

National Statistics Committee of the Republic of Kirghizstan

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Overview on non-observed economy in Kirghizstan

The non-observed economy in Republic of Kirghizstan is a recognized fact. In particular, this is one of the reasons leading to low tax revenues and the financial situation of the country deteriorates as a result. The special committee established by the Government of Kirghizstan to struggle this phenomenon comprises representatives of law enforcement and fiscal bodies, Customs Committee, Committee on Standards and Statistics Committee Experts and is supposed to obtain factual information on the impact of non-observed economy to the economy as a whole. It is generally known that the span of latent economic activities reached the point already potent to significantly affect macro-economic indicators such as GDP construction. It is already getting impossible to distinguish actual information about the state of national economy and especially some industries such as trade and services rendered unless the non-observed economy is taken into account. At the same time, alternative estimations many of which are not competent and objective are instigated by the absence of weighted and certain estimations in state statistics bodies. Due to different reasons most of these estimations are overreported two or three times.

Apart from actual information about real GDP and non-observed economy provided to consumers there is a deal of technical problems related to the methodology of estimation of National Accounts indicators and especially balancing different production indicators, disposal and acquisition of assets which cause the accounting of latent and illegal economic activities. This predetermined the fact that the measurement of non-observed economy parameters and their recording on constructing GDP as well as other macro-economic indicators be included in the methodological provisions on SNA construction.

Even though the informal production activities are legal in most cases and encouraged by local authorities it often happens that informal, latent and illegal activities overlap. In this way the informal activities that don't meet certain standards (emergency decree, sanitary and hygiene regulations, other regulations) might be included in illegal activities. Tax evasion, as a rule, is a criminal offence. As such, it would be desirable to distinguish the latent part of informal sector in terms of gross volume of latent production comprising latent production in informal sector as

well as that in other sectors. Since informal and latent productions are both covered by the field of production there is no need to clear cut the borderline between them for many purposes such as adjustment of GDP estimation.

Thus, the distinction of informal and latent economy parameters is desirable. However, in some cases this distinction can be conventional.

The problems of informal production and latent economy are closely connected. Significant part of informal sector in real life is also latent since part of informal merchandisers, for instance, doesn't pay taxes and evade some law regulations to be followed. In a more broad sense the vast informal sector gives rise to serious problems in the economy of Kirghizstan and as a result weakens the government not only in tax collection but also in exercising any regulatory and controlling functions.

In terms of the foregoing the given overview treats informal and latent sectors of Kirghizstan as interrelated. Skipping the problems of updating statistical recording in informal activities we found it essential to mention the informal sector anywhere where the division between latent and informal activities can not be determined clearly and the both types of activities affect each other.

Production is not the only part the shadow economy involves. Economy units try to evade taxation and underreport incomes gained in informal and latent production. Participation in sale-and-purchase transactions involving banned goods and services is illegal for the both parties. Unfortunately, the Blue book doesn't investigate in particulars issues related to latent receipts estimation and latent units or units related to latent economy used for GDP formation and consumption. Nonetheless, these adjustments are due to be made.

Incomes gained by latent or illegal production can exist in terms of underreported income or unofficial salary but mainly in terms of mixed income. Mixed income is an income of unincorporated enterprises, i.e. income from informal production activities as defined. Since most part of informal production in practice exists as latent production operating surplus/mixed income then it might be treated as latent income. However, the latent production can be exercised not only within the informal sector. That's why any initial earnings gained as a result of latent and illegal production must be treated as latent incomes. This might include an illegal profit as a result of evasion to pay taxes in due amount or a salary remunerated to employees as

compensation to participation in latent production. In this case it is not of considerable importance whether this salary is spent by employees as a legal one or not.

Incomes in terms of salary can be treated as latent even in case of being paid out as legal ones, which are not going to be declared in a tax return when paying an income tax. Unreported profit of enterprises liable to a current tax on capital is treated in such a way too.

Significant part of households' expenditure on final consumption should be referred to this sectors characteristics provided the participation in illegal or informal goods and services sale-and-purchase transactions is considered as participation in transactions of latent and informal economy. There is a difference of principle thereof between a person who buys drugs or prostitute's services and persons who buy at informal markets not having even an idea whether a seller pays taxes on profit or not. Nonetheless, on the analysis purposes it is usefully to know the volume of purchases covering the share of people's needs satisfied at «black or gray» markets, i.e. which are not controlled and don't bring in any profit to public budget.

Many enterprises, especially small, with latent or illegal profits sometimes invest those in a concealed way underreporting the real cost of constructed offices, computer and other equipment purchases. The housing construction cost is often underreported intentionally as well. Smuggling that provides a significant part of consumer's goods supplies mostly exists as an import concealed from taxation and affects the adequacy of GDP estimates.

Adjustments of latent and informal economic activities are made on the base of sample surveys or additional and expert's opinion estimates with other information sources engaged. Adjustments are being made by statistics departments regionally and then managed in the central office in Bishkek if those are made on the base of sample surveys. If they are based on additional information and expert's opinion estimates the adjustments are made in the central office by experts from sectoral divisions or Unit of National Accounts. As a rule, if adjustments relate to indicators by industry then they are made in structural units and recorded afterwards on designing the System of National Accounts (SNA). The experts of the Unit of National Accounts are entitled to contest the estimates of sectoral departments and to request that the estimates be revised if they don't correspond to macro-economic proportions.

As a whole this order seems to be reasonable since on one hand it does ensure the link of sectoral and macro-economic indicators. On the other one the opinion of employees of sectoral divisions

very competent in their industries and of employees of regional departments who are aware of situation in the regions does carry much weight. However this approach implies high-level skills practically in all the sections of statistical system.

Adjustments of informal and latent economic activities in respect of the **System of National Accounts** construction are made to GDP produced as well as to GDP computed by expenditure and income approaches. Meanwhile the GDP estimates are distinguished correct enough. However, there is a certain inconsistency when measuring indicators of shadow economy and classification of latent and informal production.

In production the adjustments are made for the indicators of industrial production, construction, transport, trade, services rendered to population including finance. It implies that adjustments are made for the indicators of all major industries producing market goods and services. Informal production in agriculture is also recorded but is grossed up neither in latent nor in informal production.

With respect to income, relevant sectoral adjustments are grouped in the mixed income since this indicator is calculated as a difference between the gross value-added indicator and salary and production taxes indicators.

With respect to expenditure, adjustments are made to the households' expenditures to final consumption since this value is based on the trade indicators and completely interrelated with production indicators. An adjustment insignificant by value is made to fixed capital formation, mainly on private housing construction. With respect to export, there are applied the values provided by the Customs committee in official order.

Sectoral adjustments of latent and informal production in a more specific way are made with the following methodological treatments:

Industry. The share of adjustments of informal and latent production in industry is not grate. They mainly relate to adjustments of home production of consumer's goods in households. This production is mostly focused in food and partially in sewing, jewelry and other industries. Data for these adjustments are based on a special survey. As a whole production of this type relate to informal sector but part of handicraft wares producers evade taxation and constitute informal part of this sector. For instance, home clothing is competitive at the local market due to low prices

and fair quality. Local mass mediae regularly inform about disclosing underground clothing workshops by law enforcement forces. Producers often market their output with forged brand marks. It is problematic to identify such output at the market since it is extremely important for a seller to disguise the real origin of the output marketed. Therefore, even a concentrated market investigation can turn out to be ineffective. Therefore, there is an error probability but its total value cannot significantly affect the GDP.

Apart from adjustments of home production there are adjustments to unconscientious enterprise reporting. Concealing (full or partial) of volumes of industrial production or intentional overreporting of intermediate consumption (expenditure) is made to deliberately underreport the gross value-added used for GDP calculations. This procedures lead to the decrease of assessment basis and to illegal receipts.

The National Statistics Committee has been monitoring the intermediate consumption in output by reports of enterprises and sends additional requests in case of inaccurate information provided by the former. In principle the share of intermediate consumption is applicable for the average value to be computed. The latent value-added decreases as a result but the one recorded-increases when constructing macroeconomic indicators.

Small and joint-venture enterprises. Data provided by small and joint-venture enterprises of all sectors to be reporting by a special and simplified form are subjected to examination and if necessary to adjustments. In most cases the share of intermediate consumption recorded in reports of enterprises is called into question. The experience shows that this share is often overreported. The specialists of National Statistics Committee (NSC) made a summary adjustment of unconscientious reporting from small and joint-venture enterprises of all sectors equal to approximately 0.5% of GDP when making calculations for 1997.

Agriculture. In the Republic of Kirgizstan the major volumes of output are produced by private (family) farms, which are based on informal structure and don't take any recording. Private farms differ from the farmer's ones, which are registered and supposed to pay taxes and give a simplified statistical reporting. Private farms sometimes embody subsidiary features, i.e. based on the principle of by-employment. As a rule all the work is fulfilled by family members without any commitment to one another. Hiring is rarely used. Private farms produce most of the output for own consumption (own-account production). Income exists as a mixed income, mostly in kind.

All the data for farms obtained by the National Statistics Committee is based on sample surveys taken several times a year. Budgetary surveys of population are conducted as well. Farmer's farms are currently attempted to be covered by the simplest forms of bookkeeping with employing an international experience, however, positive results have not yet been yielded.

Obtaining of actual information with regard to output, intermediate expenditure, wages of hired workers and other aspects is of supreme importance for statistics of Kirgizstan.

Construction. Part of construction in the Republic is exercised by unofficial short-lived construction teams and immediately by population rather than by professional and officially founded construction companies. The recording of these activities is based on the data on finished houses and economy facilities registered in local authorities. These activities relate to informal sector and fairly not included into the shadow economy. According to the experts from the National Statistics Committee the information obtained in this way is true enough and correctly distinguishes the constructions commissioning in natural measures. With respect to valuation it is recognized that the cost of constructions is underreported when they are registered. For instance, the cost of trimming of office spaces under redecoration is significantly and systematically underreported, according to experts. Similar things happen when private houses are under construction. For instance, according to specialists, the cost of 1 sq. meter in Bishkek varies from \$150 to \$ 300 USD whereas the reported cost for 1 sq. meter does not exceed 300-600 soms that is 10-15 times lower. As such, part of the cost of construction intentionally underreported by customers might be and is due to be treated as latent economic activities.

Trade. Trade is a sector where latent economic activities are mostly concentrated. At the same time trade is the second in priority after agriculture where the informal activities of households collect. The specific feature of the sector is that the reported data accuracy control, especially in small enterprises and households, is quite complicated.

The adjustments of the data reported by trade enterprises on the base of single reporting are the only ones that are classified by the specialists of National Statistics Committee under latent economic activities. It concerns the commerce and public catering enterprises, which ignored reporting as set by regulations. Data on these units is then adjusted on the base of the average indicators of industries obtained by single direct observations. Besides, unconscientious data under reporting form commerce enterprises, which, for instance, overreport the value of intermediate consumption to diminish the value-added and profit, are adjusted by additional

inquiries and checks. Such activities of enterprises that didn't provide any reporting and that evaded applying social undertakings can really be related to latent activities.

Underlying regular sample surveys of informal markets throughout the Republic investigate the informal part of commerce activities. These surveys are well organised and give unbiased information. The given surveys of informal markets not only used in calculations of commerce trade indicators as being a type of industry but of indicators for consumption of material valuables and services by population. It is more independent than sample surveys data for household's budgets.

Transport. Significant part of transport services is rendered by individual producers. Since it is not seem possible to collect impartial information from entrepreneurs the calculations are based on secondary information. The state road police data underlies the calculations and provides the number of trucks and buses in good working order owned or rented by people, their average run, average capacity, average traffic receipts and so on. Calculations of passenger traffic by taxi are based on the number of licenses issued to drivers because a license possessing is not only controlled by the road police but by drivers themselves who don't welcome additional competition. The calculations are presented unbiased enough. The given adjustment relates to informal activities.

Services. The volumes of the pay services produced and rendered to population are based on data for their consumption that are obtained from budgetary surveys of households. This volume includes both services rendered by non-reporting enterprises and households. Such method is methodologically proven. The rest of calculations for currency exchange offices and pawnshops is made on the base of available structure information from enterprises that reported and their size. The estimate obtained in such a way is accurate and allows the parameters of non-observed economy in respect of individual services to be adequately assessed. Part of pay services will probably be undercovered by calculations but their general and relatively small value allows assuming that it does not significantly affect the indicators of macro-economic.

External trade. The external trade transactions implemented by people involved in "shuttle trade" are recorded on the base of customs documents and special surveys of far distance trains and is conducted quarterly since 1997. Natural persons who deal with exporting or importing goods in a bulk (trucks, charter air flights) complete a cargo customs declaration and these data are included within the external trade data in a regular order. "Shuttlers" who deal with

exporting or importing goods in small quantities by railroad, air or motor transport complete a customs declaration and a list of items carried with provided their cargo was checked at the customs. Persons who export goods in baggage in small quantities are recorded by estimating on the base of surveys conducted at terminals. Goods imported by “shuttlers” in baggage are due to be declared. However, this requirement is not always complied with. The total adjustments currently made with respect to “shuttle” trade are great enough but don’t seem to be exhaustive.

The compilation of macro-economic indicators that distinguish the latent and illegal production estimates is an explicit obligation of National Statistics Committee. However, the issues of non-observed economy are handled by other public institutions as well. This includes Ministry for internal affairs, financial and tax authorities and customs services. They are both experienced in this field and possess a deal of data gathered including statistics one. Close cooperation between different public bodies might be fruitful.

Unfortunately, some possibilities cannot be used at present. There are some methodological discrepancies in non-observed economy estimates made by tax and law enforcement bodies and those made by National Statistics Committee. The law enforcement bodies tend to record any economy assets transactions such as stealing of raw materials and equipment at work or financial fraud as shadow economy transactions and this goes against the SNA’s approach. The estimates of shadow economy turn out to be overreported as a result.

The possibility to use initial information available at tax and law enforcement bodies in statistical calculations is more real. Tax inspection regularly provides NSC with reports on population engaged in entrepreneurship. This report contains data on the number of people engaged in entrepreneurship, people who are on favorable terms and registered in tax bodies but tax exempt, assessed profit, amounts of income taxes and value-added taxes. There are also data on the number of disclosed economy offences and underground shops that produce alcohol beverages and consumer goods and data on taxes that have been added additionally due to inspections.

The idea of having to use the officers of law enforcement and tax institutions as experts in the field of estimation of unknown parameters of non-observed economy looks promising. This idea has not yet been put into practice at present partly because of some related organizational issues are not solved and partly because of some officers not morally ready to act as experts and advise statistics bodies. Statistics experts rely on their own experience to give an expert’s assessment.

Nonetheless, it is quite obvious that this experience might not be sufficient in a number of cases and engaging the officers of law enforcement bodies would be effective. Organisational problems are thereof supposed to be settled as well.

The total adjustments of GDP with all computed non-observed economy units applied accounted for some 10% in 1998. More by far than half of which is of total adjustments and relate to informal trade. Additional calculations for the latent production in industry, transport and housing utilities (private dwellings for lease) are of considerable share in the related industries.

Distinction of latent and legal informal production.

The relation of unincorporated economic units to taxpaying is the most accessible measure that might be used for dividing the informal production into two parts: latent one and legal one. This measure is not the only because there are many other aspects of economic behavior, for instance, such as following sanitary regulations, rules of registration and statistics data presentation. However, in terms of economy none of them is so important as taxpaying. It is needed here to give a reservation that informal activities allowed by the law are implied such as trade, agricultural production or construction. At present statistics, as a rule, doesn't estimate illegal and informal production of goods or services illicitly rendered such as prostitution and those are not included into the informal sector of economy.

It is necessary to consider that significant part of unincorporated enterprises of informal sector does not incur any taxes. The makeup of this category hinges on economy policy and is not stable. For instance, disabled people who engage in production or other sectors of economy are entitled to benefits.

It is possible to distinguish three groups of economy units with certain conventionality within the informal sector relying on the criterion of taxpaying:

- Economy units that incur taxes and pay those
- Economy units that incur taxes but do not pay those or pay partly
- Economy units that don't pay taxes because they are tax exempt.

The first and the last categories constitute that part of informal sector which functions in accordance to the rules, that is a legal part. The second category comprises illegal part of the sector. The distinction made in such a way can serve a purpose in terms of practice because it enables the known contradictions in definitions of informal and latent sectors to be partly solved.

The calculations were made by several stages.

The goods and services produced by that incorporated enterprises that have benefits in taxpaying set by the law are excluded from the total volume of cost of goods and services in informal sector. Almost all of the informal agriculture production, sales of agriculture output by own production (in practice - all the sales of agriculture output at market because it is hard to distinguish a farmer who sells from a professional purchaser), goods and services, produced by people with physical impairments, veterans and other groups of population with social benefits relate to these categories.

At the second stage the tax volumes paid in real were excluded from the remaining amount of informal production volumes. These data (about taxes on profit that individual producers incur) were obtained in tax bodies.

The remaining amount is part of informal producer's income (output), which is in principal assessed by taxes but was not paid out in practice. We treat this part of output as latent part of informal sector.

The calculations were made by industries. The share of intermediate consumption in each of industries was used to obtain the value-added.

The output obtained persuasively shows that a latent sector constitutes most of part of informal production and is dominating in many industries. Thus, there is a practicability, on one hand, of having interrelated studies on informal and latent sectors of economy but on the other one, there is a clear distinction between them.

Latent production of alcohol beverages and cigarettes.

The elementary economic logics says that a latent production can be concentrated in that industries that engage in production of goods in high demand and therefore sell rapidly as a

result. This is supposed to be a final product the customers would pay for in cash. The profitability of this product production must be high enough, at least higher than the average profitability on legal transactions. The simplicity of production technologies is another prerequisite because it is very difficult to launch a high-tech production in a latent way.

Production of alcohol output, vodka in particular, meets the requirements described above.

There are great discrepancies between data on inputs recorded in respect of alcohol output (production plus import less export) and data on vodka, wine and other alcohol beverages sales. The actual consumption (sales) in most cases is more than disposable inputs. Latent production or illegal import could have led to such a situation. In cases when consumption is less than inputs one might stress either an underrecording in trade (what is most probable) or unregistered export. Unfortunately, the National Statistics Committee does not have any reliable information available with regard to the change in the stock of alcohol output, however this value could not determinatively affect the misbalance discovered.

The alcohol inputs/vodka production ratio is not stable enough either. The vodka production itself is simple enough and implies that the output be made up of approximately 40% of spirit substance. Judging by data available, the spirit/vodka ratio is considerably higher and what's more, the quantity of spirit exceeded the one of vodka in some years. It clearly says that the vodka production was notably underreported.

Thus, it is worth noting with more confidence that the latent production of alcohol output, especially vodka, considerable by its scale have been launched in the republic. Data provided by the Ministry for Internal Affairs to National Statistics Committee on the seized alcohol output produced in violation with set regulations cannot serve as a base for such calculations due to underreporting that ensues from ineffective work of law enforcement bodies.

The shaped level of consumption has been taken as a base when calculations are made. This is, first of all, due to the thing that determining the reasonable level of consumption is a difficult task that can be satisfactorily solved only after studying the opinion of experts and, second, proceeding from the budgetary investigations data the change in alcohol consumption really illustrates the decrease of consumption.

Thus, adjustments actually involved distribution of the difference of vodka produce inputs and its consumption between the two possible sources of inputs replenishment: production and illegal import. The apportionment was made in proportion to the shares of confiscated import and domestic vodka illegally selling at the market. Vodka was valued at average market prices.

The calculations of latent production of cigarettes were based almost on the same approach (commodity approach). Cigarettes are the product in high demand, easy to sell at a consumer market for cash. The difference between a tobacco output and its total sales for consumption is great. The figures for cigarettes consumption are rather underreported than overdone. Therefore, the difference must be covered by relevant adjustments of latent production or informal sector.

The production of cigarettes is more highly developed than the one of vodka. Thus, it is more difficult to organise it in underground. Experts assume it's most probable that part of cigarette's production at the only tobacco factory in the Republic was not properly registered, recorded in accounting documents and then provided with forged excises. Nonetheless, the amount of that cigarettes can't be high. Small amount of cigarettes was only classified as ones of latent production and most part by far – to a latent informal import.

The calculations of the volume of pay services rendered to population by unincorporated enterprises. The underlying budgetary surveys of households are used for the adjustments of calculations and contain the question with regard to purchases of goods and services by private persons. Moreover, additional sample surveys are conducted in order to estimate the volume of such services that were not originally included into standard questionnaires (clothes and footwear mending, domestic appliances repairs and so on).

The output of calculations for the volume of services rendered by informal producers is recorded when estimating the total volume of consumption of goods and services and used for GDP calculations by expenditure approach. Part of data related to so-called non-production services is recorded when calculating the indicators of these services production. However, other part related to so-called services of production type (car repairs, individual clothes making, domestic appliances repairs and so on) distinguished on the side of industry according to the classification was not recorded when calculating the indicators of production. Thus, the general indicators of industrial production were sort of underreported and the inputs were not linked with their consumption.

Latent incomes

The National Statistics Committee is currently handling the calculations of primary incomes derived from latent and informal sources within the NA procedure for calculations of mixed income that are the incomes of informal sector. This procedure implies deriving the value of mixed income presented as a difference between the gross value added produced by households and the taxes on production (paid wages in this sector do not exist as a rule). Thus, all the incomes from informal activities involving receipts from its latent part are found included within GDP. However, there is no any borderline drawn between the mixed income derived legally and the mixed income derived by latent transactions.

Latent activities incomes of other sectors (that really occur in terms of unrecorded wages and so on) are distinguished in the indicator of transaction difference (gross income) in a relevant sector and latent part is singled out from the total amount in no way. As such, the GDP calculated by income approach is adequate in general but the distribution of incomes between legal and illegal parts of economy is not recorded.

The calculation of latent incomes of households is based on a balance method. The concept of calculations of latent incomes involves the comparison of all recorded incomes of households and their expenses for final consumption, accumulation and increment of financial assets. As a rule, the expenses are found higher by far than the incomes recorded in returns. The difference can be treated as a latent profit.

The value obtained in that way can be neither plainly referred to latent remuneration of labor nor to entrepreneurial income, nor to unrecorded part of mixed income. It is obvious that the latent income comprises all the components referred to above. It is quite certain to state that some part of latent incomes was derived by committing illegal deeds such as stealing from enterprises and a fraud that are of no economic nature by its essence, that is incomes derived by illegal redistribution. Besides, international transactions have not been recorded at all. As such, this indicator, unfortunately, is perfect neither in terms of practical viewpoint nor of theoretical one. However, there are reasons to assume that the errors listed are not great as to compare with those derivations of latent incomes related to latent economic activities within the country.

In order to make calculations there were utilized the data from all the “Household” sector accounts distinguishing the indicators of disposable income, expenditure for final consumption and accumulation.

It was also necessary to take account of the value of financial assets increment in the sector. According to SNA methodology this information is supposed to be included within the system’s financial account. Due to objective reasons the NSC is not yet designing a financial account for any of institutional sectors including the “Household” sector, however, it possesses information needed for the approximate estimation of the value of financial assets increment in this sector. In particular, the increment of people’s cash (national currency), deposits at financial institutions, securities, the increment (reduction) of wage and pension arrears including the increment of foreign currency in cash were recorded in order to estimate the value of financial assets increment. The latest of indicators was calculated as a difference between purchase expenses on foreign currency and its selling receipts having been adjusted for the value of “shuttlers” expenditure for non-organised import.

The estimation of financial assets increment made in such a way is not adequate for full-bodied financial account. There is a reason to assume that some financial data have been twisted. For instance, the official foreign currency purchase expenditures are considerably underreported as actually admitted by NSC itself dealing with notable adjustments of official indicators reported by exchange offices.

The results obtained showed as was proposed that the expenditure of households for the period considered are higher than the data available. The latent profit calculated in such a way made up a considerable value. It might be presumed that errors adjusted latent income is somewhat higher than it was derived from calculations.

The total value of GDP is entirely unaffected by the calculation of latent income as the GDP by income approach is initially based on the production indicators. However it is also obvious that the availability of latent income in households significantly changes the structure of GDP calculations in a traditional way. Part of incomes, previously treated as operating difference (gross profit of economy), should now be referred to the incomes of households because these funds have been used by households.

Second part of shadow household incomes is generated by latent part of transactions on informal production of goods and services, that is, constitutes latent part of mixed income. No additional calculations to identify it are required, it is enough for the value added of latent part of informal sector that has already been calculated to be applied. No taxes deductible from this part of value added are herein assumed to be actually paid out whereas the wages don't exist either. As such, the value added is equal to the mixed income.

The total value of shadow income is equal to the total of a latent income and latent part of mixed income.

The approach used for the calculation of "shadow" income is conventional enough. Further on it should be modified by updating the informational maintenance of calculations and applying more accurate computations.

Consumption from latent and informal sources.

As an addition to the measurement of latent economy in respect of production and incomes it would be reasonable to analyse the change in the structure of final consumption and accumulation in households on the purpose to more adequately assess their welfare sustained by latent and informal sources as well. This indicator is of a different concept than the latent economic activities one since the consumers in informal and latent sale-and-purchase deals do not offend any laws and regulations. Nonetheless, the consumption indicator from latent and informal sources is of importance for these sectors definition.

The households' consumption expenditure from informal sources directly corresponds to the adjustments of informal trade made on measuring the informal production. Information obtained from households' budgetary surveys was also used because the questionnaire for the given survey apart from the general question about purchase expenses on goods and services contains the question about the purchase of goods and services from individuals. The latent part of commodity turnover (see methodology description of latent production in trade) accords to the consumption of households from latent sources. The value of consumption of own-produced output should also be related to the value of informal consumption. This indicator is derived from the mixed income in kind, which is obtained by households engaging in informal agriculture. The indicator is regularly computed by NSC when designing the System of National

Accounts. It is of great value on analysing the marketability of production and market in the country.

Latent part of accumulation comprises the total of underreported cost of living houses and offices. That underreporting is widespread and involves investing latent incomes. This value corresponds to relevant adjustments of latent construction activities.

The greatest share of adjustments in course of the project under implementation was made on estimating the latent and informal consumers goods imported by “shuttlers”. The value of informal and “shuttle” trade are distinguished in NSC’ publications according to data from Customs Committee (see methodology description to be defining parameters of latent production in external trade). However, this value seems to be insignificant.

This conclusion becomes obvious after the data on inputs and consumption of some most liquid goods such as vodka, beer, cigarettes and domestic appliances). As a rule, the inputs considered against most of goods are much lower than the indicators of uses (sales). This evidences that the basic data on inputs were underreported, that is on production or import. With respect to the goods referred to above vodka is the only one eligible for latent production within the country due to the simplicity of production techniques. The rest of goods referred to above, apparently, was imported latently with avoiding prevailing regulations and the law.

Thus, the adjustments of latent import indicators (plus the formally known value of “shuttle” trade) were made by commodity flows approach on most liquid consumers products in cost terms and terms in kind; the estimation of import was based on average market prices.

Definition of parameters of latent and informal economy in the Republic of Kirgizstan.

The gross value added obtained in latent and informal production makes up an imposing amount that varies from 45% to 50% of GDP in different years. However, the share of informal production in it is the greatest that is exercised in compliance with the regulations set, mainly in agriculture. Latent production’s share is large too and accounts for approximately 7%-8% of GDP (Table 1).

Things to be taken note of are the following. Latent part of informal production is not additively great and makes up some 5% of GDP. The other sectors’ latent production is smaller –

approximately 2-2.5% of GDP. However, the main problem is that agriculture producers in informal sector don't pay taxes either as being tax exempt. Thus, even though most of informal producers comply with the regulations set, the regulations themselves are such ones that the volumes of production approximately equal to the half of GDP constructed do not incur taxes because of the nature of these regulations. Some 40% only of all the value added generated within the country are actually assessed by taxes provided that non-market services (education, health, administration, social security, culture and so on) make up some 10% of GDP and do not incur any taxes.

It is also important that that informal sector is not government controlled. The effective activities of the government get impeded as the value of informal sector reaches crucial points.

It is also to add that the latent and informal production grows both in nominal and value terms, especially its latent part.

With respect to latent production in other sectors, its scope is not great (2.2-2.25% of GDP). This activities focus mainly on trade. Considerable scope of vodka and commercial activities on rendering pay services to population might be noted as well. This situation is quite explicable, because the entire profitability of actual production in Kirgizstan like in other CIS countries is insignificant even in latent sector (other than the sectors listed) but risks related to latent production are high. As such, it is more advantageous to concentrate the business in legal financial transactions in trade including the external one that are yielding high profits.

Table 1: Parameters of latent and informal economic activities

	1995	1996	1997	1998
(mln. Soms)				
Value added generated as a result of latent and informal production	7623.9	12762.6	15684.3	16637.3
including:				
informal production according to regulations	6362.9	11044.4	13157.4	13395.4
shadow production	1260.9	1718.1	2508.9	3241.9
latent part of informal production	819.3	1078.8	1763.2	2710.0
latent production in non-fiscal sector	441.6	639.3	745.7	531.9
Latent and mixed incomes	7852.7	13862.0	14415.0	23894.8
including:				
mixed income according to regulations	6362.9	11044.4	13175.4	13395.4
shadow income	1489.7	2817.5		10499.3
latent part of mixed income	819.3	1078.8		2710.0
latent income	670.4	1738.7		7789.4
Components of using incomes on consumption from latent sources	9697.9	15829.6	17521.4	27343.5
including:				
components of informal consumption (legal)	6005.7	10991.3	11162.1	18707.8
components of consumption from latent sources	3692.2	4838.3	6359.4	8635.7
(percent of GDP)				
Value added generated as a result of latent and informal production	47.2	54.5	51.1	48.7
including:				
informal production according to regulations	39.4	47.2	42.9	39.2
shadow production	7.8	7.3	8.2	9.5
latent part of informal production	5.1	4.6	5.7	7.9
latent production in non-fiscal sector	2.7	2.7	2.4	1.6
Latent and mixed incomes	48.6	59.2	47.0	69.9
including:				
mixed income according to regulations	39.4	47.2	42.9	39.2
shadow income	9.2	12.0		30.7
latent part of mixed income	5.1	4.6		7.9
latent income	4.2	7.4		22.8
Components of using incomes on consumption from latent sources	60.1	67.7	57.1	80.0
including:				
components of informal consumption (legal)	37.2	47.0	36.4	54.7
components of consumption from latent sources	22.9	20.7	20.7	25.3