Asia to maintain economic growth in the face of the economic slowdown in Europe. For economic development of East Siberia and Far East regions, it will also be necessary to cultivate economic and technological cooperation with Asian countries and to attract capital investment from Asian countries into these regions. In his annual address to the Federal Assembly, delivered on December 12, 2012, President Putin stated his view that Russia's would economic development in the twenty-first century would be led by country's east, and stressed the need for rapid integration of the Russian economy with those of the Asia-Pacific region.

Secondly, under the Kremlin's perception that the world is already a multipolar one and American unilateral actions are less remarkable, the focus of Russian interest in the field of international relations has become how to strategically face and deal with China, which is rapidly emerging as a major new power center. The Russian authorities have national security concerns about potentially increasing influence of China over East Siberia and the Russian Far East, where the population is in decline.

In his executive order regarding foreign policy, released on May 7, 2012, President Putin announced that Russia would actively engage in a process of integration with the economies of the Asia-Pacific region in order to promote economic development in East Siberia and the Russian Far East, and in the field of diplomacy in Asia, it would forge stronger strategic ties with China, India, and Vietnam. Among Asian countries, Russia places the greatest importance on China, which it has positioned as a strategic partner. At present, the relationship between Russia and China has been officially announced to be "at a historically high level," and on the political stage the two countries give the appearance of extremely cordial relations, but behind the scenes the details of their strategic partnership are becoming increasingly complex: declining Russian exports of weapons to China, disagreements over energy prices between the two sides, and

competition for a dominant position in the Central Asian geopolitical theater.

An example of this can be seen in the wording of their joint statements. In September 2010 President Medvedev visited China, where he and Chinese President Hu Jintao signed a joint statement in which they agreed to comprehensively strengthen the “strategic partnership of coordination between China and Russia.” Within this statement, the Chinese phrase translated into English as “core interests” (*hexin liyi*) was rendered in Russian by a phrase that would be translated as “fundamental interests” (*korennyye interesy*). By contrast, when President Putin visited China in June 2012, the joint statement signed on that occasion rendered the Chinese phrase in Russian by the more common phrase translated into English as “key questions” (*klyuchevye voprosy*). This seems to indicate that Russia’s formerly positive attitude toward the concept of mutual support of “core interests” in the Russia-China relationship has weakened.

In the background to this development may lie the fact that China’s GDP reached four times the size of Russia’s in 2011 and the former position of the Soviet Union as a mentor to the newborn People’s Republic of China decades ago has been turned on its head, and Russia can now hardly maintain a relationship on an equal footing with China. In the foreign policy paper published by Putin at the end of February 2012, before the presidential election, he stated that while the growth of China is certainly not a threat, he admitted that there was friction between the two countries, and indicated his intention to closely monitor the influx of immigrants from China. In this way, Putin publically expressed his apprehension with respect to China, and from that point onward, a large number of media pundits and other experts have also voiced their fears about China, something that had long been politically taboo.

It has been reported that, at the seventh round of strategic security talks between Russia and China held on August 20, 2012, State Councilor Dai Bingguo of China (a deputy prime minister-level official with responsibility for foreign relations) suggested that the two sides cooperate on the Russian territorial dispute with Japan and the Chinese claims on Japanese territory, but that Secretary of the Security Council Nikolay Patrushev rejected this suggestion.

Russia is also making efforts to strengthen its strategic ties with India, which is a traditional rival of China, and with Vietnam, which is currently locked in a territorial dispute with China over islands in the South China Sea. In the above-mentioned executive order regarding foreign policy, after statements about China



and India, President Putin also mentioned Vietnam, indicating the rapidly rising strategic value to Russia of ties to Vietnam with respect to their mutual relationship with China. Russia is taking steps to reinforce its strategic partnership with Vietnam, which is currently distancing itself from China, through the sale of six *Kilo*-class submarines and the construction of a nuclear power plant. For its part, the Vietnamese government is believed to be attempting to persuade Russia to increase its presence in Southeast Asia, by such means as pursuing joint resources development projects with Russia in the South China Sea, and by encouraging Russia to participate in such forums as the Asia-Europe meeting and the East Asia Summit. In this way, it appears, Vietnam hopes to prompt the United States to more strongly affirm its commitment to the Southeast Asia region.

At the end of July 2012, Vietnamese President Truong Tan Sang paid an official visit to Russia, where he signed a joint statement on strengthening the comprehensive strategic partnership between Russia and Vietnam. In this statement, the two sides agreed on the construction of a supply base for the Russian Navy in Cam Ranh Bay, and also mentioned the possibility of Vietnam being admitted to the customs union currently consisting of Russia, Belarus, and Kazakhstan. In early November of last year Prime Minister Medvedev paid an official visit to Vietnam, when he held talks with his Vietnamese counterpart Nguyen Tan Dung. The two agreed to commence negotiations in 2013 on a free trade agreement, and to expand cooperation in oil and natural gas development, as well as in the military and aerospace fields.

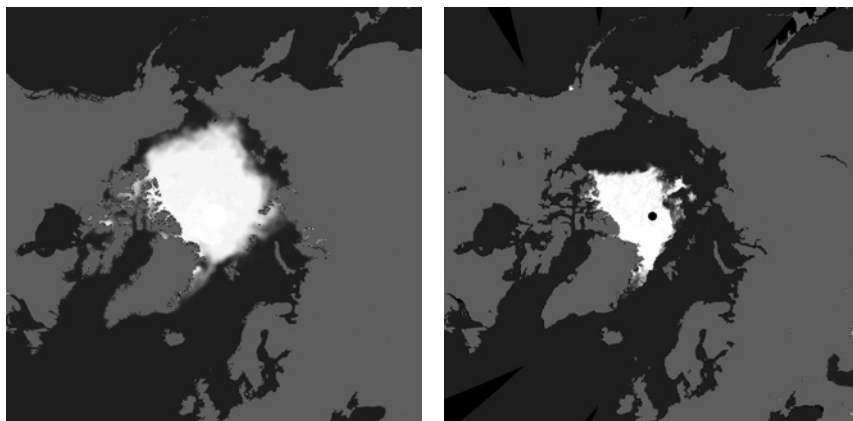
### **(3) Russia's Focus on the Arctic, and Its Impact on East Asia**

On the security front, a new development by China of which Russia is wary is its emerging presence in the Arctic Ocean. Since August 2007, when a Russian Arctic expedition planted a titanium Russian flag on the seabed at the North Pole, at a depth of 4,261 meters, Russia has shown a very assertive stance on development of resources in the Arctic. On September 13, 2008, a Security Council meeting was held under the theme of “championing the interests of the Russian Federation in the Arctic,” with the participation of Sergey Naryshkin, then chief of the Presidential Administration, and other standing members of the Security Council. The venue of the meeting was Franz Josef Land, an archipelago where the northernmost-located unit of Russian border security forces is stationed. Then, on the seventeenth, the Russian government published a document entitled

*The Fundamentals of State Policy of the Russian Federation in the Arctic in the Period up to 2020 and Beyond*, in which they affirmed the overriding importance attached to the Arctic region as a strategic source of natural resources and the government's intention to pursue development projects in the Arctic to realize the growth of the Russian economy, and also affirmed the importance to Russia's national interests of the use of the Arctic Ocean as a transportation route.

At a Security Council meeting in March 2009, the Council approved a policy for the period up to 2020 of treating the Arctic as a strategic source of natural resources, and in April then Prime Minister Putin paid an inspection visit to Franz Josef Land. In the summer of 2010 a supertanker belonging to the major Russian shipping company Sovcomflot successfully completed a voyage through the Arctic Ocean via the Northern Sea Route (formerly known as the Northeast Passage), and Russia signed a treaty with Norway that delineated national borders in the Barents Sea and the Arctic Ocean. The two sides also agreed to pursue further cooperation in the Arctic Ocean.

The three main reasons why Russia attaches great importance to the Arctic are the desire to develop its natural resources, the emergence of the Northern Sea Route as a viable transport artery thanks to the decreasing extent of sea ice, and security concerns. Firstly, the Arctic region is believed to contain large amounts of untapped natural resources, including 30 percent of the world's undiscovered gas deposits and 13 percent of its crude oil deposits. Of the total of 4.5 million square kilometers covered by the Arctic continental shelves, Russia exercises sovereign rights over 60 percent, or roughly 2.70 million square kilometers. Russia has made an official submission to UN Commission on the Limits of the Continental Shelf for the extension of the current limits of the Russian Continental Shelf. If allowed, this would give Russia an additional 1.2 million square kilometers of Arctic seabed territory. As a result of the ongoing melting of the Arctic Sea ice due to climate change, the extent of Arctic sea ice reached a record low on September 16, 2012, of 3.49 million square kilometers. In addition, advances in the technologies employed in locating and developing natural resources are making it more feasible to develop such resources in the Arctic. For these reasons, in 2011 major Russian oil company Rosneft signed an agreement with the US company ExxonMobil to jointly develop oil resources on the Russian Arctic shelf.

**Figure 7.8. Extent of Arctic sea ice**

Average distribution of Arctic sea ice during minimum-area period in September during the 1980s

Sea ice area on September 16, 2012

Source: Japan Aerospace Exploration Agency. (c)JAXA

The next major factor behind Russia's focus on the Arctic is the growing period of each year when the Northern Sea Route through the Arctic Ocean is navigable. This is the shortest route connecting Europe and Asia by sea, and it appears that a new commercial marine transportation route is opening up. Compared with taking ships through the Suez or Panama canals, the use of the northern route would greatly shorten the distances and durations involved. Moreover, as the route includes no "choke points" such as straits, nor pirate-infested areas, if it becomes a practical route it would introduce revolutionary possibilities for maritime transport. In 2011 a Japanese shipping company successfully transported a cargo of iron ore from Murmansk in northern Russia to the port of Tangshan in China's Hebei Province via the Northern Sea Route. The total volume of cargo transported via the Northern Sea Route in 2011 was roughly 2 million tons, but the Russian government expects this to grow to between 55 million and 60 million tons by 2020.

For Russia, the Northern Sea Route promises to become a new transportation artery under its sovereign rights, as well as a new source of revenue in the form of fees levied for the services of Russian icebreakers, which will escort foreign-owned ships (this will be mandatory) through the waters of Russia's exclusive economic zone (EEZ). Russia can thus look forward to a considerable overall

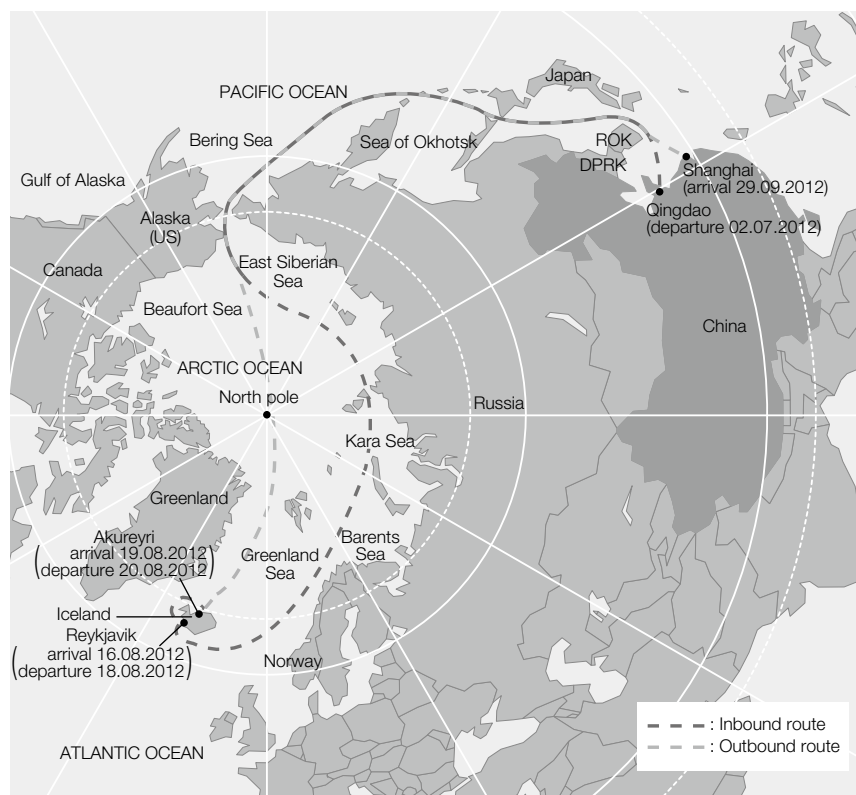
economic boost from the opening up of the Northern Sea Route. At the end of July 2012, President Putin signed into law the Federal Law Regulating Commercial Navigation along the Northern Sea Route, which included provisions setting up an official administrative body for the Northern Sea Route with effect from February 2013. As this indicates, the Russian authorities are hastening to set up an administrative structure to take full control over this new shipping lane.

In addition, the ongoing shrinkage of the Arctic ice cap constitutes a major problem for Russia from the military and security standpoint. During the Cold War period, in spite of the fact that the Arctic was a strategic front where the Soviet Union and the United States faced each other directly, neither side treated the region as a theater for military operations, this being deemed impossible for climatic reasons. From the security viewpoint, the Arctic was merely a region that nuclear ICBMs would have to cross on their way to their targets. Now, however, with the possibility opening up of a shipping lane through the Arctic Ocean, naval vessels of all nations will be able to make use of a much larger area of the Arctic than hitherto. For Russia and the other countries bordering on the Arctic Ocean, a greater extent of coast will become a potential target for the landing of enemy troops, and the Arctic is thus turning into a new strategic front. During the Russo-Japanese War of 1904–1905, the main force of Russia's Baltic Fleet arrived in the East China Sea after rounding the southern tip of Africa, but if these ships had been able to traverse the Arctic Ocean, a route that is very much shorter, the course of the war might have been different. It is from considerations such as these that Russia attaches such importance to the strategic significance of the Northern Sea Route. Some observers speculate that, if it becomes feasible to project power through the Arctic Ocean, it could become the scene of a fierce struggle for naval supremacy, and such a development would require major changes in Russian geopolitical theory and military strategy.

In fact, the emergence of the Northern Sea Route has already begun to exert a considerable influence on Russia's views on security issues. On July 2, 2012, the *Xuelong* (Snow Dragon), a Chinese icebreaking research vessel, left the port of Qingdao in Shandong Province on its fifth Arctic expedition. The *Xuelong*, which is owned by the Polar Research Institute of China and was purchased from Ukraine in 1993, is the world's largest non-nuclear-powered icebreaker. On this recent expedition, the ship completed its longest voyage to date—to Iceland and back to its home port—a distance of 31,000 kilometers and lasting roughly three months.

In 2006 China applied for observer status at the Arctic Council, an intergovernmental forum consisting of the eight countries bordering the Arctic Ocean, and it also signed a bilateral agreement with Council member Iceland regarding cooperation in the Arctic. The *Xuelong* called at Reykjavik, the capital of Iceland, where marine experts from Iceland came on board and then cooperated with the Chinese staff in polar research. During the voyage, the *Xuelong* trailed a sensor along the Arctic seabed for fifty days, and data on the ship's position, the depth of the ocean, the ocean temperature, and other research matters was displayed on the *Xuelong* website and updated every hour.

**Figure 7.9. Fifth Arctic voyage of the *Xuelong* (Snow Dragon); planned routes**



Note: The above map shows the originally planned routes; the actual route of the return voyage was changed, with the ship passing through the Tsugaru Strait.

Source: CHINARE 5 website.

On its outward voyage, the *Xuelong* sailed through Russia's EEZ along the Northern Sea Route, but on the return voyage, the ship was able to use a transpolar sea route, passing very close to the North Pole, thanks to faster-than-predicted melting of the Arctic ice cap in 2012. This was the first case in which a country other than Russia had succeeded in passing close to the North Pole, which is on the high seas. This route constitutes the shortest route between Europe and Asia. While the passage of ships through the Arctic Ocean normally refers to passage through the Northern Sea Route close to the Russian coast, in which case Russia will have effective control over such the passage of foreign vessels, in that ships will have to apply for permission and be escorted by Russian icebreakers, China has demonstrated its desire to avoid Russian control by developing the Transpolar Sea Route.

When the *Xuelong* sails from the Sea of Japan to the Arctic Ocean, there are two possible routes it could take. One is through the Tsugaru Strait directly into the Pacific, and the other is through the La Pérouse Strait (also known as Soya Strait) into the Sea of Okhotsk, and from there into the Pacific and subsequently the Bering Sea. According to experts in Russian security issues, in response to the passage through the Tsugaru Strait of four Chinese naval vessels in October 2008, which was the first such occurrence in history, the Russians for the first time began to seriously consider the future possibility of the Chinese presence on the high seas to the north. Moreover, the Russian military has long regarded the Sea of Okhotsk as a de facto Russian inland sea—a “sacred area” set aside for Russian military activity only—and the fact that the *Xuelong* has frequently made use of the La Pérouse Strait route since 1999 has caused growing apprehension among the Russian military and experts in military affairs. Russian military maneuvers conducted in the Arctic region include those intended to test and verify the success of effects to reform the armed forces, but in addition include maneuvers that seem designed to prepare Russia for an increased Chinese presence on the high seas.

As if to oppose the use of the La Pérouse Strait as a means of accessing the Pacific from the Sea of Japan as part of the route to the Arctic Ocean, in 2011 the Eastern Military District of Russia held the first large-scale military exercises in the Sea of Okhotsk since the end of the Cold War. In addition, from June 28 to July 6, 2012, sixty warships, forty aircraft, and around 7,000 sailors and marines belonging to the Russian Pacific Fleet took part in large-scale maneuvers in the Sea of Okhotsk.

A large number of Russian warships stationed in the Far East assembled in the Sea of Okhotsk for the purpose of taking part in these maneuvers, with twenty-six naval vessels passing through the La Pérouse Strait from west to east on the July 1–2, 2012. Immediately prior to the start, the Russian Ministry of Defense announced a one-day extension of the exercises, and on July 6, the final day, surface-to-ship missiles were launched from the eastern coast of Sakhalin at floating targets stationed at a distance of 200 kilometers. As this was just when the *Xuelong* was passing from the La Pérouse Strait into the southern part of the Sea of Okhotsk, there were speculations that the firing of these missiles may have been deliberately timed to act as a warning against the intrusion into the Sea of Okhotsk of Chinese official vessels. According to the original expedition plan, the *Xuelong* was to have passed through the Sea of Okhotsk on its return trip, too, calling at the port of Shanghai at the end of September, but the route was changed without warning and the ship returned to the Sea of Japan via the Tsugaru Strait instead. The Okhotsk maneuvers in 2011 commenced on September 2, which is designated in Russia as the anniversary of the end of World War II (i.e., the end of the war against Japan), but no repetition of this sort of “anti-Japanese rhetoric” was seen in relation to the Sea of Okhotsk maneuvers in 2012.

After serving as a sanctuary for Russian nuclear submarines armed with ballistic missiles during the Cold War, the Sea of Okhotsk is now being given the additional strategic role of acting as a barrier to foreign ships hoping to take a shortcut to the Arctic Ocean. On its recent voyage, the *Xuelong* passed out from the Sea of Okhotsk to the Pacific Ocean just south of the island of Paramushir in the northern portion of the Kuril Islands chain, but one more possible means of egress is close to what Japan calls the Northern Territories, east of the island of Hokkaido. The Russian military reinforced its garrisons on two of the islands—known as Kunashiri and Etorofu in Japanese—and has drawn up plans for the steady modernization of its forces in the area, including the deployment of

surface-to-ship missile batteries. If the significance of the process of turning the Sea of Okhotsk into a “sanctuary” acquires greater importance within the Russian military and government, the military importance of these two islands is likely to grow. In this way, the emergence of the Northern Sea Route as a viable shipping lane is beginning to have a considerable impact on Russian military policy and on the country’s military posture in East Asia.

#### **(4) Russia Seeks Security Cooperation with Japan**

Following President Medvedev’s visit to the island of Etorofu in November 2010, political relations between Japan and Russia deteriorated to an all-time low. However, since September 2011, when Putin announced his intention of running in the presidential election, at bilateral summit meetings and foreign ministerial conferences, the Russian side has persistently requested Japan to cooperate in security matters, particularly maritime security. At the Russo-Japanese summit meeting held in Vladivostok on September 8, 2012, the two sides confirmed their intention to take concrete actions to step up bilateral cooperation in maritime matters, particularly in the Arctic, in recognition of the changing strategic environment in the Asia-Pacific region. Following this, Russian Security Council Secretary Nikolay Patrushev visited Japan in late October, and reached agreement with Foreign Minister Koichiro Gamba to further advance the Russo-Japanese cooperation initiatives in the security field that have been conducted in the last few years. These include discussions and exchanges in the area of national defense, the conduct of joint search-and-rescue exercises (SAREX) by the Japan Maritime Self-Defense Force and the Russian Navy, and antidrug operations in Afghanistan.

In an interview with Russian Security Council Secretary Patrushev at his official residence, Japanese Prime Minister Yoshihiko Noda welcomed the beginning of full-fledged cooperation between Russia’s Security Council and Japan. In talks between Patrushev and Defense Minister Satoshi Morimoto, the two sides agreed to continue regular consultations on multilateral security in the Asia-Pacific region, and the Russian side requested Japan to send a representative to the international conference on security matters scheduled to be held in Vladivostok in July 2013. It is expected that Japan and Russia will collaborate increasingly in defense matters in the coming years, and visits by ministerial-level officials of both sides will be scheduled.



Secretary Patrushev and President Putin have known each other well since the days when they were both officers of the KGB (the Committee for State Security), a security agency of the Soviet Union. In 1999 Patrushev replaced Putin as Director of the FSB (the main successor to the KGB), and served in that post for eight years. Patrushev is said to be very loyal to Putin, and in turn, the only man to enjoy Putin's complete confidence. As stated above, the Security Council, whose secretariat he leads, plays an important role in drafting and determining national strategy. In October 2012 a memorandum was signed between the Foreign Ministry of Japan and the Secretariat of the Security Council of the Russian Federation. This memorandum is believed to be significant in strengthening Japan's relations with the Security Council—which had not had close working relations with Japan before that—and with Security Council Secretary Patrushev, and in advancing the relationship between the two countries, including with respect to the Northern Territories.

Patrushev is thought to have visited Japan at the behest of President Putin, and it is speculated that this was intended as a political act that would demonstrate to China—which was about to go through a change of leadership—Russia's intention of strengthening its cooperation with Japan in the security field. The planned official visit to Russia by Prime Minister Noda in early December was postponed due to changes in the political calendar of both countries.

Russia seeks cooperation in maritime security matters with the United States as well. The executive order issued on May 7 by President Putin with respect to foreign relations not only proposed the strengthening of strategic collaboration with Asian nations such as China, India, and Vietnam, but also the forging of closer ties with four countries that have strong security relationships with the United States—Japan, South Korea, Australia, and New Zealand. In its recent public announcements concerning foreign policy, it is notable that Russia has made reference to all these four allies of the United States. According to experts in Russian security policy, Russia recognizes that Chinese maritime activities will extend toward the north in the future, and for this reason is seeking increased cooperation in maritime security with both Japan and the United States.

In fact, Russian naval vessels took part in the Twenty-third RIMPAC (Rim of the Pacific Exercise), hosted and administered by the United States, from the end of June 2012 offshore of Hawaii. This was the first time the Russian Pacific Fleet participated in this exercise, signalling that maritime cooperation between the

United States and Russia has entered a new stage. Additionally, prior to his recent visit to Japan, Security Council Secretary Nikolay Patrushev held talks in South Korea with President Lee Myung-bak on security cooperation between the two countries, and following the conclusion of his talks in Tokyo, he visited Vietnam.

At the Russia-Japan foreign ministers conference held in the southern Russian city of Sochi on July 28, agreement was reached to upgrade the Trilateral Conference on Security Challenges in Northeast Asia (a conference involving civilian experts), to the level of Track 1.5 diplomacy, with the participation of government officials. Against this background, we can expect to see more trilateral talks on security issues among Japan, the United States, and Russia. In the proposal put forward at this conference, it was apparent that Russia's perception of the strategic environment in Northeast Asia, including China and North Korea, was moving closer to the views of Japan and the United States, and the proposal document included a statement to the effect that the three parties shared many common security interests. The Russian government envisages its armed forces taking part in joint trilateral military exercises, and the focus of interest in coming years will be on how Japan and the United States respond to these requests for cooperation in the security field.

However, it can be pointed out that the following issues may constitute stumbling blocks in the event of attempts to pursue further security cooperation among Japan, the United States, and Russia. Firstly, Russia is not an alliance partner of Japan or the United States, which of itself limits the degree to which Russia can cooperate with them in the security sphere. Secondly, because few Japanese people regard Russia with friendly eyes or believe that Russo-Japanese relations are currently good, Japanese officials naturally adopt a cautious stance on security cooperation with Russia. In particular, the existence of the unresolved Northern Territories issues could well be a major obstacle to improving relations between the two sides in the sphere of security. And thirdly, even if Russia pursues further security cooperation with Japan and the United States, it is highly unlikely that it would do so to the point where this might imperil its multifaceted and complex relationship with China.

As most Russian experts point out, at the moment, Putin himself does not possess a clearly defined strategy vis-à-vis China, and they predict that Russia will remain uncertain of its stance with respect to relations with both the United States and China for some time to come. Nonetheless, the emergence of national security

as a new sphere of possible cooperation between Japan and Russia, in addition to the pre-existing cooperation in the economic and resources development fields, is a development to be welcomed for the increased significance it adds to the Japan-Russia relationship.

### **3. Measures to Reform the Russian Military and Defense Industry**

#### **(1) Results after Four Years of Military Reform Initiatives**

##### **(a) Successes in reforming the military, and the impact of leadership changes at the Ministry of Defense**

On November 6, 2012, President Putin dismissed Defense Minister Anatoliy Serdyukov from his post and appointed as his successor Sergey Shoygu, governor of Moscow Oblast. Then, on the ninth he dismissed Nikolay Makarov, chief of the General Staff, installing in his place Valery Gerasimov, commander of the Central Military District. Minister of Defense Shoygu did not serve in the armed forces, but was awarded the military rank of General of the Army after being appointed minister of emergency situations and thus head of a ministry that possesses military command powers. In the background to the appointment of Shoygu as defense minister lay growing dissatisfaction among military officers with the drastic reform measures forced through by Defense Minister Anatoliy Serdyukov (also of a civilian provenance). The dismissal of Serdyukov is believed to have been aimed at defusing this situation. Moreover, some observers have suggested that the change of leadership at the General Staff was intended to promote a reevaluation of the role of the General Staff headquarters, which was expanded as a result of the military reforms pushed through by Defense Minister Serdyukov.

No changes in the basic direction of the currently ongoing military reforms have been noted as a result of these personnel changes at the Ministry of Defense and the General Staff, but certain revisions to the details of particular items on the reform agenda are forecast. On December 6, 2012, General Gerasimov spoke at a traditional end-of-the-year meeting with foreign military attachés accredited in Moscow. In this briefing, Gerasimov asserted that there would be no significant change in the military reform policy, merely some adjustments.

The military reform measures pursued under former Defense Minister Serdyukov commenced in October 2008 and continued for four years. During this

period, progress was achieved in reorganizing the structure of the armed forces and the defense ministry, and major reductions were made in the number of both military and civilian personnel. Also during this period, the *State Weapons Program for 2011-2020* (hereinafter, the “current state weapons program”) was drafted, and the procurement of new weaponry under this program was commenced. This was part of a larger reform initiative aimed at realizing a “new look” for the Russian military. At a meeting with the top officials of the Defense Ministry in March 2012, President Medvedev pointed to four principal achievements of the military reform program from 2008 to 2011.

The first achievement was the progress made in organizational reform, which had raised the level of preparedness of many of the armed forces’ units, had advanced the degree of integration between the different armed services, and was raising the efficiency of command and control of military units by the staff of new military districts. The second achievement was the establishment of the Air-Space Defense Forces as a new branch of the services that possesses unified control over Russia’s surface-to-air defense system, missile defense system, early-warning system against potential missile attack, and system for control over outer space. The third achievement was the strengthening of Russia’s strategic nuclear force, which the Russian leadership countries to position as a pillar of national defense. Finally, the fourth achievement of the reforms was the commencement of the procurement of new weaponry for the armed forces, raising the proportion of state-of-the-art weapons possessed by the Russian military to 16 percent. Finally, President Medvedev declared that the creation of new military units and the reinforcement of existing ones was one of the top-priority elements of national policy.

#### **(b) Reforms make progress in all services and branches of the armed forces**

We here present a round-up of the achievements of Russia’s military reform program in all armed services and branches and a description of their current state. According to Victor Bondarev, commander-in-chief of the air force, the air force is composed of basic units that existed prior to the start of the reforms, i.e., the long-range and military transport air command, the air force and air defense command, the air-space defense brigades, air bases, and air groups. The respective air units of the navy, strategic missile forces, aerospace forces, and airborne forces have been

integrated into the air force. Brigades Nos. 1–4 of the air force and air defense command have been transferred to the authority of four different military districts. The air-space defense operation and strategic command units have been removed from the air force and placed under the command of the Air-Space Defense Forces.

Weapons procurement in 2012, under the current state weapons program, included over a hundred attack helicopters and transport helicopters, more than sixty fighter aircraft, transport aircraft and long-range aircraft, and the S-400 and Pantsir S surface-to-air missile systems, among others. Apart from the Su-T-50 PAK-FA leading-edge fifth-generation fighter, which is under development and slated for deployment in the near future, all the aircraft for which purchases are planned consist of upgraded versions of models originally developed in the 1980s and 1990s, but in view of the fact that, at present, only 40–60 percent of the aircraft possessed by the Russian Air Force are fit for combat, even the purchase of somewhat outdated planes would be an improvement over the current situation.

The Russian leadership continues to attach great importance to maintaining the country's nuclear deterrent, and thus they put a high priority on the procurement of new weaponry in the field of strategic missile forces. Six regiments of Topol-M (RS-12M2) silo-based intercontinental ballistic missiles (ICBMs), two regiments of Topol-M (RS-12M1) mobile ICBMs, and two regiments of Yars ICBMs with MIRVs (RS24) have already been deployed, and preparatory measures were taken for equipping another two divisions with Yars ICBMs within 2012. Sergey Karakaev, the commander of the Strategic Missile Forces, stated that 30 percent of the ICBMs possessed by strategic missile forces would be replaced by the latest models by February 2012, and that this proportion would probably rise to 60 percent by 2016 and to 97 percent by 2020. In September 2012 Karakaev revealed that in 2011, the Russian authorities had taken the decision to develop new ICBMs capable of penetrating the United States' missile defense shield.

The Air-Space Defense Forces, which were created in December 2011, are divided into the Space Command and the Surface-to-Air Defense and Missile Defense Command. With regard to weapons procurement, priority is given to one division and three surface-to-air missile brigades deployed near Moscow under the command of the Air and Missile Defense Command, which has responsibility for defending the capital. To improve the missile attack warning system, a radar tracking base has begun operations in the Kaliningrad Oblast, and test operations have commenced at a similar facility in Irkutsk.

Simultaneously with the deployment of the Russian Global Navigation Satellite System (GLONASS) all air-space defense brigades have been equipped with the Universal 1S computerized system of command and control of units and troops. An increase is planned in the number of surface-to-air missile brigades up to the year 2020, and it is planned to introduce fifty-six S-400 anti-aircraft missile systems and ten battalions equipped with the latest S-500 anti-aircraft missile systems. Some observers have estimated that to reach the long-term procurement targets for the air-space defense forces would require roughly 20 percent of the total amount budgeted for the period up to 2020 under the current state weapons program.

Russia's airborne units are positioned as a very important part of the armed forces as a whole, in view of the goal within the reform program of achieving a high level of mobility and permanent readiness capability. In June 2012 Vladimir Shamanov, commander of the Russian Airborne Troops, was promoted to the senior rank of colonel general, but will continue to act as commander of the airborne forces while also carrying out his new duties. The Airborne Troops comprises five rapid reaction battalions, which indicates the degree to which they are expected to display rapid reaction capabilities, and a high proportion of the soldiers serving in these units are enlistees (i.e., professionals, not conscripts), who are very experienced and capable. At airborne battalions stationed in Ulyanovsk Oblast, the proportion of professional troops is as high as 60 percent, and in airborne artillery regiments stationed in Kostroma Oblast, only 350 kilometers or so from Moscow, the ratio of enlistees in certain battalions is even higher. With respect to equipment procurement, the computerized command and control system Polet-K was introduced in the airborne forces, starting with 75 percent of units in 2011, and finishing deployment to the remaining units in 2012.

Vladimir Shamanov has requested the replacement of the currently-used BMD-2S airborne infantry fighting vehicle with the BMD-4M model. Because of a lack of agreement on the purchase of this vehicle among the defense ministry, the staff headquarters, and the defense industry companies involved, President Putin ordered the interagency committee headed by Dmitry Rogozin, vice-premier in charge of the defense industry, to examine this issue. In December 2012 Shamanov received permission from the Ministry of Defense to order the production of ten BMD-4M vehicles and ten Rakushka multipurpose armored transport vehicles in the first half of 2013.

Regarding Russia's ground forces, progress is being made in the formation of

brigades. In July 2012 Colonel General Vladimir Chirkin, commander-in-chief of the Russian Ground Forces, announced that one hundred or so new brigades had already been formed and that the formation of twenty-six further brigades was scheduled by 2020—ten reconnaissance brigades, fourteen air brigades, and two surface-to-air missile brigades. Chirkin also made it clear that the formation of two Arctic brigades was proceeding to strengthen Russia's military capabilities in the Arctic. Chirkin stated that Pechenga and Kandalaksha in Murmansk Oblast in Russia's far northwest, and the Yamalo-Nenets Autonomous Okrug in western Siberia, among others, were being examined as potential sites for the stationing of these units. He also said that the Arctic brigade would be a light, mobile, rapid-reaction force capable of carrying out its mission in any kind of complex situation.

Despite the ongoing formation of brigades in the ground forces, the number of troops is insufficient. Alexander Postnikov, former commander-in-chief of the Russian Ground Forces and currently deputy chief of the General Staff, has said that approximately 70 percent of ground force troops are conscripts, and moreover, as the number of conscripts falls short of the target, there are quite a large number of brigades without a sufficient number of troops, and that one of the avowed goals of the military reforms—to ensure that all units were capable of rapid response at all times—would end up being merely an empty slogan. The General Staff headquarters revealed in January 2012 that as of that point in time, the number of Russia's military personnel totaled 774,500, of which 220,000 were commissioned officers, 200,000 were enlisted noncommissioned troops, and 354,500 were conscripts. The total falls more than 200,000 short of the country's officially stated military manpower of 1 million troops.

In addition, the procurement of new equipment is lagging behind schedule, and this is a factor that hinders the improvement of the strategic and deployment capabilities of military units. In particular, the Russian military is still lacking in sufficient precision-guided weapons and in the introduction of the C4ISR (Command, Control, Communications, Computers, Intelligence, Surveillance and Reconnaissance) systems, nor have the armed forces' armored combat vehicles been sufficiently upgraded. Moreover, the Russian Ground Forces have not necessarily been assigned a high priority within the current state weapons program. In February 2012 Nikolay Makarov, chief of the General Staff, admitted the difficult position of the ground forces with respect to the weapons modernization program.

As described above, in his decree relating to the modernization of the armed forces and the defense industry issued on May 7, 2012, President Putin expressed his intention of strengthening the navy, with priority on the Arctic and the Far East. To prepare for the emergence of the Arctic Ocean as a new strategic front, the Russian authorities intend to expand and reinforce Russia's military presence in the Arctic region as a proactive response to possible security issues. In other words, the three strategic fronts that have existed for Russia up to now—the European front to the west, the Central Asian and Caucasus front to the south, and the Far East front in East Asia (especially with respect to China)—will soon be joined by a fourth front, namely, the Arctic Ocean front to the north. Nikolay Patrushev, secretary of the Security Council, clearly stated in August of 2012 that Russia was considering constructing a string of bases along its Arctic Ocean coast, running from the Atlantic to the Pacific, for temporary use by vessels of the Russian Navy and the Border Guard Service.

Meanwhile, one of the reasons why the Russian government stresses the importance of building up its naval strength in the far eastern theater is the growing degree of naval activity by China in this region, and the widening maritime area of this activity. In October 2012 Defense Minister Anatoliy Serdyukov made it clear that of the eight *Borey*-class nuclear-powered ballistic missile submarines (SSBN) scheduled to be purchased by 2020 under the current state weapons program, the first—the *Yuriy Dolgorukiy*—was assigned to the Navy in January 2013, while the second—the *Alexander Nevskiy*—will enter service in 2014 with the Pacific Fleet. It has also been reported that the third of these submarines, the *Vladimir Monomakh*, which is currently undergoing sea trials, is scheduled to be deployed (in a theater still undecided) in 2014. On a visit at the end of July 2012 to the Sevmash shipyard, where these strategic nuclear submarines have been constructed, President Putin revealed his policy regarding the procurement of equipment for the Navy under the current state weapons program, and stated that 4,440 billion rubles, equivalent to 23.4 percent of the total planned expenditure up to 2020 under the weapons procurement program, would be allocated to strengthening the Russian Navy.

### **(c) Status of weapons procurement, and outstanding issues**

Despite the achievements described above, made during the period of roughly four years in which military reform efforts were pursued under former Defense



Minister Serdyukov, it is recognized by all concerned that a large number of issues remain to be addressed if further progress is to be made in modernizing and strengthening Russia's defense capabilities. These primarily include the continued procurement of cutting-edge equipment for the armed forces, and to make that possible, the strengthening of the Russian defense industry. These points were underscored in Putin's presidential decrees of May 7, in which he stated his aim of raising the proportion of state-of-the-art weaponry possessed by the armed forces to 70 percent of all weaponry by the year 2020, and positioned the further development and modernization of the country's defense industry as a top-priority task. President Putin also listed Russia's nuclear deterrent force, defensive measures in the aerospace field, systems for telecommunications and intelligence gathering and analysis, wireless electronic weaponry, unmanned air vehicle systems, robot-based offensive systems, up-to-date transport aircraft, precision-guided weapons, and others among priority items for procurement.

In an article in the newspaper *Rossiyskaya Gazeta* written prior to the issue of the above decrees, President Putin not only explained the current situation with respect to the reform of the military, but also referred in detail to problems besetting the Russian defense industry. In the article, he mentioned certain specific plans for weapons procurement, and gave the following specific figures for weapons procurement over the next ten years. They include 400 of the latest land-based and sea-based ICBMs, 8 strategic nuclear-powered submarines, about 20 multipurpose submarines, over 50 combatant ships, approximately 100 military satellites, over 600 of the latest aircraft, including fifth-generation fighters, 28 regiments equipped with S-400 surface-to-air missile systems, 38 divisions equipped with Vityaz surface-to-air missile systems, 10 brigades equipped with Iskander-M short-range mobile theater ballistic missile systems, over 2,300 of the latest-model tanks, roughly 2,000 self-propelled artillery systems, and over 17,000 assorted military vehicles.

It is thought that the achievement of these plans would raise the proportion of up-to-date equipment possessed by the Russian armed forces above 70 percent. However, the Russian Ministry of Finance has clashed with the Ministry of Defense over these plans, arguing that the total planned expenditure of about 23 trillion rubles under the current state weapons procurement program is excessive, and has called for a reduction by 20 percent. At the moment, therefore, it remains uncertain whether the intended purchase of the latest weapons and systems will

go according to plan.

Regarding the current state of the Russian defense industry, Putin stated that both research and production efforts over the past thirty years had lagged behind the times, and severely criticized the defense industry for producing outdated weapons due to “going by the book,” without innovation and originality. He raised four issues that need to be addressed: (1) increased production of leading-edge, next-generation weapons and other equipment; (2) development of technological capabilities designed to meet future needs; (3) the development of the sort of technological expertise required to enable the production of competitive weaponry, and; (4) the improvement of a defense industry technological base specifically designed to produce state-of-the-art weaponry. To achieve these goals, during 2012 Putin called for the start of drafting of a *State Weapons Program for 2016–2025*, with the goal of updating the weapons and other equipment used by all the armed forces through the nurturing of a competitive Russian defense industry.

## **(2) Conduct of Military Exercises to Verify Reforms and Improve International Military Cooperation**

In 2012 Russia once again conducted a number of military exercises aimed at verifying the results of the reform program, helping improve the armed forces’ capabilities, and strengthening international military cooperation. These include the joint naval exercise with the Chinese Navy off the coast of China, and other exercises around the Russian Far East. In June 2012 in a meeting with top officials of the Ministry of Defense, President Putin revealed that about 280 military exercises of various scales had been conducted in the first five months of 2012, and a further 300 or so were planned during the remaining part of the year. He pointed out that it was an important task to significantly improve the proficiency of the units taking part in these exercises and to raise the quality of the exercises themselves.

Large-scale operational and strategic exercises have been held in four military districts (i.e., in one military district each year) that were newly created in a reorganization of the military district system as part of the reform program. In 2009 the Zapad (West) 2009 exercises were held in the Western Military District, mainly in the former Leningrad Military District, now integrated into the Western Military District. In 2010 the Vostok (East) 2010 exercises were held in the Eastern Military District, which prior to the reorganization consisted of the

Siberian Military District and the Far Eastern Military District. In 2011 the Tsentr (Center) 2011 exercises were held in the Central Military District, and finally, the Kavkaz (Caucasus) 2012 exercises were held in the Southern Military District from September 17–23, 2012. These last exercises involved approximately 8,000 personnel from the Ground Forces, Navy, and Airborne Forces, as well as 200 tanks, 100 artillery pieces, 10 naval vessels, and 80 aircraft. They were aimed at preparing for the reestablishment of Russian internal security, and were conducted solely by the Russian Armed Forces.

One of the most important purposes of this exercise was to test the effectiveness of the latest computerized command and control systems, which have been developed to incorporate the lessons learned from the conflict between Russia and Georgia in 2008, when existing systems proved inadequate. According to Deputy Chief of the General Staff Alexander Postnikov, no foreign observers were invited to this exercise because its purpose was purely concerned with internal issues.

From September 15–19, almost exactly the same time frame as Kavkaz 2012, joint maneuvers were held in Armenia with the Collective Reactive Operation Forces (KSOR in Russian) of the Collective Security Treaty Organization (CSTO) under the name *Vzaimodeystvie* (Mutual Action) 2012. This exercise involved roughly 2,000 troops from Russia, Armenia, Belarus, Kazakhstan, Kyrgyzstan, and Tajikistan, and was intended to verify the ability of military units of the CSTO in the Caucasus region to resist an attack from a hypothetical enemy and then counterattack. The CSTO has been conducting Mutual Action exercises each year since 2009, but this was the first such to be staged in the Caucasus region. Moreover, it was held at almost the same time as the Kavkaz 2012 exercises by Russian forces alone, and in a very close location. It is thought that the holding of these two exercises was aimed at Georgia and NATO, which has been forging stronger collaborative ties with Georgia and is seen to be attempting to exert growing influence over the Caucasus region.

This strengthening of military cooperation within the framework of the CSTO is one of the priority items in Russia's current military doctrine, and it also conforms with the policy on the strengthening of Eurasian integration (Eurasia in the sense of the post-Soviet region) that has been put forward by President Putin. In April 2011 the CSTO's Collective Peacekeeping Forces (Russian acronym of KMS), numbering 4,200 troops, were formed, giving the CSTO a framework of military action involving three separate forces—the KSOR, the Collective Rapid

Reaction Force (Russian acronym of KSBR), and the KMS. However, there is not necessarily any clear consensus of interpretation among the members of the CSTO as to how these forces should be employed. Uzbekistan, which is no longer a member, was particularly negative about cooperation with the CSTO. President of Uzbekistan Islam Karimov has insisted that a unanimous vote of all members should be required for deployment of the CSTO's forces, and that they should not be used to intervene in conflicts among members. At a summit meeting of CSTO members in December 2011, a resolution was adopted requiring any member country wishing to allow a third-party country to establish a new military base on its territory to obtain the approval of all other members.

This resolution effectively gives Russia a power of veto over plans by any CSTO member to allow the establishment of new foreign military bases, and is an important means of preventing the United States from further expanding its influence over the Caucasus and Central Asia. Additionally, a number of proposals were discussed at a CSTO summit held in Moscow in December 2012. These included the integration of all the separate units possessed by the CSTO into one collective military force, the establishment of a Military Committee and a Joint Staff under the Council of Defense Ministers, and the appointment of a Chief of the Joint Staff.

It is difficult to say whether these efforts being led by Russia to more strongly integrate the armed forces of the CSTO members will proceed the way Russia wishes. Some in the CSTO member countries are wary of these developments, believing that they may restrict those countries' relations with other nations. In June 2012 Uzbekistan suspended its membership of the CSTO. This move is believed to have been prompted by fears that once the International Security Assistance Force (ISAF) withdraws from neighboring Afghanistan in 2014, the Taliban movement will become a threat to Uzbekistan, and that therefore military cooperation with the United States will be vital. This move by the Uzbekistan government came as a shock to Moscow, and the holding of the joint KSOR exercise in Armenia was partly motivated by a desire to demonstrate to the outside world the solidarity that exists among the CSTO members.

In addition, Tajikistan and Kyrgyzstan, which are also close to Afghanistan, harbor the same fears about the Taliban, and believe that a certain degree of military cooperation with the United States is important. Since the United States commenced its operations in Afghanistan, Tajikistan has been cooperating with

the US forces, such as by throwing open its air space for use by American military aircraft, and allowing them to use Dushanbe International Airport. Kyrgyzstan, meanwhile, has expressed its intention of allowing the Americans to make use of Manas Airport from 2014 onward, for the transport of non-military supplies. In early September 2012 Kazakhstan for the first time hosted the annual joint exercises held under the name Steppe Eagle on its own territory, with the participation of US and UK forces. The purpose of these exercises was to strengthen cooperation and liaison between Kazakhstan's peace-keeping battalion and NATO forces. Armenia, which appears to enjoy a good relationship with Russia, also participated in a week-long joint exercise with US forces within the framework of exercises held with NATO. In these ways, CSTO members other than Russia are beginning to reduce their dependence on Russia in the military and security spheres.

From April 22–27, 2012, Russian and Chinese naval units took part in the first joint naval exercises between these two nations, under the name Maritime Cooperation 2012, in the Yellow Sea near the city of Qingdao. Seven ships from Russia's Pacific Fleet and eighteen ships from China's North Sea Fleet and other units, including two submarines, took part in these exercises. Although described as "joint exercises," some sources say that they were effectively two separate sets of maneuvers, as the two sides had difficulty in agreeing on details, and the exercises had been postponed at least once. Previous joint military exercises between Russia and China had been designed for "external consumption," i.e., to demonstrate to other countries the strategic cooperation between the two sides, but recent exercises seem to have been more for "internal consumption." That is to say, they have been at least partly intended to allow the two sides to assess each other's capabilities.

In the background to the recent exercises lies a desire on the part of both countries to restrain the ongoing expansion of the military presence of the United States in the Asia-Pacific region, but at the same time there are other factors at work. The Russians aimed to use the exercises to evaluate the capabilities of the Chinese Navy, which is constantly growing in strength, while for their part the Chinese wished to assess Russian capabilities in antisubmarine operations. For these reasons, neither side sees any further need for large-scale maneuvers involving all branches of the armed forces, such as the Peace Mission exercise conducted in 2005 with the participation of around 8,800 troops and 140 naval

vessels including submarines. As that exercise was conducted immediately following North Korea's launching of a long-range missile, China played up the political importance of the exercise, whereas Russian media aimed at foreign audiences played down its significance.

The Russian authorities are becoming increasingly wary not only of China's growing naval activity but also of its expanding influence in Central Asia. China's bilateral relationships with the countries of Central Asia have begun to develop not only at the economic level, but in the military sphere as well, and this process could lead to a diminished Russian influence in this region. In June 2012 President of Kazakhstan Nursultan Nazarbayev paid a visit to Beijing, where he reached an agreement with the Chinese leadership on closer cooperation, including in the military field, in the struggle against terrorism, separatist movements, and religious extremism. In the previous month, Chen Bingde, then chief of the General Staff of the People's Liberation Army, had visited Uzbekistan, where he reached an agreement on strengthening military cooperation.

### **(3) Russian Defense Industry Comes under Pressure to Implement Reform, while Arms Exports Continue to Grow**

The Russian leadership views the country's defense industry as lacking in the ability to manufacture adequate volumes of the latest weaponry and other military materiel, which is necessary for the modernization of Russia's armed forces. The industry lags behind particularly severely in its ability to produce the high-tech equipment needed to engage in network-centric warfare. Russia's military is said to be some twenty years behind those countries that possess armed forces fully equipped with state-of-the art equipment. Currently, levels of investment in both R&D and production are insufficient, and the average age of employees in defense industry corporations is rising. Under these conditions, technological innovations in the defense industry have not made much progress, and the level of production efficiency remains low. In May 2012, Sergey Chemezov, president of the government-owned business group Rostekhnologii, which manufactures advanced weaponry and related equipment, stated that although the Rostekhnologii group comprises over 600 companies and employs around 940,000 people, the products they manufacture account for only one-quarter of the total output of the Russian defense industry.

In August 2012, President Putin convened a Security Council meeting to

examine ways of remedying this low level of production efficiency. The meeting examined a number of proposed measures to achieve reform of the defense industry, including the establishment of public-private partnerships in the field of military equipment production. In his article published in February 2012 and in his executive orders issued on May 7, Putin had already pointed to the necessity of creating a system enabling the Russian defense industry to make use of cutting-edge foreign technology to stimulate their business activities, through business tie-ups with companies all around the world that possess advanced technologies. This would facilitate the manufacture of high-quality weapons and other materiel. From this perspective, the pursuit of military cooperation with various countries is a promising means of furthering the development of the Russian defense industry.

Not only has Russia negotiated a military technology cooperation deal with France for the purchase of two *Mistral*-class assault ships, and the building of another two ships in Russian shipyards, it has also reinforced its military technology cooperation with India involving the development of fifth-generation fighter planes. Additionally, military technology cooperation projects are proceeding with Israel, which has advanced technology in the field of unmanned aircraft, and with Italy, which boasts a high level of expertise in the manufacture of armored transport vehicles.

Russian exports of arms continue to grow. According to Viktor Komardin, vice president of Rosoboronexport, the sole state intermediary agency for Russia's arms exports and imports, the total value of Russia's arms exports in 2011 was \$10.7 billion, an increase of \$2 billion over the figure for 2010. This growth trend continued in 2012, with total arms exports in the first six months alone reaching \$6.5 billion, up 14 percent over the same period of the previous year. Anatoliy Isaykin, president of Rosoboronexport, cited the following two factors as reasons for this increase.

The first factor is ongoing efforts by Russian arms manufacturers to develop new markets. Although exports of arms to important markets in the Middle East and North Africa such as Syria and Libya have been hindered by recent political upheavals, the Russians have been working to conclude export agreements with Latin American countries such as Guatemala and Uruguay, as well as Southeast Asian countries including Laos and Singapore. The second factor is that the Russians have been attempting to succeed in the competitive global arms market by changing the nature of the country's military technology cooperation with

other nations. That is to say, they have been taking steps to move away from the conventional relationship model in which one side is the seller and the other the buyer, to a joint-development, joint-production model in which Russia licenses out the production of weaponry to the other party.

This second factor stems from the Russian defense industry's attempts to address the problem of its inadequacies with respect to cutting-edge technology, as explained above. Russia currently engages in trading in weapons with fifty-seven countries, and Asian countries account for a comparatively high 43 percent of Russia's total arms exports. India is Russia's largest customer, but here, too, emphasis is being placed on joint development and production. Cooperation with India in the field of military cooperation up to now has included the production in India under license of Su-30MKI fighter planes and T-90S tanks, and a joint development project involving fifth-generation fighter planes based on the Su-T-50 PAK-FA. In 2012 agreement was reached on establishing a joint venture in India to manufacture BM-30 Smerch 300 mm multiple rocket launchers.

Russia's exports of arms to China have been stagnating in recent years against the backdrop of the Russian leadership's concern with China's growing military might, as well as the Chinese side's desire to foster the arms development and production capabilities of their own defense industry. Nonetheless, the Chinese have been showing renewed interest in Russian arms since 2011. The Chinese are especially interested in the S-400 antiaircraft missile system and the Su-35 fighter. However, the Russians have demonstrated a lack of enthusiasm for the export of these items. This is because the deployment of the S-400 system at sites throughout Russia has been assigned a high priority, and the Su-35 fighter will remain the mainstay fighter for the Russian Air Force until such time as significant progress has been achieved in the production and deployment of the Su-T-50 PAK-FA, for which reason the deployment within Russia of the Su-35, too, will take priority over exports.



**Table 7.3. Principal developments in Russian arms exports in 2012**

<b>Destination</b>	<b>Nature of exports/agreements</b>
India	<p>Contract for delivery of 39 IL-476S transport planes (total approx. \$5 bn)</p> <p>Talks ongoing on contract for 42 Su-30MKI fighters (new contract for additional follow-up purchases, total approx. \$12 bn)</p> <p>Talks ongoing on sale of 71 Mi-17V-5 helicopters (new contract for additional follow-up purchases, total approx. \$1.34 bn)</p> <p>Talks ongoing on technology transfer for licensed production of T-90S tanks and improved model T-90MS</p> <p>Agreement reached on establishment of joint venture for manufacture in India of BM-30 Smerch 300 mm multiple rocket launchers</p>
China	<p>Contract for delivery and joint production of 4 <i>Lada</i>-class submarines (total approx. \$2 bn)</p> <p>Talks on delivery of Su-35 fighters (number undecided)</p>
US (purchases for use by Afghan National Army)	Contract for delivery of 12 Mi-17V-5 helicopters (additional to 21 helicopters under 2011 contract, total cost of all 33 to be \$584.7 mn)
Indonesia	Delivery of two Su-30MK2 fighters (first 2 of 6 under 2011 contract, total approx. \$500 mn)
Malaysia	Contract for delivery of RVV-AE air-to-air missiles (number unknown, total approx. \$35 mn)
Iraq	Contract for delivery including 30 Mi-28NE attack helicopters, 42 Pantsir S1 surface-to-air missiles, and MiG-29 fighters (number unknown) at total cost of approx. \$4.2 bn
Syria	<p>Talks ongoing on contract for delivery of 36 Yak-130 training aircraft (total approx. \$550 mn)</p> <p>Contract for delivery of S-300 surface-to-air missiles (number unknown) currently suspended</p>

Sources: Compiled from various sources.

