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on Measurement of the Non-Observed Economy

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**Comments on NOE Handbook
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Unrecorded economy

The question of terminology seems to be rather important. What does it mean – “non observed” economy? Generally speaking, elements of the “non observed” economy are easily and directly observed by everybody, at least in the underground and informal economy. So, to make this term correct, we always have to add “non observed by direct statistical observations” or something else. Is it convenient?

Every definition needs to meet at least two main requirements: the completeness and the accuracy.

The term “**unrecorded economy**” seems to be the most appropriate in the context of statistical analysis. Some reasons to mention are:

1) The term “unrecorded economy” is fully *complete* regarding the topic under discussion. It is one of the most extensive terms. It covers the area under consideration in an exhaustive way. Every event belonging to this part of economy (i.e. “hidden”, “gray”, “shadow” ... economy) falls into the category “unrecorded”. None of those events can be recorded directly. Otherwise, the event would be an element of the “white” (“official”, “formal”, “legal” ...) economy.

2) The term “unrecorded economy” provides quite an *accurate* definition. According to this definition, the total economy might be strictly divided into two parts. For every economic event the criteria is definite – is this event recorded within any formal procedure or not. These two parts do not intersect but complement each other. No event would be lost but included into one of these parts. It is to emphasize that every event would be included into one part only.

3) Finally, the statistical *methodology* is explicitly referred to in the term “unrecorded economy”. The definition relies on the main statistical instrument – the record. The two advantages mentioned – completeness and accuracy – are related to the methodological basis.

“Top - bottom” procedure

Economic and social statistics can not be expected to make exact measurements of hidden events. According to its nature, the economic and social statistics is able to measure accurately first of all the legal activity. There are other public systems to estimate and to deal with the illegal activity. An attempt to get a micro-level statistical estimation of a hidden event looks rather problematic – normally, if a hidden event might be statistically disclosed on the micro-level, this event might be registered and becomes not hidden. That’s why the indirect estimations of unrecorded (non observed) economy seem to be effective on a rather high level of data aggregation.

In Russia, national accountants often played the key role in initiating and then co-ordinating the unrecorded (non observed) economy estimations. A lot of problems related to the unrecorded economy become obvious in balancing different indicators within national accounts compilation.

E.g., in 1992, just at the start of the radical economic reforms in Russia, it was national accountants who first had raised the question on the retail trade adjustments needed. It was not possible to balance the GDP expenditures only on the basis of the official data, without adding estimations for non registered retail turnover. The adjustments reached 40% of the officially collected data. Trade statisticians accepted adjustments and developed detailed methodological solutions.

Hidden wages in Russia make about 10% of the GDP. The first assessment was made by national accountants in 1996, by macroeconomic balancing of the official income data and the personal expenditures data. Then, the methodology was applied and developed by labour statisticians.

Macroeconomic analysis of the Russian balance of payments data provided well-founded assessment of the capital flight, which makes an important problem in Russian economy. Macroeconomic

estimations gave the framework to measure the dimensions of this phenomena, and pushed the micro-level researches.

Actually, we are faced with the problem of statistical discrepancy in the GDP production and expenditures balancing. The expenditures are constantly higher than the production. It means, there is a systemic shift in the basic data, which national accountants can not adjust themselves. The most probable reason is the concealment of earnings, related to export goods. Exports are recorded by the custom and included in the GDP expenditures (net exports), but the related internal earnings are widely concealed by producers and traders in production records. The wholesale trade data are the first to be checked, as the problem became really serious after the 1998 August.

So, macroeconomic balances are an indispensable tool to obtain general estimations of the unrecorded (non observed) economy.

It is to applause for the central idea of the “Handbook...” – the three-step approach to the NOE measurement. It goes from bottom to top: from the data collection improvement, through the supplementary surveys to the national accounts adjustments. It provides an effective methodology system.

The feed back idea is also mentioned in the draft of the “Handbook...” (e.g. chapter 6). Regarding the significance of a feed back step, it seems necessary to note it directly as a special procedure in the “Handbook...”.

The compilation of macroeconomic balances can involve the review of adjustments made before – in a descending order, to lower aggregation levels. So, a **“top - bottom” procedure** seems to be named as an element of URE (NOE) measurement system. It would consist of:

- macro level determination of URE (NOE) elements, not completely adjusted during previous three-step analysis,
- “frame” macroeconomic estimation of these elements,
- methodological solutions on the branch level,
- micro level assessments.