

## Chapter 6

# External Drivers for OPK Success: Emerging Markets

Other than the lucrative Indian and Chinese markets, there are a number of other markets that have been cultivated by the Putin Administration since 2000. With widespread expectations that the Chinese market in particular will begin to level out within the next 5–10 years, concerted marketing drives have been made into the Middle East, Southeast Asia, and Latin America by Rosoboronexport and the leading Russian defence enterprises. These efforts are beginning to pay dividends, as major arms contracts in 2006 signed by Algeria and Venezuela are expected to trigger further exports in these regions. As for Southeast Asia, a Russian offer of a US\$1 billion export credit for arms was accepted by Indonesia in December 2006, and ratified in September 2007. This agreement, in conjunction with other Russian arms sales to China, Myanmar, and Malaysia, bodes well for future Russian arms exports to Southeast Asia.

While the sheer volume of Russian arms sales is a clear economic indicator, it also demonstrates the extent of Russia's growing influence around the world. Recent arms deals show that Russia is building on its former influence in the Middle East, and forging ahead in the relatively untapped markets of Southeast Asia and Latin America. These markets have not only conducted business with Rosoboronexport, but also with individual manufacturers such as Sukhoi and RSK MiG. In 2005, Russia sold weapons to 61 countries, some of which are now challenging the likes of India and China in terms of financial recompense for Russia.<sup>1</sup> Both the Venezuelan and Algerian contracts were multi-billion dollar affairs, showing that Russia's market diversification efforts are now beginning to pay handsome dividends.

Russia's foreign order book for arms had reached approximately US\$20 billion by the time of publication. Alexander Fomin, Deputy Director of the Russian Federation Military-Technical Service, indicated that actual sales were likely to reach US\$8.5 billion in 2009. This would account for 40 per cent of the workload of Russia's *Oboronnyi-promyshennyi kompleks* (OPK) and he suggested that defence industries would be able to manage this demand comfortably.<sup>2</sup>

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1 Victor Yasmann, 'Russia: Putin Pushes Greater Arms Exports', 4 April 2006, available at <<http://www.globalsecurity.org/wmd/library/news/russia/2006/russia-060404-rferl01.htm>>, accessed 28 April 2009.

2 'Russia Optimistically Targeting \$8.5 Billion in Arms Exports in 2009', *Defence Talk*, 17 February 2009, available at <<http://www.defencetalk.com/russia-optimistically-targeting-85-billion-in-arms-exports-in-2009-16578/>>, accessed 7 December 2009; and Nikolai Novichkov, 'Russian defence exports surpass targets', *Jane's Defence Industry*, 1 March 2006.

Vladimir Putin maintains a keen interest in Russian arms sales around the world and to date has successfully lobbied for the sale of weapon systems during visits to Algeria, Libya, Malaysia, Thailand, South Korea, Turkey and several other Middle Eastern countries.<sup>3</sup> Key to this diversification success has been the efforts in recent years by Putin, Sergei Ivanov, and indeed ex-Rosoboronexport chief, Sergei Chemezov, to provide more flexible and creative financing and payment options for prospective arms clients. This has been a major contributing factor to the recent boom in arms sales. As stated by Richard Grimmett in his report to the US Congress regarding arms transfers to developing nations, the Russians have

agreed to engage in counter trade [with China], offsets [with Malaysia], debt-swapping [with South Korea], and in key cases [China and India], to make significant licensed production agreements in order to sell it weapons.<sup>4</sup>

This flexibility, coupled with an export drive focused on market diversification has not only increased sales but also expanded the market. In 2002 the geography of cooperation of the world arms market included 30 countries, but, according to Ivanov, as of January 2006 Russia was exporting arms to 82 countries.<sup>5</sup>

Moreover, the Russian export credit offer of US\$1 billion was formally accepted by Indonesia in December 2006. Such credit offers represent yet another funding option that Russia can offer its arms clients in the future. This flexible financing policy, in conjunction with its liberal export policy, (it rarely lets political considerations such as those related to human rights or 'rogue states' affect its export policies) makes Russia a more attractive option as an arms source than the United States for many countries around the world.

Assisting Russia's booming arms export receipts are economic and political developments within three of the world's geopolitical regions. In the Middle East, the steady rise in the price of oil and natural gas has ensured that the oil-rich Gulf States and Algeria have the financial capability to procure large amounts of military hardware. Furthermore, within Latin America, these high oil prices have ensured that Venezuela has the financial capability to satisfy its arms requirements, with at least US\$3 billion worth of arms contracts signed with Russia in the last four years, and more likely to follow. Such a large volume of arms will almost certainly upset the balance of power in Latin America,

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3 Yasmann, 'Russia: Putin Pushes Greater Arms Exports'.

4 Richard Grimmett in 'Asia overtakes Middle East as developing world's arms market', 3 September 2005, available at <<http://www.inq7.net>>, accessed 22 February 2006.

5 Rosoboronexport Representative in, 'Russian Arms Exports up 15-Fold in Last Three Years—State Agency', 21 November 2005, available at <<http://www.mosnews.com>>, accessed 22 February 2006; and 'Ivanov says Russia's 2005 arms exports up 9% on year', available at <<http://www.prime-tass.com>>, accessed 6 March 2006.

and will probably trigger further sales to the region. In Southeast Asia, the traditional procurement of 'prestige pieces' of military hardware has resumed, following the recovery from the 1997–98 Asian financial economic crisis, and the subsequent growth in defence budgets.

## Regional Sales Drives

### The Middle East

Marketing arms to the conflict prone Middle East has never been particularly difficult for the world's arms exporters. However, the region's thirst for arms has been superseded in recent years by Asia, and market competition has ensured that Russian arms manufacturers have had to maintain a considerable sales drive within the Middle East.

The Middle East market includes states that have large debts to Russia, such as Libya and Syria. Others have important economic relations with Russia, such as Turkey and Iran. Of major importance to Russia are its relations with Turkey and Iran, particularly given their influence in Central Asia and Transcaucasia and the potential threat they pose to Russia's influence in those regions. In 2002, Turkey was the largest market for Russian exports in the Middle East, accounting for nearly 48 per cent of Russian exports to the region. Sales to Iran accounted for 11 per cent.<sup>6</sup> The Persian Gulf is also a Russian priority because the oil-rich states have the ability to pay. Moscow has sought, though not always successfully, to balance its policy among Iran and the Gulf Cooperation Council states. Russia operates in the Middle East within the context of its Soviet legacy, but it cannot afford to offer the subsidies that the Soviet Union bestowed or that the United States provides through its military aid to Israel, Egypt, and other regional allies. Nonetheless, Russia's newfound willingness to offer flexible finance may well support its position in Middle Eastern states such as Syria and Morocco, considered to be on the region's financial periphery.

Between 1992 and 2003, the Middle East was Russia's third largest market, after China and India, and was worth about US\$10 billion in 2003 prices, equating to 17 per cent of its total arms exports. The largest purchaser within the Middle East was Iran (US\$3.7 billion) followed by Algeria (US\$2.3 billion) and the United Arab Emirates (UAE) (US\$1.8 billion). Other significant markets were Yemen, Syria, Kuwait, Sudan, Egypt, and Turkey.<sup>7</sup> Between 1992 and 1999,

<sup>6</sup> Paul Rivlin, *The Russian Economy and Arms Exports to the Middle East*, Memorandum no. 79, Jafee Center for Strategic Studies, Tel Aviv University, November 2005, p. 34, available at <[http://www.inss.org.il/upload/\(FILE\)1188301974.pdf](http://www.inss.org.il/upload/(FILE)1188301974.pdf)>, accessed 28 April 2009.

<sup>7</sup> Rivlin, *The Russian Economy and Arms Exports to the Middle East*, p. 34.

Russian arms exports to the Middle East averaged about US\$620 million a year. Between 1999 and 2003, they rose to nearly US\$1.3 billion a year. The volume of Russian arms sales during this period was strongly influenced by the changing circumstances of each Middle East purchaser. As oil underpins most Middle Eastern economies, these changing conditions were largely due to fluctuating oil revenues, governed by changes in the price of oil. From 1992 until 1998, oil prices were weak; by 1998, oil prices had slumped to a low of about US\$12 per barrel. Since then they have increased, and reached over US\$140 per barrel in 2008. Predictably, therefore, arms sales share a positive correlation with the price of oil, which is likely to remain high for at least the next 25 years according to the International Energy Agency. Sales grew in the period from 1998, marked especially by purchases by Algeria, Iran, the UAE and Yemen.<sup>8</sup>

Sales to Iran and Syria are a politically sensitive issue for Russia because the United States perceives both states to be active supporters of terrorism. Russian sales have continued, however, as only weapons of a defensive nature are sold to these countries. 'Defensive' in this case is a somewhat loose term and over the last three years this has encompassed *Kornet* and *Metis* anti-tank guided weapons and *Igla* MANPADS to Syria and Su-25 *Frogfoot* close air support aircraft and *Tor* M1 (SA-15) air defence systems to Iran.<sup>9</sup> Interestingly, the *Kornet* and *Metis* systems were used to great effect by Hezbollah during the last Israeli incursion into Lebanon. Syria's facilitation of arms deliveries to Hezbollah may see stricter export controls being exercised by the Russians, but ongoing negotiations for the delivery of MiG-29 and Su-27 fighter aircraft will probably continue until an agreement is made, as Hezbollah cannot utilise these platforms. On the other hand, Iran's receipt of Russian weaponry looks set to continue. The Iranian Su-25 and *Tor* M1 contracts were signed in 2005, despite US protestations, and were the first arms agreements signed by both states since 2000, suggesting a renewal of the old relationship. Iran's interest in Russian S-300 long-range SAM systems, the upgrade of its *Kilo*-class submarines, and the past agreement with Russia in upgrading its Su-24 *Fencer* strike aircraft and T-72 MBT fleets, could see further sales, albeit under the watchful eye of the United States.

The two other key customers in the Middle East for Russia are Yemen and the UAE. Since 2002, Yemen and Russia have developed their relationship into that of traditional 'buyer-seller'. Yemen has procured 22 MiG-29 fighter aircraft, as well as 180 BMP-2 Infantry Fighting Vehicles (IFVs) since 2002, and future sales are almost certain, with a US\$1.3 billion order for 32 of the advanced MiG-29SMT variants close to agreement. Like many of the global MiG-29 operators, Yemen

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8 Rivlin, *The Russian Economy and Arms Exports to the Middle East*, p. 35.

9 Liam Devlin and Tom Cooper, 'Iran bolsters Su-25 fleet', *Jane's Defence Weekly*, 20 September 2006.

is also upgrading its older MiG-29 fleet to SMT standard which, according to MiG officials, boosts the aircraft's capability by more than 300 per cent, whilst reducing operating costs by 40 per cent.<sup>10</sup>

The UAE military relationship runs deeper than mere procurement, as the UAE is involved in funding Russian research and development (R&D). The UAE bought 402 BMP-3 IFVs from Russia between 1994 and 2000 and, more importantly, signed a contract for the development and exclusive delivery of the *Pantsyr-S1* air defence system for US\$500 million in mid-2000.<sup>11</sup> This capable system comprises both missile and gun armaments on a mobile platform and has the capacity to track and engage four air targets simultaneously.<sup>12</sup> To be delivered in 2009, the contract stipulates that the UAE and Russia will be the exclusive users for two years after the final delivery date. The systems manufacturer, KBP Tula, stated that it has concluded US\$2.6 billion worth of contracts for the system,<sup>13</sup> presumably with the UAE and other countries prepared to wait two years for delivery. The UAE's relationship with Russia's OPK is important not only for financial return and R&D funding; it is also an example of the traditional Western arms procuring countries that have now begun to diversify and procure Russian equipment. A new contract between Russia and the UAE for shore-based *Klub* (SS-N-27 *Sizzler*) missile systems signed in Abu Dhabi in October 2006,<sup>14</sup> during Putin's visit, demonstrates the strength of the two states' burgeoning relationship.

The renewed Russian sales drive into the Middle East has been very fruitful due to the large number of Soviet and Russian sourced platforms in the region. Countries that operate such platforms include Algeria, Libya, Egypt, Syria, Yemen, the UAE and Iran, whilst traditional Western procuring countries such as Morocco, Kuwait and Saudi Arabia have begun to diversify by procuring niche Russian equipment such as air defence and multiple-launch rocket systems. This newfound interest in Russian weapons stems from a combination of competitively priced and durable products that in many cases have no Western analogue or equal. Morocco was looking to sign a US\$1 billion arms deal with Russia following Putin's visit to Casablanca in September 2006. Although still undecided, the contract was expected to include Mi-17 helicopters, BMP-3 and BTR-90 vehicles, the *Metis* anti-tank guided missile system and a further

10 B. Vogel and P. Butowski, 'Yemen poised to order MiG 29SMTs', *Jane's Defence Weekly*, 13 September 2006.

11 Estimates put the cost at over US\$800 million, as development was more expensive than was first anticipated.

12 M. Gyuros, 'Delays but increased capability for Pantsir', *Jane's Defence Weekly*, 16 August 2006.

13 'Russia Reports \$2.6Bln Air Defense Sale Deal', 21 September 2006, available at <[http://www.news-rus.com/2006/09/21/russia\\_reports\\_2\\_6bln\\_air\\_defense\\_sale\\_deal/](http://www.news-rus.com/2006/09/21/russia_reports_2_6bln_air_defense_sale_deal/)>, accessed 28 April 2009.

14 Alexandra Gritskova and Konstantin Lantratov, 'Russian Rockets Will Keep Emirates Shores Safe', 23 August 2006, available at <[http://www.kommersant.com/p699605/r\\_1/Russian\\_Rockets\\_Will\\_Keep\\_Emirates\\_Shores\\_Safe/](http://www.kommersant.com/p699605/r_1/Russian_Rockets_Will_Keep_Emirates_Shores_Safe/)>, accessed 28 April 2009.

tranche of *Tunguska* air-defence systems.<sup>15</sup> It is likely that this as yet undecided deal is a direct response to Algeria's large arms contract signed in 2006 and it bodes well for future Russian sales to North Africa. Moreover, Russia agreed to cancel Libya's US\$4.5 billion foreign debt in April 2008, paving the way for an arms and oil deal in similar structure to that of Algeria's before the end of 2008.<sup>16</sup>

## Southeast Asia

Southeast Asia is another geographic region focusing on military modernisation. During the 1990s the bulk of the Association of Southeast Asian Nations (ASEAN) member states had ambitious programs for improving their armed forces capabilities. These programs were not merely responses to particular threats, but, for the most part, reflected long-established, domestically-based strategic rationales. These rationales included the increasing availability of funding, the military's role in decision-making, internal security concerns, overall national modernisation and industrialisation and supplier pressure/corruption.<sup>17</sup>

The Asian financial crisis which permeated through the region in 1997–98 reduced overall economic growth and cut state revenues, forcing several Southeast Asian governments to drastically curtail defence spending. At the same time, local currency depreciation against the dollar substantially reduced the international purchasing power of the remaining procurement funds. Most ASEAN member state economies have now recovered to pre-crisis levels and defence spending has resumed its pattern of growth in Indonesia, Thailand and Malaysia

Russia has been eager to exploit these newfound Southeast Asian fortunes by securing arms contracts. With only Vietnam a traditional user of its weaponry (Indonesia had transferred to Western-sourced equipment after Suharto came to power in the 1960s), Russia was almost entering an untried market. However, beginning with a delivery of MiG-29 fighter aircraft to Malaysia in 1993, and continuing after Putin's election as President in 1999, Russia made considerable inroads into the Southeast Asian arms market. Russian MiG-29 and Su-27/Su-30 combat aircraft are now present in the inventories of Myanmar, Malaysia, Indonesia and Vietnam; and Thailand may well follow suit, in a traditional response to growing military capabilities across its borders. Indeed, the total

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15 Konstantin Lantratov, 'The Moroccan minister arrived in Moscow for weapons', *Kommersant*, Moscow, 9 June 2006, p. 10.

16 O. Shchedrov, 'Russia, Libya seal debt accord, eye arms deals', *Reuters*, Tripoli, 18 April 2008, available at <<http://www.polity.org.za/article/russia-libya-seal-debt-accord-eye-arms-deals-2008-04-18>>, accessed 28 April 2009.

17 Tim Huxley, 'Southeast Asian Force Modernisation', *Global Forces 2005: Proceedings of the ASPI conference. Day 2—Strategic Change*, Australian Strategic Policy Institute, Canberra, 2005, p. 46.

value of arms export contracts signed with Malaysia, Indonesia and Vietnam in 2003 exceeded that of arms export contracts signed with China or India, heralding Southeast Asia as a new major destination for Russian arms.<sup>18</sup>

Other than aircraft contracts, Vietnam and Singapore have received Russian air-defence systems, varying from the S-300 long-range unit to the *Igla* MANPADS. Myanmar and Malaysia are also considering contracts for medium-range systems. Traditionally, procurement of new capabilities in Southeast Asia has led other countries within the region to follow suit, such as the Singaporean submarine program being hotly followed by a Malaysian one. This would suggest that the aforementioned air-defence systems would spur other countries such as Indonesia and possibly Thailand to also embark upon improved air-defence programs of their own in an effort to keep up with the military developments of their neighbours—a trend that has occurred since the 1960s.

Russian naval exports to Southeast Asia have so far been exclusively to Vietnam; however Indonesia has ordered *Kilo*-class submarines within its US\$1 billion export credit offer, and possibly a *Steregushchyy* frigate to be constructed in Spain as part of a separate deal.<sup>19</sup> Moreover, Vietnam's recent orders have been for 12 *Tarantul* fast-attack craft, two *Gepard* frigates, and interest has been shown for the *Steregushchyy* frigate: moves sure to spike the interest in the governments of the remaining Spratly Islands claimants, including those of the Philippines and Malaysia.<sup>20</sup> Both of these countries have been subjected to heavy marketing (Russia sent its largest naval exhibition to Malaysia's Langkawi-based biennial arms show—LIMA, in 2009) for Russian fast-attack vessels that are highly suited to operations in and around the Spratly Islands. Of course, other than regional one-upmanship and territorial disputes, there is the fact that China to the north and India to the west have devoted billions to their naval modernisation programs, which in turn has stimulated the requirement for naval vessels within Southeast Asia.

## Latin America

The final corner of the Russian arms drive triangle is Latin America. Like Southeast Asia, this region has traditionally preferred Western-sourced equipment, but changing governments, aggressive US foreign policy and successful Russian marketing have seen many Latin American countries shift their procurement preference to Russian arms. Both Mexico and Uruguay have

18 'Russia—Tightening State Control', *East Asian Strategic Review 2005*, National Institute for Defense Studies, Tokyo, 2005, p. 184.

19 'Russia, Indonesia sign corvette construction agreement', *RIA Novosti*, 29 June 2007, available at <<http://en.rian.ru/russia/20070629/68046148.html>>, accessed 28 April 2009.

20 'Russian Weapons for Southeast Asia', *Kommersant*, 13 December 2005, available at <[http://www.kommersant.com/p634447/r\\_500/Russian\\_Weapons\\_for\\_Southeast\\_Asia/](http://www.kommersant.com/p634447/r_500/Russian_Weapons_for_Southeast_Asia/)>, accessed 28 April 2009.

bought small numbers of Russian weapon systems in recent years. Mexico purchased a fleet of Mi-17 helicopters, whilst Uruguay focused on land systems such as trucks and IFVs. However, two recent developments in Mexico are worthy of further mention. First, Rosoboronexport agreed to build a service centre for Russian equipment in Mexico in 2004, indicating the likelihood of future sales there. Indeed, a new contract was signed in June 2006 with the Mexican Navy selecting a fleet of 10 Su-27 fighters to form its first air defence unit.<sup>21</sup>

Further evidence of Russian expansion into the Latin American arms market came from the SINPRODE 2006 arms expo, held in Argentina in September 2006. Rosoboronexport sent its largest delegation to date and came away with a contract for the delivery of Mi-17 helicopters to the Chilean Army and Air force, and an agreement with Brazil to buy an unspecified model of the Sukhoi *Flanker* family of fighter aircraft.<sup>22</sup> The Mexican and Brazilian pilots of these Sukhoi aircraft will apparently be trained in Venezuela. Furthermore, the SINPRODE exhibition gave Rosoboronexport the opportunity to showcase a number of weapon systems it is hoping to export to Argentina as part of an 'arms for beef' deal. Russia is currently the largest importer of Argentine beef and, after the 2001 economic downturn in Argentina, the country could not fund its military procurement programs. Therefore, an 'arms for beef' barter deal was offered to Argentina. If Argentina agrees to the proposal, it could acquire *Tor* (SA-15), *Buk* (SA-11) or *Tunguska* (SA-19) air defence systems, Mi-35 attack helicopters, and unspecified number and class of naval craft as part of the contract. This offer follows on from an intergovernmental memorandum on military-technical cooperation signed in June 2004 and a presentation by Rosoboronexport to the Argentine military in 2005.<sup>23</sup>

By far the most important development within the Latin American market, however, has been Russia's courting of Venezuela. An agreement signed by Hugo Chavez and Vladimir Putin in Moscow in 2001 laid the framework for military cooperation and it bore fruit in 2005 with the signing of contracts for small arms, transport and attack helicopters. Future deliveries may include submarines and fighter aircraft, as Caracas moves steadily away from the US camp. The last two years have seen arms contracts valued at over US\$3 billion signed between Caracas and Moscow, at a time when rhetoric and arms embargo have soured US-Venezuela relations to an all-time low. Russia has exploited the US arms embargo, which has prevented President Hugo Chavez from procuring US and European equipment with US-sourced components. In particular,

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21 'Mexico: 10 Su-27s selected by Navy', *Military Procurement International*, Switzerland, 1 June 2006, p. 3.

22 'Russia to Sell Sukhoi Warplanes to Mexico, Brazil—State Arms Exporter', 28 September 2006, available at <<http://www.mosnews.com>>, accessed 30 September 2006.

23 'Russia offers Argentina e 'weapons for beef' barter deal', *Jane's Missiles and Rockets*, Jane's Information Group, Coulsdon, Surrey, 1 October 2006.



the embargo has led to the collapse of a Spanish contract to provide CN-235 transport aircraft with US components, and, for the same reason, could yet lead to a cancellation of a contract for Spanish built offshore patrol vessels. As the vast bulk of the Venezuelan military inventory is of US or European origin, Russia could yet gain even further arms contracts from Caracas. Contracts to date have included 100 000 AK-103 *Kalashnikov* derivative assault rifles, and an agreement to set up factories within Venezuela for their licence-production.<sup>24</sup> Moreover, the July 2006 visit by Chavez to Moscow yielded a contract for 30 Su-30MK2 multi-role fighters and 33 helicopters to add to the 15 Mi-17 utility, Mi-35 attack and Mi-26 heavy lift helicopters signed for in 2005.<sup>25</sup> Furthermore, the outcome of the July 2008 visit by Chavez to Moscow is a deal for an additional 12 Su-30MK2, expected to be signed before the end of the year.<sup>26</sup> These deals are no doubt partly responsible for the Mexican, Chilean and Brazilian decision to procure Russian equipment in response to Venezuela's arms purchases and will have an impact on the balance of power in Latin America.

More Venezuelan arms deals with Russia are likely to follow, as the country has an ambitious military modernisation program, considerable oil revenues with which to pay and few sourcing options due to US restrictions. The Venezuelan Navy requires a number of frigates and three submarines and *Jane's* sources in Venezuela indicated that the Russian *Amur*-class or *Kilo*-class diesel-electric submarine will be the preferred choice for the submarine requirement.<sup>27</sup> Furthermore, *Tor* M1 (SA-15) and S-300 (SA-10) air-defence systems are on the Venezuelan shopping list, with the total value of the armed forces modernisation program out to 2012 being some US\$31 billion.<sup>28</sup> This is a considerable sum and its completion will be heavily reliant upon world oil prices remaining high. Even so, from the Russian perspective it is an encouraging development and one that will likely see further Russian arms deliveries not only to Venezuela but also to its regional neighbours, who will need to respond to Caracas' modernisation drive to remain militarily competitive.

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24 'Chavez hails Russian arms deals', 27 July 2006, available at <<http://news.bbc.co.uk/2/hi/europe/5221468.stm>>, accessed 28 April 2009.

25 'Venezuela Reportedly Finalises \$1B Deal for Helicopters, SU-30s', 27 July 2006, available at <<http://www.defenseindustrydaily.com>>, accessed 28 April 2009.

26 J. Higuera, 'Venezuela looks to Russia for new fighter, air defence systems', *Jane's Defence Weekly*, 1 August 2008.

27 J. Higuera, 'Russia poised to win Venezuelan contract', *Jane's Defence Weekly*, 14 June 2006.

28 'Venezuela Poised to Take Over as Top Latin American Buyer', 14 November 2005, Press Release, Forecast International, available at <<http://www.forecastinternational.com/press/release.cfm?article=82>>, accessed 28 April 2009.

## Creative Export Practices

A key ingredient to the success in Russian arms export diversification has been a newfound willingness to accept flexible means of payment. The early 1990s saw barter trade with China as a component of its arms contracts, but Russian determination to earn hard currency ensured that barter trade only ever made up a percentage of an arms deal, never the total amount. Since 2000, efforts made by Putin and Ivanov have ensured that more diverse payment options are now available to Russia's arms customers. Moreover, the global boom in oil and natural gas prices has given the Russian Government a stronger financial position, negating the old desperation for hard currency. Moscow's flexibility has seen it explore finance options such as offsets, the clearing of Soviet-era foreign debt, and the offering of export credit to its arms customers.

As previously mentioned, Russia offered Indonesia an export credit for arms procurement in 2006. Interestingly, this was the first time Russia had offered its arms wholly on the basis of credit, indicating the strong desire to secure Indonesian business and the first example of a new arms export policy. The deal includes an offer of US\$1 billion credit for the procurement of military equipment, to be paid back in two US\$500 million installments over the next five years.<sup>29</sup> Indonesia has been interested in procuring Russian equipment such as the Su-30 *Flanker*, Russian *Steregushchy* corvettes and submarines, but economic crises and natural disasters have continuously delayed government funding for such projects.<sup>30</sup> The offer of credit means Russia can secure Indonesian business earlier than would be the case under a conventional agreement, thereby ensuring that Indonesia becomes a major regional customer. The details of the package were confirmed following Putin's September 2007 visit to Jakarta, with 10 Mi-17 utility and five Mi-35 attack helicopters, 20 BMP-3 IFVs, two *Kilo* 636 submarines and a weapons package for the Su-27/30 *Flanker* fleet making up the costs.<sup>31</sup> Outside of the credit agreement, Indonesia ordered six more Su-27 *Flanker* aircraft at the MAKS 2007 airshow in Moscow; and in June 2007 signed a contract for the design and construction of corvettes based on the *Steregushchy*-class frigate.<sup>32</sup>

Myanmar is another likely recipient of Russian flexible finance in exchange for arms. Following an historic April 2006 visit by high-ranking Burmese military officials to Moscow, a Memorandum of Understanding (MoU) was

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29 'Russia will arms Indonesia on credit', *Kommersant*, Moscow, 9 June 2006, p. 10.

30 'Exploring Russia, Forgetting Indonesia', *Tempo Magazine*, 13 October 2005, available at <<http://www.antenna.nl/~amokmar/projecten/Indonesie/pers/Russia.html>>, accessed 28 April 2009.

31 Donald Greenlees, 'Russia Widens Its Asian Reach With Arms Deals', *New York Times*, 6 September 2007, available at <<http://www.nytimes.com/2007/09/06/world/asia/06indo.html?scp=5&sq=indonesia%20russia%202007&st=cse>>, accessed 28 April 2009.

32 *RIA Novosti*, 2 July 2007.

signed between Russian oil giant Zaburezhneft and the Myanmar Ministry of Energy. The MoU included giving Russia access to the oil and gas fields in Myanmar. Several Russian media sources, including *RIA Novosti*, *Pravda* and *Kommersant*, suggested that this MoU was a means for Myanmar to repay Russia for a rumoured arms deal that also took place in April.<sup>33</sup> There is speculation that Myanmar may opt for MiG-29 fighters and either the *Tor* (SA-15) or *Buk* (SA-11) air-defence systems.<sup>34</sup> If true, it would imply that Russia is beginning to utilise an 'arms for oil' policy for its arms exports, because the Algerian contract signed a month earlier also incorporated an oil and gas component. Moreover, future arms deals with countries such as Malaysia, Vietnam, Indonesia and Venezuela may also include oil and gas components, as each of these countries has large reserves of one or both of these fossil fuels.

However, the attraction of Russian arms to these new markets is by no means restricted to financial benefit. Russian military equipment is perceived as durable and now includes a slowly improving after-sales service reputation. More importantly, these weapon systems go to countries such as Iran, India, China, Venezuela and Indonesia who do not fear a Russian embargo in response to political or human rights abuses. Russia's heedlessness to political factors, in conjunction with the aforementioned flexible finance policies, gives Russia, rather than the United States, preferred status as an arms supplier to these countries and to a growing number of other countries that are beginning to show a preference to the non-aligned camp.

## The Algerian Deal: Russia's Largest

Like Myanmar, Algeria has allowed Russian access to its oil and gas deposits as part of an arms procurement package. The US\$7.5 billion deal is the biggest single contract in the field of military-technical cooperation in Russian post-Soviet history.<sup>35</sup> It was signed in March 2006, during Putin's visit to Algiers, and includes a further US\$2-3 billion option package for further arms. As Ruslan Pukhov, the Director of the Centre for Analysis of Strategies and Technologies, has stated: 'The contract will be Russia's triumphant return to North Africa ... [And] the deal will trigger a pride race among the North African nations.'<sup>36</sup>

33 Dmitry Kosyrev, 'Myanmar: new field of Russia, China Cooperation', *RIA Novosti*, 5 April 2006, available at <[http://www.news-rus.com/2006/04/05/myanmar\\_new\\_field\\_of\\_russia\\_china\\_cooperation/](http://www.news-rus.com/2006/04/05/myanmar_new_field_of_russia_china_cooperation/)>, accessed 28 April 2009; and 'Foreign ministers of Russia, Myanmar meet in Moscow', 3 April 2006, available at <<http://english.pravda.ru/news/world/03-04-2006/78266-%20Myanmar-0>>, accessed 28 April 2009.

34 Guy Anderson, 'Russia eyes arms for energy deal with Myanmar', *Jane's Defence Weekly*, 12 April 2006.

35 'Putin rates highly results of his 'lightning visit' to Algeria', *Moscow Rossiyskaya Gazeta*, Moscow, 11 March 2006.

36 Ruslan Pukhov, in an interview conducted at the Centre for Analysis of Strategies and Technologies, Moscow, 6 June 2006, and Ruslan Pukhov, in Nabi Abdullaev, 'Russia eyes debt-for-deals strategy', 20 March 2006, available at <<http://www.cast.ru/eng/?id=231>>, accessed 28 April 2009.

The US\$7.5 billion deal for arms signed with Algeria in March 2006 included the suspension of Algeria's US\$4.7 billion Soviet-era foreign debt, and this action could trigger further arms for debt suspension deals in the region, with Libya and Syria also being recipients of Soviet-era loans. Therefore, one of the important factors impinging upon the Algerian deal is the response it may trigger from Morocco, Libya and Egypt, who are all currently discussing arms packages of varying size with the Russians. This will ensure that the North African market takes some of the strain from the projected downturn in arms transfers to China. The other important factor is the way the deal was structured. Like many Russian arms deals, only some of the specific details have been disclosed to the public. What is known, however, is that it includes the writing-off of US\$4.7 billion worth of Soviet-era foreign debt and that this was the key component of the deal that ensured Algerian agreement to take the Russian arms package. Furthermore, Algeria extracted from Russia an assurance that Moscow would not object to Algeria's early payment of its US\$8 billion debt to the Paris Club.<sup>37</sup>

Other than the above concessions, Algeria is to receive a US\$3.5 billion air package, including 34 MiG-29SMT fighters, 28 Su-30MKAs fighters, and 14 Yak-130 advanced jet trainers between now and 2009. A US\$2-3 billion option package was also signed and, if Algeria exercises these options, it is predicted that it will receive a further 20 MiG-29SMTs and 16 Yak-130s.<sup>38</sup> Coupled with the original deal is a ground package of *Metis* and *Kornet* anti-tank guided missiles, 180 T-90S MBTs, the upgrade of 250 T-72 MBTs, and an air defence package of 30 *Tunguska* (SA-19) and eight batteries of S-300 (SA-10) air-defence systems.<sup>39</sup> This ground component is worth in excess of US\$2 billion. The contract also includes unspecified work on various Algerian naval vessels. Furthermore, Algeria has agreed to part with another US\$400 million as part of a separate contract for two more *Kilo*-class submarines, signed in June 2006. Clearly, Algeria is undertaking a near total refurbishment of its largely Cold War era armed forces including naval, ground and air components, and Russia is the facilitator.

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37 Andrei Maslov, 'Risk Factors of the Delivery of Russian Arms to Algeria', *Moscow Defense Brief*, Issue 2, 2006, available at <<http://mdb.cast.ru/mdb/2-2006/item3/item2/>>, accessed 28 April 2009. The Paris Club (and thus the name) arose out of crisis talks that were held in Paris in 1956 between Argentina and its various creditors. It is an informal group of financial officials from 19 countries, with the current permanent member-nations being: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, Norway, Russia, Spain, Sweden, Switzerland, United Kingdom, and the United States.

38 Konstantin Makienko and Dmitry Vasiliev, 'The Algerian Deal', *Moscow Defense Brief*, Issue 2, 2006, available at <<http://mdb.cast.ru/mdb/2-2006/item3/item1/>>, accessed 28 April 2009.

39 'Algerian Arms Deal Brings Russia US\$7.5 billion, Gas Market Leverage', 15 March 2006, available at <<http://www.defenseindustrydaily.com/algerian-arms-deal-brings-russia-75-billion-gas-market-leverage-02024/>>, accessed 28 April 2009.

Russia receives three major returns in its structuring of the Algerian deal. First, it has probably gained access to Algeria's oil and gas fields. Accompanying Putin on his Algiers visit were the heads of Gazprom, Lukoil and Itera—three of Russia's largest oil and gas companies.<sup>40</sup> Despite few official statements from either government, the presence of the gas and oil chiefs and a subsequent MoU signed between Algerian gas giant Sonatrach and Gazprom in August 2006<sup>41</sup> indicate a developing relationship within the oil and gas sector. The final arrangement is that Algiers will probably give those Russian oil and gas companies access to Algerian deposits, with the proceeds split between the producers and the Algerian Government.<sup>42</sup> The Algerian Government is then bound to immediately transfer the revenues to Russian arms manufacturers until such time as the debt is paid off. Moreover, Algeria will also share its expertise in gas liquefaction (a legacy of French rule and subsequent investment), and Sonatrach has already promised to help build infrastructure for the production of liquefied natural gas in Russia.<sup>43</sup> Despite Russia's huge natural gas reserves, its knowledge and experience in gas liquefaction remains relatively limited compared to the West and Sonatrach will help to rectify these deficiencies within the Russian gas fields.

The second return Russia will receive from the Algerian deal is yet another boost to the OPK, with more concrete orders ensuring continued work and finance for several weapons production lines. It has given RSK MiG valuable orders, which will assist the company in its quest to gain the lucrative US\$5-9 billion contract for India's 126 Medium Multi-role Combat Aircraft tender. The Algerian deal also gave Yakovlev its first export customer for the *Yak-130* advanced jet trainer, necessitating the opening of a second production line for the aircraft. As important, the deal touched every facet of the Russian OPK: aerospace, naval and ground—something very rare in terms of arms contracts, which are not normally so universal and usually only favour one of the three sectors.

Finally, both Ivan Safranchuk (the head of the Moscow branch of the Centre for Defence Information) and Ruslan Pukhov concurred that the Algerian deal will bring further regional orders for Russian arms because of the impact the deal will have on the balance of power in North Africa. The next most likely customers for a 'debt for arms' swap are Libya and, to a lesser extent, Egypt and Morocco, because of their close proximity to Algeria, possession of Soviet-era

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40 Nabi Abdullaev, 'Russia eyes debt-for-deals strategy', *Defense News*, 20 March 2006, available at <<http://www.cast.ru/eng/comments/?id=231>>, accessed 28 April 2009.

41 'Gazprom, Algeria's Sonatrach Sign Official Cooperation Accord', 14 August 2006, available at <<http://www.mosnews.com>>, accessed 8 October 2006.

42 'Algerian Arms Deal Brings Russia US\$7.5 billion, Gas Market Leverage', 15 March 2006.

43 'Algeria signs \$5 billion arms-for-energy deal with Russia', *Military Procurement International*, vol. 16, no. 6, 15 April 2006, p. 1.

foreign debt, and largely Russian sourced weapon systems. Libya in particular is likely to be Russia's next major North African arms customer, as it has large gas and oil deposits, an outdated military, and a recently forgiven US\$4.3 billion Soviet-era foreign debt to Moscow.

## Arms Market Diversification: A Return to Soviet Policy?

Russia's newfound willingness to accept recompense other than hard currency for its military hardware is clearly apparent. However, the reasoning behind such a policy shift remains a mystery. There is no doubt that that arms-market diversification has assisted Russia's OPK with more weapons orders, but the meshing of energy sector agreements with arms agreements, export credits, and the growing use of Russian weapon systems around the globe is also contributing to Russia's growing political influence.

During the Cold War, the Soviet Union and the United States used arms transfers and military assistance as one element in foreign and security policies that was primarily intended to further a political and ideological competition.<sup>44</sup> The traditional arms clients of the former Soviet Union were more often than not poorer developing countries valued more for their ideological tendencies and desire for Soviet weaponry, rather than for their financial credentials. Today, Russia's arms exports to Myanmar in exchange for oil concessions and Indonesia for export credit are reminiscent of the deals struck with the developing countries during the Soviet era. Many of the Soviet client-states received substantial military aid grants and significant discounts on their arms purchases, although this trend is yet to appear within current Russian arms exports.

Russia's regional sales drive is proof that arms exports are no longer just about receiving hard currency. Argentina's potential 'arms for beef' deal, Algeria's debt reduction and 'arms for oil' deal, Burma's likely 'arms for oil' deal and Indonesia's export credit all offer concrete examples of the Russian policy change. Whether or not political considerations or energy politics are at play when Russia decides upon new arms contracts remains unclear; however the thirst for hard currency has certainly been quenched since those anxious years following the collapse of the Soviet Union. What is clear is that the increasingly concerted effort by Russia to cast its arms out to a wider net, in anticipation of an eventual Chinese market closure, is proving to be of great assistance to the longevity and success of the Russian OPK.

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<sup>44</sup> See press release for Ian Anthony (ed.), *Russia and the Arms Trade*, available at <<http://editors.sipri.se/pubs/pressre/iabk2.html>>, accessed 28 April 2009.