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Pumping GDP Growth

By Rudiger Ahrend

Everybody familiar with the Russian economy knows at least two things: that natural resources, especially oil and gas, play an important role, and that Russia has had fairly strong growth in recent years. However, what is less well understood is the degree to which this growth has been driven by increasing oil sector output and exports and, in particular, by privately owned companies within the sector.

One reason for the lack of recognition of the oil sector's role in recent growth is that the size of the hydrocarbon sector as a whole is not adequately reflected in official statistics. As World Bank and other researchers have noted, a large share of the value added of oil and gas production is not attributed to the production companies, but to their affiliated trading companies. The rationale for this transfer pricing may in many cases be tax evasion, but, as a recent article by Nat Moser in *The Moscow Times* points out, transfer pricing may also serve to optimize internal resource allocation. In any case, as a result of these practices, official statistics underestimate value creation in oil and gas extraction, and they attribute too much to trading activities and thus to the service sector.

The upshot is that official data significantly understate the size of the industrial sector in general, and the hydrocarbon sector in particular. While exact estimates of the oil and gas sector's importance in the economy differ, most estimates of adjusted GDP weights suggest that the sector has generated approximately 20 percent of GDP in recent years -- not less than 10 percent, as the official data indicate. Using the adjusted relative weights of different sectors published by the World Bank this year, I have re-estimated the direct contribution of hydrocarbons to growth in recent years. The results are striking indeed.

It appears that the contribution of industry to GDP growth during 2001–03 was slightly below 50 percent. The oil sector accounted for almost half of industrial output growth over that period, while the gas sector accounted for less than 10 percent. In other words, increasing output in the hydrocarbons sector accounted for approximately one-quarter of total GDP growth in 2001–03.

Yet this estimate includes only the hydrocarbon sector's direct contribution to growth. The oil industry's ability to sustain rapid growth has been an important contributor to growth in other sectors, particularly those that produce investment goods for the oil industry. Moreover, Russia has been experiencing a consumption boom in recent years, which has significantly contributed to GDP growth. Rising real incomes have fueled very rapid consumption growth, much of which has been satisfied by imports. With import volumes increasing by an average of 21 percent per year

between 2000 and 2003, rapid export growth has been the most important factor allowing Russia to enjoy this rapid consumption growth without -- so far -- hitting the current account constraint. And here again, we find the contribution of the oil sector to be critical.

The oil industry has been the major driver behind export growth since 2000. Overall, export volumes increased by roughly 30 percent during 2000-03. This increase was overwhelmingly driven by the oil sector, which increased export volumes by more than 60 percent. The other major export sectors -- ferrous and non-ferrous metals, as well as machine building -- contributed little to overall export growth, as their export volumes increased by only about 10-15 percent over the period, and the export volumes of the gas sector actually fell significantly (though higher-priced exports to Western Europe increased somewhat at the expense of exports to CIS countries).

Where, then, has oil sector growth been taking place? The answer is, in the private sector. There has been precious little growth in the output or exports of state-controlled companies. It is a half-dozen or so private oil companies that have been driving growth. In this respect, it is also interesting to note that oil companies owned by financiers who entered the oil sector in the 1990s have grown faster than those owned by professional oilmen who have worked in the industry since the Soviet era.

Altogether, it is clear that since 2000, the importance of private oil companies' performance for the economy as a whole has been enormous. As noted above, industry accounted for almost half of GDP growth in 2000-03 and the oil sector for somewhat less than half of industrial growth. Since state-owned oil companies barely grew, this implies that Russia's private oil companies directly accounted for somewhere between one-fifth and one-quarter of GDP growth. Given the knock-on effects from oil sector procurement and wages on domestic demand, the actual contribution of private oil companies to economic growth was probably greater still. Moreover, the private oil companies have played a crucial role in keeping Russia's external balance in surplus, and thus in allowing the current consumption boom to unfold.

It is unlikely that Russia would have been able to grow at anything like the rates it has experienced in recent years had the private oil companies not raised investment, output and exports very rapidly. Moreover, the performance of state-controlled oil companies and other important state-controlled companies would appear to suggest that Russia's leading private oil companies would not have achieved the growth performance of the last few years if they had remained under state control.

Obviously, in a country the size of Russia, growing oil output by itself would not have delivered the growth rates seen. Rapid modernization and strong growth in the service sector, as well as significant increases in productivity in most industrial sectors, were also crucial.

Nevertheless, one cannot escape the conclusion that in recent years Russia has largely been pumping growth.

Rudiger Ahrend, Russia economist in the OECD's economics department, contributed this comment to The Moscow Times. It is based on the 2004 OECD Economic Survey of the Russian Federation, published last week.