Comments on Tatiana KHOMENKO Paper, CISSTAT

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by

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A. Tatiana Khomenko's paper "Measuring the Non-Observed Economy in transition countries with special reference to the Commonwealth of Independent States (CIS)"

1. This paper is a very good, well-written paper, especially at the beginning. I will summarize it, sprinkling in a few observations of my own, and then make a few minor criticisms.

    ARGUMENTS OF THE PAPER:

2. Activities presently known as NO were very important in making the command economy function, but for obvious reasons many of them were not well captured by the MPS. The Soviet statistical system did take pains to include one important category in Net Material Product, however, namely households' production of food and construction of dwellings on own account.

3. With the collapse of the USSR and planning at the end of 1991, many NOE activities were legalized and NOE activity soared. This was mainly on account of the formation of multitudes of small businesses, who then omitted to report any information to the statistical authorities. As the Vienna Institute used to put it, output collapse and very high inflation led to falls in real wages and benefits. In addition, many wages, products and taxes were simply unpaid. Bankrupt and inexperienced new states introduced high and unfamiliar taxes. All these radical changes led to a burgeoning of informal activities, including street trading and shuttle trading, plus many more hours of own-account work on urban and rural agricultural plots, as people struggled to get by.

4. As Khomenko points out, the various CIS statistical authorities responded to the new phenomena by making some ad hoc estimates of the NOE in the early nineties, but these were not comprehensive and in any case were not included in NMP, itself an aggregate on the way out.

5. 1995 ff. CISSTAT began publishing methodologies for dealing with the post-

Soviet peculiarities of CIS NOE, and for including these activities within an SNA framework. The OECD et al's NOE Handbook (2002) crowned several years of work and took into account CISSTAT's recommendations. It was translated into Russian, and clarified the concepts and methods for dealing with the NOE in post Soviet statistical administrations.

6. [As in OECD countries, in the CIS even the educated public remain poorly informed about the coverage of the national accounts, with journalists regularly accusing government statisticians of not even attempting to estimate 'shadow' activities, which they assume to be gigantically large in proportion to reported output.]

7. According to Khomenko, CISSTAT's first priority at that time was better to measure legal activities a) purposely concealed and b) not accounted for due to their falling under the radar of traditional statistical observation. Capturing the newly burgeoning (1) underground economy, (2) reducing the 'statistical underground', and better capturing the unincorporated, unregistered, newly-legal (3) informal sector, got priority attention.

8. Since the late 1990s all the CIS countries have been trying to estimate the NOE and have included the estimates in GDP, applying the concepts, definitions and classifications contained in the 1993 SNA, CISSTAT's methodologies, and what became the NOE Handbook. Theoretically, then, results are mostly comparable both within the CIS and internationally.

9. Specifically, all 12 CIS countries claim they are making estimates of: underground production, informal sector production, production of households for own consumption, and 'statistical underground' production not captured due to deficiencies in the basic data collection programme.

10. Some of these estimates are rather crude, and there are differences in methodology and quality of data collection across the CIS. These factors make problematic international comparisons of GDPs and NOE subcomponents.

11. To date, only 3 countries estimate Illegal Production: Belarus, Ukraine and Turkmenistan, and only the first 2 include them in GDP.

12. Most CIS countries only attempt to measure NOE activities of production, distribution and disposal of goods and services. Redistribution of income and wealth proceeding via the NOE is not covered. Only Armenia adjusts other non-GDP SNA aggregates for NOE, viz. current transfers from the rest of the world, as remittances are a huge item in that country.

Table 1: CIS Shares of NOE in GDP, production method, %, 2005
(see her paper on the IARIW website)

13. It is mainly the scale of own-account household production that produces the wide range of size estimates of NOE in the 12 countries; there is e.g. a 10% NOE adjustment in Belarus and a 30-32% one in Tajikistan and Uzbekistan.

14. Countries have had problems drawing lines between categories. E.g. Azerbaijan puts most of its NOE in 'NOE not elsewhere classified', as it is unable given its data to attribute activities e.g. to underground, informal or household sectors. A staggering 85% of the gross value added of the manufacturing sector in that country is NO (Table 2, 2005).

Table 2: CIS NOE shares of GVA by industry, %, 2005

16a. The biggest adjustments for NOE on the production side have to be made for the usual culprits: agriculture, trade, manufacturing, construction, transport, health care, education, and services of owner-occupied and rented housing.

17. Adjustments to components of GDP by final use can be large. NOE pushes up household final consumption by 37% in Russia, 20-24% in Georgia, Moldova, and Kyrghyzstan, 19% in Ukraine; adjustments for GFCF vary, e.g. from +1% of GFCF for Belarus but 19% for Armenia. (Table 3)

18. Merchandise trade requires substantial adjustment for NO activity. For instance, Russian imports were adjusted upwards by 17% in 2005. Unfortunately similar estimates are not available for all other republics. (Table 3)

Table 3. CIS NOE Shares of GDP by final use, 2005 (% of GDP and its final use components)

21.   Illegal activities that some CIS authorities do try to measure differ in definition and coverage: Belarus tries to estimate just the illegal production of alcohol, while Ukraine estimates production and income for a wide range of "classical" sins: narcotics, smuggling, prostitution, resale of stolen goods ("fencing"). Turkmenistan estimates not only illegal alcohol and fishing (think caviar!), but also supposedly illegal services of professionals like lawyers, doctors and teachers. A good part of these belong in the underground or informal sectors, not in illegal activity. In the near future Turkmenistan plans to estimate the value of trade in drugs, jewellery and prostitution, but does not intend to include the output in GDP 'on moral grounds'. Other CIS countries, including Kazakhstan, have plans to start estimating illegal activity, which is admirable given the country's importance to international drug enforcement.

22.   No countries' presently bother with 'Models', though e.g. Belarus tried the monetary method at the start of its transition, and Russia and Ukraine tested the electricity consumption method. These methods were not found to be very useful in estimating GDP under CIS conditions (WIIW would say: on account of dollarization, non payment, barter and unstable velocities; and soft budget constraints, unresponsive demand owing to high fixed costs and derisory prices, plus transmission losses unrelated to factories' output). Moreover, the NOE amount thus estimated could not be sub-attributed to components of GDP, further limiting its usefulness.

23.   Supply-based methods are now used especially to estimate output of agriculture and construction, using data on inputs such as seeds, forage or cement. Five countries use the commodity flow method in a framework of resource and use tables. Balances of selected products in 8 countries. However, this is effective only if the groups are sufficiently disaggregated, not really the case.

24. An example of a problem in measuring household production of agricultural goods using commodity flows, the best method for that, is that whereas in Soviet times input and output data was gathered on a nomenclature of about 100 agricultural goods, in the early post-Soviet period this requirement was, sadly, dropped.

25. Demand-based methods include e.g. estimating individuals' provision of transport services via data on motor vehicle registrations.

26. Data from the tax authorities is used to assess output of the self-employed.

27. The labour input method is used to estimate output in a wide range of activities. Data comes from employment and LF surveys and surveys of small enterprises.

28. The usual data sources are mined: administrative sources such as: registers of businesses, land, dwellings, vehicles; enterprises' and individuals' tax returns, on the one hand, and survey data, on the other: surveys of small enterprises, households, joint sample surveys of households and household unincorporated enterprises, sample surveys of household expenditure, employment and LF surveys, sample surveys of specific activities like household construction, bazaar and market trading, services of individuals.

29. Output, cost and employment data are gathered by industry and size of establishment, and ratios calculated, which are then compared with results from enterprises suspected of underreporting; such ratios are also used in imputing output of non-reporting enterprises. Business registers present familiar problems. In terms of GDP, it is much more important to address underreporting

by medium and large enterprises, than to go after small and family firms. More up-to-date registries, though, help the design of surveys of small firms.

30.   Standard household surveys have been extended to include periodic combined surveys of households and household unincorporated enterprises, in several countries including Azerbaijan, Georgia, Moldova, Turkmenistan and Ukraine. Specific surveys in specific countries have targeted: household production on plots, small farms, individual production of food, clothing and footwear, wood processing, construction, transport, trade, personal services; household spending on construction, car repair, catering of takeout meals, and even health and education.

31.   The CIS states are due for a census. Many have censuses planned for 2010 or thereabouts. If the questionnaires are well designed and reveal labour force activity by sector, for example, this should yield a more useful framework for household sampling.

32.   A problem in measuring household production by the labour input method is failure to capture the often quite important *ancillary activities of rural households*, including hunting, fishing, woodcutting, materials processing and construction on own account.

33.   In Russia, e.g. "hidden wages" are adjusted for first at the national level in the balance of money income and expenditure, and then allocated to industries and regions proportionally to output. However, the excedent of expenditure over income also includes mixed income and transfers, so the method has its faults.

CRITIQUE OF KHOMENKO'S PAPER:

34.   The paper is a good overview of the methodological issues and achievements of the CIS statistical authorities in the past 15 years of transition. It is hard to find much to criticise in the paper itself, as opposed to the situation regarding NOE estimation that the author describes in it. The paper starts out concisely but seems a bit less well edited towards the end, with some repetition that can presumably be dealt with in a final version. There is also evidence part of the text is taken from an earlier paper, as she refers to 2004 as in the future.

35. The paper repeatedly refers to ideal practice as per the OECD Handbook, since the author wishes to set out correct theoretical benchmarks against which current CIS practice may be measured.

36. The author makes many recommendations, familiar to readers of the Handbook, that would, if implemented, lead to more accurate basic data and allow more useful disaggregation of it so as to focus attention on problem professions and industries. The paper sometimes reads as if it had been written for a different audience, one of government officials and economists, rather than

the present audience, some of whom are more than familiar with the OECD Handbook, since they wrote it! She 'preaches to the converted'.

37. This reader might have been happy to read an even less distilled draft with more of the gory details and regional differences included, but the author kept to her mandate and omitted them, in order to produce a paper of the required length.

38. I would also have liked an extra table showing how the NOE share estimates fluctuate in the past decade, as per her sentence to that effect.