

NON-OBSERVED ECONOMY IN NATIONAL ACCOUNTS

SURVEY OF NATIONAL PRACTICES



UNITED NATIONS ECONOMIC COMMISSION FOR EUROPE

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Background

- **UNECE:** Survey of national practices in the collection and compilation of statistics on the hidden and informal activities for national accounts, 1991 (9 countries).
- **UNECE:** Inventory of National Practices in Estimating Hidden and Informal Economic Activities for National Accounts, published in 1993.

Background (continuation)

- **ECE/Eurostat/OECD:** Joint meeting on National Accounts, 2000.
- **OECD:** Handbook for Measurement of the Non-observed Economy, 2002.
- **Eurostat:** Pilot project, “Exhaustiveness of National Accounts”.

Definitions

Non-observed Economy refers to all productive activities that may not be captured in the basic data sources used for national accounts compilation.

The following **activities** are included:

- Underground
- Informal (those undertaken by households for their own final use)
- Illegal
- Other activities omitted due to deficiencies in the basic data collection programme

Eurostat Pilot Project

- **Statistical underground:**
 - T1: non-response to surveys
 - T2: out of date registers
 - T3: unregistered units due to reasons other than deliberate non-registration
- **Economic underground:**
 - T4: underreporting of production
 - T5: intentionally not registered

Eurostat Pilot Project

(continuation)

- **Informal sector:**
 - T6: unregistered units
- **Illegal production:**
 - T7: unregistered units
- **Other:**
 - T8: other types of undercoverage

Structure of countries' contributions

- Definitions and concepts
- Sources and estimation methods
- Implications for and effects on national accounts and GDP estimates

Countries were split in 4 groups:

- Developed market economies (8 countries)
- EU Candidate (9 countries) and Turkey
- Commonwealth of Independent States (7 countries)
- South-East Europe (4 countries)

Main data sources

- Household Labour Force Surveys (LFS)
- Unemployment data
- Business surveys
- Household Budget Surveys (HBS)
- Population censuses
- Special purpose surveys
- Business registers
- Administrative records (official records)

Methods used

- Labour input method
- Comparing data on similar activities from various data sources
- The commodity flow method
- Input-output comparisons (including ratios of input to output by industry)
- The application of known per capita output and value added data

Conclusions from the survey

- The underground economy is **most highly developed in industries** that supply the major part of their output to individuals (trade, construction, transport, hotels and restaurants, and business services).
- Most adjustments for non-observed activities are made to the **Non-financial corporations** and the **Households sectors**.

Conclusions from the survey (continuation)

- The largest contribution to non-observed activity can be attributed to **economic causes**:
 - the deliberate underreporting of revenue (7% of GDP in the EU Candidate Countries),
 - the output of producing units (4.8 % of GDP in the EU Candidate Countries) .

Conclusions from the survey (continuation)

- **From the expenditure side:** the largest contribution to the NOE is accounted for by households final consumption expenditure.
- **From the production side:** the most significant contributors are trade, construction, transport, hotels and restaurants, and other community, social and personal services.

Informal activities

- **The informal economy** is more important for CIS countries and EU Candidate Countries (e.g. 25% of Armenia's GDP and more than 38% of GDP for Kyrgyzstan in 1999).
- **Activities:** trade, transport, agriculture, construction, repair and renovation of dwellings, repair of motor vehicles and household appliances, private lessons and other personal services.
- **Data sources:** HBS, LFS, special purpose surveys and opinion polls, and tax and other administrative data.

Illegal activities

- Particularly **difficult to measure**.
- **Main sources:** information from police, health authorities, customs authorities, crime statistics, public opinion polls and other data (internet, radio, TV, newspapers), experts' estimates and assumptions.

Illegal activities (continuation)

Estimates have been made for the following **illegal activities**:

- the production, import, sale and consumption of illegal drugs,
- prostitution,
- trade in illegally produced audio and video products,
- theft and smuggling.

Illegal activities (continuation)

- 12 countries have made **estimates** of one or more of these (Bulgaria, Canada, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovakia, The former Yugoslav Republic of Macedonia, United Kingdom and United States).
- Due to the difficulties of measurement, in most cases the estimates of illegal activities can **only be regarded as indicative.**

Illegal activities (continuation)

Five countries **include** allowances for the illegal economy in their published estimates of GDP:

- **Bulgaria:** drug consumption
- **Czech Republic:** prostitution, and the sale of stolen goods
- **Estonia:** prostitution, trade in drugs and audio-video products
- **Slovakia:** trafficking and distribution of drugs and prostitution
- **United Kingdom:** smuggled alcoholic drinks and tobacco products

Effects on GDP estimates

Adjustments for NOE activities (4 groups of countries):

- **CIS countries:** highest estimated shares in GDP (from 12% of GDP in Belarus to 48% in Kyrgyzstan),
- **EU Candidate Countries:** second highest shares (from 9% of GDP in Czech Republic to 22% in Slovakia),
- **Turkey (2%)** does not follow the EU Eurostat tabular framework,
- **South-East Europe countries:** two available estimates (8% of GDP in Croatia and 14% in Macedonia).

Effects on GDP estimates **(continuation)**

Differences in **measurement techniques** used, and **varying reference years**, make it difficult to compare the developed market economies with other countries, or between themselves.



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Underground production:

Production activities that are legal but deliberately concealed from public authorities in order to avoid paying tax or social security contributions; meeting statutory standards; or complying with official procedures and regulations such as the completion of administrative forms or statistical questionnaires. Other terms employed: “concealed activities”, “hidden economy” or “black economy”.

Informal activities:

Legal production activities which are characterized by a low level of organization, with little or no division between labour and capital as a factor of production. The informal sector functions on a system of unofficial relationships and does not rely on official agreements. It consists of units engaged in small-scale production of goods and services with the primary objective of generating employment and incomes for the persons concerned. The definition of the informal sector corresponds with that of household unincorporated enterprises.

Illegal activities:

Productive activities, which are forbidden by law or which become illegal when carried out by unauthorised persons.

T1: non-response to surveys

Non-response to surveys is one of the main problems affecting data quality. It can arise for a number of reasons, including time required to complete questionnaires, belief that information supplied will be used for other than purely statistical reasons, and badly designed or burdensome questionnaires.

T2: out of date registers

Business registers may be out of date because they include enterprises that no longer exist; they do not include new enterprises; changes such as mergers or splits of enterprises are not included; or they may contain incorrect information about types of economic activity, enterprise size or address, etc.

T3: unregistered units due to reasons other than deliberate non-registration

Enterprises may be missing from data sources due to statistical reasons. This can occur where there are high rates of enterprise turnover (the share of small production units is particularly high), or as a result of inefficiencies in regulatory or statistical systems.

T4: underreporting of production

The causes are often deliberate understating of revenues or overstating costs for taxation purposes that the respondent also declares to the statistical office. When misreporting is due to genuine mistakes, the errors may result in either understatement or overstatement of income.

T5: intentionally not registered

The owners have deliberately avoided obligations to register in order to avoid costs such as value added taxes, social security contributions, and costs of compliance with health and safety standards, etc.

T6: unregistered units (informal sector)

The informal sector typically comprises small-scale production units (often household units). In some circumstances, non-registration can be a criterion for defining the informal sector, and in these cases enterprises may be missing from registers simply because they are not required to register by any kind of legislation. A major activity is own-account construction.

T7: unregistered units (illegal production)

In most cases illegal production units are not registered. However, in some cases they may be registered but under incorrect activity descriptions. For example, illegal brothels may be described as health-care clubs or massage shops; illegal gambling operations may be described as nightclubs, etc.

T8: other types of undercoverage

Includes a series of reasons for non-observation of the types of productive activity that are often very significant in transition economies. The main ones are production for own final use, tips, and wages and salaries paid in kind.