Non-Observed Economy in National Accounts

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Eurostat - Unit C5 : Integrated global accounts and balance of payments
Main points in this presentation

- Exhaustiveness of National Accounts
- Non-Observed Economy: underground, illegal, informal, omitted
- Exhaustiveness adjustments – not comparable
- No estimates of actual size of Non-Observed Economy
- GNI inventories
- Eurostat Tabular Approach to exhaustiveness
- Methods: 3 country cases
Exhaustiveness of National Accounts

- National Accounts: needs to be exhaustive and cover both observed and non-observed economy → Non-observed does not mean non-measured
- The Non-Observed Economy: all productive activities that may not be captured in the basic data sources used for National Accounts compilation
- Includes:
  - underground
  - informal
  - illegal
  - other activities (omitted due to deficiencies)
Underground production

• Production activities that are legal but deliberately concealed from public authorities in order to avoid paying tax (e.g. VAT or income tax) or social security contributions; meeting statutory standards; or complying with official procedures and regulations.

• Also called “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.

- Typically functions on a system of unofficial relationships and does not rely on official agreements. Small-scale production of goods and services with the primary objective of generating employment and incomes for persons concerned.
Illegal activities

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

- Both ESA 1995 and ESA 2010 explicitly requires illegal activities to be included in the National Accounts.

- Eurostat Taskforces have identified drugs; prostitution and smuggling as the most significant illegal activities in Europe.
Explicit and implicit exhaustiveness adjustment - no comparable data

- Exhaustiveness adjustments are made implicitly (i.e. the balancing process) as well as explicitly.

- This varies very much between the Member States as they are making explicit exhaustiveness adjustments or implicit ones, at many and different parts of the calculation. Both are equally valid.

- Exhaustiveness adjustments by no means can be seen as being comparable across Member States
No estimates of actual size of Non-Observed Economy available

• Moreover, it should be noted that ensuring the exhaustiveness of GNI data and compiling estimates of the non-observed economy are two very different issues.

• The exhaustiveness adjustments gives no information about the total size of the Non-Observed Economy.

• Therefore, not possible to use Non-Observed economy figures as proxy for the tax gap.
ESA GNI inventories

- Up-to-date inventory of the sources and methods used to calculate GNI and its components according to ESA (the GNI Inventories).

- One of the main instruments enabling Eurostat to assess the comparability, reliability and exhaustiveness of the Member States’ GNI data.

- The inventories also include Process Tables showing all stages of the national accounts compilation process.

- Public versions available for 12 European countries (10 EU: RO, MT, AT, SE, FI, EE, DE, FR, NL, DK + NO & CH)
Eurostat Tabular Approach

• The Eurostat Tabular Approach to exhaustiveness was designed to identify potential sources of underestimation of GDP estimates due to omissions from the source data used in compiling National Accounts.

• The seven types of non-exhaustiveness under this framework can be broadly classified into the four categories of: not registered, not surveyed, misreporting and other deficiencies.

• Different exhaustiveness methods can cover one or more types completely or partly, this makes exhaustiveness adjustments incomparable.
Eurostat’s Tabular Approach: types of non-exhaustiveness

N1 - Producer deliberately not registering – underground
N2 - Producers deliberately not registering - illegal
N3 - Producers not required to register
N4 - Legal persons not surveyed
N5 - Registered entrepreneurs not surveyed
N6 - Producers deliberately misreporting
N7 - Other statistical deficiencies
Methods: Country case Germany

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<thead>
<tr>
<th>Country</th>
<th>N2</th>
<th>N6</th>
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<tbody>
<tr>
<td>Germany (2016)</td>
<td>Drugs and tobacco trafficking: Demand based approach</td>
<td>Use of SBS and VAT statistics</td>
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<td></td>
<td>Alcohol not relevant (low prices)</td>
<td>Tax and fiscal authorities</td>
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<td>Prostitution mostly legal (model estimated)</td>
<td>Model to estimate the “real” income, independently of the one declared</td>
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## Methods: Country case France

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<tr>
<th>Country</th>
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<tbody>
<tr>
<td>France (2016)</td>
<td>No adjustment for alcohol</td>
<td>Fiscal audits results corrected by selection bias</td>
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<tr>
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<td>Drugs and tobacco: Demand based approach</td>
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<td>Prostitution mostly legal and covered by</td>
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<td>N6 fiscal audits</td>
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## Methods: Country case Estonia

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</table>
| Estonia (2018)| Alcohol, tobacco and fuel smuggling: demand based approach  
Drugs smuggling: supply based approach | For envelope salaries and profits: data from SBS and administrative sources for estimation  
For VAT: Commodity flow approach (supply and use tables) |