



## The Magic of Russian Economic Statistics

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### Abstract

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Wrong or even falsified statistic indexes come to serious consequences in economic policy. The divergence of statistic data and real life in Russia becomes the source of tensions in the society. It harms people's confidence in the government. Primarily it concerns the volume and the dynamics of Gross Domestic Product (GDP), which is most often used to judge about both the decline and the rise of economic development. The article analyses significant faults of this indicator and even its falsification in Russia. The author suggests to elaborate and use an new indicator which could characterize the volume and dynamics of *the real economy sector*. The main meaning of this indicator is to point out the production of goods and services creating the real national wealth. The analysis reveals that official data, especially concerning inflation, population income, unemployment rate, poverty size, capital outflow, brain drain, demography, physical and psychical health of population, corruption, turn to be unreliable, inadequate to Russian reality.

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## ANALYSIS

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*People believe that we tell lies and falsify facts. And they have reasons to believe so.*

*Nicolas Sarkozy, President of France*

*What we measure affects what we do... If we don't measure correctly, we don't get the correct result...*

*Joseph Stiglitz, Nobel Prize Winner*

As an economist myself, I am very concerned about the reliability of statistical information. Aviation knows to its own cost what troubles we can face when navigation tools fails. But defects of economic indicators can lead to more serious and massive consequences because they are taken into account while making important decisions. Mistakes in economic policy, rooted in wrong or even falsified statistic indexes, come especially expensive. Moreover, they destroy confidence in the government. The divergence of statistic data and real life becomes the source of conflicts and misunderstandings.

It stands to reason that French president appealed to Joseph Stiglitz and Amartya Sen, two Nobel Prize winners, in order they worked together with French statisticians and puzzled out the validity of statistic indexes. All the specialists came to a conclusion that many figures cannot be considered representative and gave their voices for the additional set and the improvement of economic development indicators. Primarily it concerns the index of volume and dynamics of Gross Domestic Product (GDP), which is most often used in the official statements and the mass media. This comprehensive indicator is often used to judge about both the decline and the rise of economic development of the countries. The global crisis and the efforts to overcome it made the issue concerning reliability of the statistic measurement of economic processes extremely crucial.

First of all, it is important to take into account GDP characteristics. It measures a newly-created value of products and services plus the sum of annual amortization charges. That is why it does not comprise the cost of the so-called 'intermediate product', the one which had been used in the inquiry period but produced in previous years. Meanwhile, GDP is considered by many people to be an estimated value of all products and services produced within the inquiry period. For example, it takes several years to build a bridge. Annual expenses to its building (labour, materials, transport and other services) would influence GDP of a certain year. That is why when the bridge is finished GDP would include only part of the expenses to its construction corresponding to that particular year. If shops sold the bread made of the last year's flour then GDP would include only baking expenses but not the whole value. Thus, this index is a little conditional being a kind of virtual dimension. It does not measure the cost volume of all the made products and services of the country, so it cannot reflect the real economic condition of the country. As the barometer sometimes shows 'fair', and it is raining outside.

As an indicator of the volume and the dynamics of economic growth, GDP has significant faults which should be remembered. For example the GDP of Russia consists of services by 60 % including not only transport, telecommunication, banking, wholesale and retail, but also education, science, healthcare, all the administrative sector,



the armed forces etc. Not all the services included in GDP are comprised by 'real economy sector' concept which is usually mentioned in economic books, although there is no confirmed definition of it and its quantitative measurement.

The main meaning of the term is to point out *the production of the material weal and the services that people and the country cannot live without, and which makes wealth of the country, its population security and welfare*. Some of the services reflected in GDP are not connected with accession but mainly with exemption from the essential material weal of the society. For example, advertisement which makes consumers buy things they do not need or low-quality goods and services. The same might be said about fake dealers who pump up the prices and consequently the GDP volume. A huge army of private guards also contributes to it, although it is a product of a sick and criminalized society where law and police systems are not efficient and public mores are in decay. In these terms the growth of administrative bureaucracy, police services, prisons, penitentiaries counted statistically as GDP growth would be actually considered as a waste from the viewpoint of real economy sector.

Speculative operations at the stock exchange and in the bank sector also contribute to GDP growth. But population of the country does not become richer and economy does not become stronger. Thus, there is a gap between GDP growth and indicators of fix capital increase and its renewal, employment improvement, birth and death rates, population health conditions, retirement coverage, living standard increase of population majority, inflation dynamics, progress of culture, science and education, crime and corruption decline.

Meanwhile, the condition of those issues must be one the main indicator of crisis or economic growth. If there is divergence between the volumes of GDP and *the real economy sector*, then there is a necessity to assess the results of economic activity not only by GDP dynamics but also by some other indexes. Danilo Türk, President of Slovenia, thinks that the understanding and measurement of economic development roots in 'the well-being in its general sense but not only in the production... The corresponding instruments must be developed to measure progress, well-being and development of the country.'

And we also need an reliable indicator of real economy sector. Unfortunately, there is no clear understanding of the need of it. That is why Russia Statistic Committee would not measure its volume and dynamics. In this respect science owes practical knowledge. But government also does not set it as a mission for science. Official data, especially concerning inflation, population income, unemployment rate, poverty size, capital outflow, brain drain, demography, physical and psychical health of population, corruption, turn to be unreliable, inadequate to reality and thus prevent effective decision-making process to improve the situation on the whole.

Limited representativeness of Russian GDP can be accounted for by some other defects. So, to indicate the growth pace within several years, the comparison must be made on the bases of constant prices to eliminate the price increase during this period. Official statistics usually uses an deflator (adjustment rate of the price growth in comparison with the basis). But its size is disputable.

Thus, in 2010 Russian Statistic Committee when adjusting the prices to 2009 level used the deflator of 10.3 %, while the prices of the production sector grew in 16.7 % during the year, in the agricultural sector in 23.6 %, and in the service sector in 33.1 %. Such generalization of sectoral inflation rates at the deflator level of 10.3 % may only be the result of wizardry.



But 2010 was not an exception. In 2011 preliminary official assessment of GDP dynamics has also seen a deflator of 15.4 %. GDP of 2010 was calculated as 44.5 trillion rubles, and of 2011 as 54.4 trillion rubles. In terms of changeless prices the growth within the year, according to the official information, was 4.3 %. But if the deflator is 15.4 % (54.4 divide by 115.4 %) then GDP of 2011 is 47.1 billion rubles. It means that annual GDP growth was 5.84 % ( $47.1 : 44.5 = 105.84\%$ ). However, we are being very modest announcing that the growth is only 4.3 %.

The problem is that such growth corresponds to the deflator of 17.5 % but not to the one of 15.4 %. The first number seems to be very close to the real inflation level. There is an obvious mismatch of indicators because the deflator, showing the adjustment to the price growth of all the produced products and services, is highly connected with the consumer price index. The growth of the former, according to the official data, was 6.1 % in 2011.

Such a gap (3 times more) between the deflator and the consumer price index might be only the result of pure magic. There seems to be a great understatement of general and consumption inflation together with GDP growth overstatement. Western countries usually have a very small gap between consumption goods inflation and GDP deflator. In 2011 the USA saw GDP deflator as 2.1 % and consumption prices growth was 3.0 % meaning 43 % higher. In the developed countries excluding the US, the EU and Japan, both indexes were 3.5 % in 2011.

It is obvious that the stated indexes are calculated with great errors by the Russian statistic office. The results of calculations of inflations rate depend on which set of products and services is taken into account, as well as the chosen specific gravity of different goods and services in this set. Any voluntarism and anarchy may falsify the deflator and consumption inflation index to the desirable size. A lowered deflator and consumption price index increases GDP growth. Taking into account social and political meaning of GDP dynamics indexes, their calculation must be pure with the participants of great scholars and independent experts.

GDP statistics also needs the correction because the fact that not all the activities which give real benefits and consequently GDP increase are registered and calculated. Shadow economy, for example, is never taken into account but gains, according to different sources, from 20 % to 40 % of the GDP in Russia. It includes the salary paid in cash without the accountant's statements. According to some sources, the rate of such salaries gains 40 % of the whole salary paid in Russia.

It is very difficult and sometimes even impossible to calculate the income received from the farmlands, house-keeping, suburban gardens, private builders, mechanics, fix men, tradesmen (including tourist traders) and other workers of different professions who have additional and even main income without being registered by tax inspection and other offices. The volume of its huge add-value is officially added to GDP as 20 %. But this is a voluntary estimation without any scientific research, social opinion polls and random checks. It might lower the share of the shadow sector including clandestine production, and consequently the amount of GDP.

There is also one more problematic issue concerning the duplication of Value Added Tax (VAT) which artificially raises GDP. VAT is included into the price of products and services by the producer and then it is declared together with a salary and revenue as the produced additional cost. But at the same time when the product or



service is being sold VAT is taken again. The duplication of this tax is calculated at GDP and makes it higher by 2 - 3 percentages. Is that right?

There is one more issue of criminal kind that leads to GDP increase when a fake export agreement is fulfilled and VAT was paid without the factual product supply, and then VAT is returned to the supplier on their demand. Amortization charges included into GDP might not be authentic, too. In order to force self-sufficiency of the main funds they might be overstated and charged from the consumers as additional taxes.

On the other hand, a great part of GDP is lost due to substantial losses of products and services provided by the lack of responsibility, natural disasters, smuggling export, capital outflow, rusty technology etc. According to the calculations made by V.M. Simchera, the volume of the losses in 2010 could actually reach half of GDP, or readjusting to the parity rate of purchasing power it would be about 1,250 billion dollars. It is not so disputable as it may seem because to make 1,000 dollars of GDP Russia spends power recourses 8 - 10 times as much as any developed Western country. The same concerns the usage of metal, wood etc. Legal and illegal capital outflow was not less than 80 billion dollars in 2011 and during 20 years of market reforms capital outflow from Russia might reach 1 - 2 trillion dollars. It is surprising how the country could endure such bleeding.

However, in order to control and stop such losses, it is necessary to start with securing a reliable statistics of capital outflow, including expert assessments of the capitals missed by official calculation. It is the only way for the country to measure its real exemption from GDP.

Today we face different (sometimes extremely different) evaluations of capital outflow and brain drain, and correspondingly, different evaluation of economic damage connected. It is only natural that Russian influential, comprador bourgeoisie that merged with government should be satisfied with the situation. It is easier to dodge taxes, save and hide the loot not only at the accounts of international banks but also by investing to football teams, yachts, palaces, villas, hotels, restaurants, houses and flats in London, New York and other attractive places. At the same time it matters for Russia and its population feeling the crisis burden and the market reforms gravity. Soviet slogan 'socialism is calculation' was forgotten by us, though in civilized market economy accurate accounting and calculation together with independent and fair audit are still key issues of economic functioning.

Inflation indexes deserve special attention in terms of Russian consumer market as well as wholesale market and markets of construction, shares, loans and other lending markets. It is natural that accuracy of such indexes influences GDP representativeness. Consumer goods inflation is a highly sensitive process for the population. The announced indexes of consumer prices growth are rather different to the reality and are considered by people as deliberate falsification of the real social and economic situation in the country.

It is clear that government is interested in positive results as well as it wishes to have a 'controlled' statistic service. That is why it became subordinate to the Ministry of Economic Development and Trade. But managerial effectiveness at all levels requires independent and fair statistics which is not imposed from above. It is also essential for the population who wants to know the truth in order to trust the administration. Yet such independence might not be reached. It might be proved by the fact that the report on privatization results made by formally independent Audit Chamber has not been discussed at the State Duma session due to its acuity. And all the revealed breaches were left with no further effects.



Population losses due to inflation which is actually a hidden consumption tax are covered partially, if they are covered at all. Besides, independent scientific researches show that if based on the price rise of the consumer goods and services basket used by poor and disadvantaged people then annual inflation would reach 20 - 25 % within the past 5 - 7 years. Though the official index of consumer inflation calculated for the rich and for the poor together at the level of 8 - 12 % could be compared with the indicator of the average temperature of all patients in a hospital. Thus, the population has the right to demand fair data based on the clear scientific methodology and proved by independent experts.

There is no need to prove social importance of such indexes as subsistence level, average income, average wage, minimum hourly wages, poverty line, decile indexes of income inequality, degree of people education productivity, flairs, qualifications of labour power, product quality. They are being the main characteristics of economic progress or decline. But mainly this sphere sees a considerable lag of the state statistics and statistic science.

According to the economic theory, salary and social transfers made from the state budgets must provide normal reproduction of working-age people taking into account qualifications, labour complexity and intensiveness, and health influence. It means that not only essential needs in food, clothes and shelter should be met but also the ones in culture, health care and recreation. Moreover, work force reproduction and what is more its improvement charges information and new knowledge, social integration, family maintenance, children education and upbringing. It is obvious that work force reproductive expenses would be different in certain countries depending on the level of economic development, age-old traditions and customs, climate etc. But in any case, if the expenses of work force reproduction are not covered (at least to its minimum) by the salary volume and the whole income, then labour and intellectual potential of the country might degrade.

Unfortunately, administrative guidelines and standards especially in terms of the subsistence level and adequate incomes are voluntary and far from the ones in terms of scientific criteria. Such important criterion as minimum hourly wages is not implemented at all. Public limited company 'Vserossiyskiy Centr Urovnya Zhizny' (Russian Centre for Living Standards) calculated minimum consumer budget providing reproduction of unqualified labour force in the third term of 2011. It was 16.5 thousand rubles – 2.6 times higher than the official subsistence level. These numbers might be considerably corrected if the more substantial investigation would be done.

There is a great underestimation of labour value apart sometimes completely corrupted data of remuneration of complicated qualified labour compared with the middle-complexity labour. For example, labour capacity measured by GDP for one working hour in Russia is 4 times less than that in Italy and hour salary is 10 times less. It is interesting that 33 % of Russian GDP falls to the salary, 31 % to the profit and capital income, 36 % to taxes, yet developed Western countries salary share reaches 60 % of GDP. Because of the lack of reliable methodology of statistic comparisons the numbers may prove even less suitable to assess labour payment in Russia.

If the size of average salary in market systems varies depending on the development level of appropriate countries, but the proportions of the salary depending from complexity, qualifications and intensiveness of labour are still quite similar. A scholar, an engineer, a surgeon and a teacher are usually paid more than a worker, a



clerk, an officer, and a supervisor. In Russia these correlations can be the reverse and completely different from the world practice. Many socially important professions and kinds of qualified labour have become low-paid. It leads to social breach and tension in the society, provokes corruption and has negative influence on working efficiency. Moreover, it deals with the sense of the social justice.

World Bank report on 'Equity and Development' states that 'high level of economic inequality usually makes economic institutions and social conditions act in the interests of more influential groups. Such unfair institutions can lead to economic losses... Social services are distributed among the rich and the talents of middle and poor population are left behind. Society in general becomes less effective and loses an opportunity to invest and innovate.' It can actually be proved by the situation in Russia nowadays. The crisis resulted in the reduction of production and consuming in Russia which was much higher than in many other countries, but the number of dollar billionaires, according to *The Forbes*, increased by 70 %. In this respect we take the third place after the USA and China.

More alarming in terms of social, political and economic consequences for the Russian society is that the gap between the rich and the poor is growing. And again official statistics tries to neutralize the real situation, quoting lowered data of social differentiation and poverty scale. According to the data, an average income of the poorest 10 % part of the society is 15 times smaller than an average income of the richest 10 % part. But the research made by the Russian Academy of Sciences shows that the gap cannot be less than 30 times, and 50 times in Moscow, when it is 7 - 10 times in the EN and 15 times in the USA.

Unprecedented inequality of income distribution and lack of the necessary measures have negative consequences for the economic growth and improvement of a demographic situation. Statistical analysis shows that with the European level of inequality here we could have 30 - 50 % growth of Russian GDP in 2000 - 2007. And annual growth of real income of the main population (main, not all the population) in 10 % would lead to over-coming depopulation.

Lowered retirement payments and social payments which could hardly cover public utility charges and medical service of the poor population are considered to be social inequality and undeserved underestimation of their contribution to the national welfare. Such future at the retirement cannot inspire active population of Russia to work effectively, initiatively and hard.

To improve the situation we have to switch from flat to progressive taxation scale together with other measures to support the poor. In the USA it allows to reduce inequality between the extreme ten-per-cent groups of population to 15 times, otherwise it would reach 68-times difference. Should the American administration cancel the progressive taxation, as we did, the country will face a severe difficulties.

It is obvious that we do not have reliable state statistics and moreover a substantial social and economic analysis of living standards and social stratification based on it. It may also be said about the economic statistics in general. The ship of government sailing in the white waters of national and global crisis lacks a reliable navigation system, which prevents it from choosing the right course. They ought to be put in order.

Before the 1917 Revolution and within the Soviet period economic statistics had a good reputation and was represented by great scholars. There was academicians S.G. Strumilin (1877 - 1974), V.S. Nemchinov (1894 - 1964), associate member V.N. Starovsky. Those great traditions of Russian statistics must be restored.





To change and update Russia without true statistic indexes would be impossible. Its renewal requires fair and real evaluation of the situation, fair information concerning economic and social spheres and easily available for the population. And this requires the development of statistics as science and close connections of the reformed statistic service with scientific analyses.

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*Remarks: Opinions expressed in this contribution are those of the author.*

### About the Author of this Issue

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