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Challenges in Covering the Informal Economy in External Sector Statistics

CHALLENGES IN COVERING THE INFORMAL ECONOMY IN EXTERNAL SECTOR STATISTICS¹

Executive Summary

Against the background of continued interest in capturing the informal economy in macroeconomic statistics, this paper highlights the issues associated with covering informal activities in cross-border statistics, in the broader context of the typology of the non-observed economy, which comprises informal, underground and illegal activities. Informal activities are generally outside the scope of the regular data collection programs because they are undertaken by households or small-scale nonfinancial corporations and with a relatively low level of organization. They may not be registered and are therefore difficult to measure. Further, the boundaries of informal activities are not always clear as these activities may overlap with other activities that units may attempt to conceal because they are illegal or incentives exist to evade government regulations. Therefore, covering informal activities in cross border statistics poses numerous challenges, including the lack of a consistent measurement framework across countries and the cost of data collection. The Committee is asked to discuss a proposal to establish a task force to develop a strategy for addressing collection methods, coverage and consistency of informal sector activities in cross border statistics.

I. INTRODUCTION

1. Addressing coverage gaps in cross-border statistics at the national level is critical for improving data accuracy essential for effective policy decisions. While there is a body of methodological and empirical-based work on measuring informal activities in national income and output estimates, less attention has been paid to addressing coverage gaps in the international accounts (cross-border statistics) arising from activities that are not captured in data compilation systems. In line with the IMF's commitment to foster data accuracy and availability particularly in low income countries, the informal economy is among the anchors of the IMF's Statistics Department (STA) work agenda. From the international accounts standpoint, taking stock of country practices and scoping the key issues would be critical to developing appropriate strategies tailored to country needs.
2. A leading cause of imperfections in cross-border statistics is the omission of activities that are outside the scope of the regular statistical inquiries and data collection systems (i.e., surveys of enterprise accounts, international transactions reporting systems, merchandise trade statistics). These statistical inquiries are predicated on the existence of a structured system where businesses adhere to government regulations regarding the payment of taxes, the registration and operation of a business entity, and the provision of certain benefits to their workers (ILO 2013). Therefore, some activities may be omitted because they are illegal or hidden from the authorities. However, some activities may also be omitted because they are undertaken

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by households—and not business units—that are not required to adhere to the regulations that may be applied to businesses; or in the case of small-scale non-financial corporations—the costs versus the benefits of data collection.

3. **This paper focuses on informal activities and examines some of the issues relating to covering these activities in cross-border statistics.** The size of the informal economy²—especially in developing countries—is of interest to policymakers because large or growing informal activities are associated with increasing poverty. Further, macroeconomic stimuli designed for the formal economy may be less effective in these circumstances. Estimates of the size of the informal sector in a domestic economy may vary widely, depending on the measurement techniques used.³ However, macroeconomic statisticians generally avoid deriving specific, separate estimates of the sector, preferring instead to derive comprehensive (exhaustive) estimates of the economic variable that would implicitly include both formal and informal activities.⁴

4. The paper is organized as follows: Section II presents some of the main components of non-observed economy activities (NOE). Section III reviews some of the key challenges associated with covering informal activities in cross-border statistics, including the degree of overlap between informal activities and other NOEs. Section IV examines the way forward in covering informal activities in cross border statistics.

II. NON-OBSERVED ACTIVITIES

5. The Handbook on Measuring the Non-Observed Economy identifies the NOE broadly as the range of activities that are most likely to be non-observed as well as activities that may be missed because of deficiencies in the regular data collection programs. The three broad groups of NOE activities that may be relevant for cross-border statistics are as follows:

A. Informal Activities

6. The *System of National Accounts, 2008 (2008 SNA)* and Handbook for the Nonobserved Economy⁵ both follow the international definition of the informal sector as developed by the *International Conference of Labor Statisticians* as “...consisting of units engaged in the production of goods or services with the primary objective of generating employment and incomes to the persons concerned. These units typically operate at a low level of organization, with little or no division between labor and capital as factors of production and on a small scale.

²

³ See, for example, Leandro Medina, Andrew Jonelis, and Mehmet Cangul, 2017, “*The Informal Economy in Sub-Saharan Africa: Size and Determinants*”, IMF Working Paper No. 17/156. Using a multiple indicator-multiple cause (MIMIC) method, they determined that informality ranged from a low of 20 to 25 percent in Mauritius, South Africa, and Namibia to a high of 50 to 65 percent in Benin, Tanzania, and Nigeria.

⁴ Noted in conclusions of the Tenth Meeting of the Advisory Expert Group on National Accounts, Paris, 2016.

⁵ IMF, 2002, *Measuring the Non-Observed Economy: A Handbook*, by a team of the IMF, ILO, OECD, and CIS STAT

Labor relations—where they exist—are based mostly on casual employment, kinship or personal and social relations...”.⁶

7. The informal economy therefore comprises economic activities that are undertaken by individuals and households as a source of income and are not formally registered as a separate business enterprise. These informal activities provide goods and services that may be perfectly legal as the goal may not necessarily be to evade taxes and social security contributions, or to bypass government regulations. However, in the process, these activities may in fact bypass regulations and avoid taxes. Informal activities are therefore characteristically small-scale in nature with few or no employees.

8. The informal sector is considered a subset of the household sector and the assets associated with informal activities are not differentiated from household assets.⁷ Therefore, the activities associated with the informal sector relate mainly to transactions in goods and services (trade; travel; transport), and current transfers. It should be noted that informal activity is not a perfect subset of the NOE and some informal activities may be covered as part of the regular statistical inquiries.

B. Underground Activities

9. The *2008 SNA* identifies underground activities as activities that are legal and productive in an economic sense but are concealed from the authorities for the following reasons: (i) to avoid the payment of taxes and social security contributions; (ii) to avoid having to meet certain legal standards such as minimum wage, maximum hours, safety or health standards; or (iii) to avoid complying with certain administrative procedures. Underground activities may therefore include undeclared transactions (relating to production or income), overstated expenses for tax purposes, and non-reporting of employees or compensation paid.

C. Illegal Activities

10. The *BPM6* explicitly states that illegal actions are treated the same way as legal actions when the institutional units involved enter the actions by mutual agreement. It notes that differences in the definition of illegal transactions between economies or within an economy over time would cause inconsistencies in the international accounts if illegal transactions were omitted. Furthermore, illegal transactions generally affect other legal transactions (e.g., certain legal external financial claims may be created through illegal exports of goods).

III. CHALLENGES IN COMPILING CROSS-BORDER STATISTICS ON INFORMAL ACTIVITY

11. Methods of estimating informal activities in cross-border statistics vary across countries. While broad in coverage, the methods are not always based on consistent statistical

⁶ The definition was adopted in 1993 by the Fifteenth International Conference of Labor Statisticians (15th ICLS).

⁷ “Sector” in this case, does not denote an institutional sector, as defined in the System of National Accounts, 2008.

methodologies. The ILO has released a technical manual to assist in compiling statistics on the informal sector and informal employment; however, international guidelines on informal activity and cross-border transactions are not available.⁸ Although not exhaustive, this section addresses some of the challenges related to the compilation of informal cross-border statistics.

A. Boundary Problems and Overlaps

12. There may be considerable overlap among the activities of the NOE, and between informal activities and formal activities. For instance, informal activities may also be underground because households may attempt to evade government regulations. However, whereas informal activities are exclusively undertaken by households (or household enterprises), a significant proportion of underground activities may be undertaken by business enterprises. Since they may be attempting to hide these activities from the authorities, businesses enterprises may deliberately exclude these activities from the regular data collection exercises.

13. Further, as the *2008 SNA* notes, the informal sector is not a complete subset of the NOE and there is a large overlap between the two concerns. Some activities may be informal but may be observed and captured as part of the regular data collection exercise. This is so in the case of travel, which compilers typically measure using visitor expenditure surveys. These surveys are designed to capture both the activities undertaken with enterprises—major hotel chains, airlines, credit card companies—as well as activities undertaken with other households, such as room rentals. Another example is Airbnb, which may be considered informal activity from the perspective of the renters (households). However, information on rentals may also be collected from the business records of Airbnb, which would make it an observed activity.

14. Likewise, illegal activities may be both formal and informal. One example is transactions in counterfeit products. These products may be imported or exported by registered merchants who report them to the authorities as genuine and then be sold at street corners at discount prices by small retailers.

15. Whereas informal activities are associated with households, they can affect all accounts of the balance of payments and contribute to large errors and omissions—for example, households' hoarding of banknotes acquired through informal cross-border trade. However, the scope of the informal sector varies across countries and there is no official definition of cross-border informal statistics at the international level. The lack of general guidelines on informal activity associated with cross border transactions therefore drives each country to define informal activity according to its means and convenience. Moreover, the coverage of the sector may change from year to year because some informal activities become formal, and some unobserved activities can shift to observed activities. Thus, there is a constant need for adjustment.

⁸ International Labour Office, *Measuring Informality: A Statistical Manual on the Informal Sector and Informal Employment* (Geneva, 2013)

B. Measurement Framework

16. Currently, there are two broad measures that are used to derive estimates for informal activity: (i) direct approaches based on surveys, and (ii) indirect approaches based on statistics from related sources and macro-economic estimation techniques. Both methods face a common issue of identifying the "economic unit" to be defined as "informal". Therefore, there are two primary issues that need to be addressed: (a) hidden external transactions within the formal economy; and (b) activities in the informal economy that are difficult to cover or measure (e.g., the case of a small trader, who may not have a deep knowledge of the administrative rules, or who has problems, either managing or financial, to comply with them).

17. Considering the above, accurate measures of informal external transactions depend on the coverage parameters, the identification of the economic unit, and the sources of data collection. Direct approaches based on surveys may have difficulty in covering activities that may also be hidden or illegal. Thus, it is very difficult to use the same parameters to measure and compare the informal cross-border data in different countries. The techniques associated with the indirect approaches, have been criticized as being too hypothetical as they depend heavily on the assumptions made and on the coverage and quality of the statistics used.

C. Source Data Collection

18. Data collection programs for cross-border statistics do not routinely cover households. Further, enterprise surveys may apply a specific employment or income exclusion threshold (i.e., enterprises above a given employment or income level) that may exclude the small units that undertake informal activities. The main areas examined in data collection, namely, the selection of measurement variables and sources for data collection, might be difficult to be defined with respect to the informal sector.

19. Covering the informal sector is costly. Because of the nature of the activity, face-to-face interviews of respondents may be required, although prospects for technology-based solutions are improving. Moreover, the activity types in the informal sector are very diverse and are often of small scale, which is likely to render it costlier to cover. Alternatively, the information may be collected using a special module of household budget surveys; however, these surveys are undertaken infrequently in developing countries and may not provide the level of transactions detail for cross-border statistics.

IV. WAY FORWARD

20. Developing a strategy to address the coverage and consistency of statistics on informal cross-border activities is of vital importance to improving the accuracy of balance of payments and international investment position statistics (the international accounts). However, the basis for outlining a strategy requires taking stock of existing country level experiences, cross country comparisons, and shared experiences for reforming and improving national compilation techniques. In this regard, it may be useful to establish a task force to assess the feasibility of developing compilation guidance on covering informal sector activities.

21. Compilers of cross-border statistics should also work closely with national accounts compilers as they may have broader experience on compiling statistics on household transactions and the informal sector. This could also help fill the gap between the corresponding accounts.

Questions for the Committee:

1. *Do Committee members have views on the compilation of informal cross-border statistics?*
2. *Do Committee members agree to create a task force to develop guidance on compilation and data collection methods for informal cross-border statistics?*
3. *If the case, do Committee members have comments on the proposed terms of reference? Expressions of interest (even if just tentative at this stage) to participate in the Task Force would also be welcome.*

**THE TASK FORCE ON COVERING INFORMAL ECONOMY
IN CROSS-BORDER STATISTICS**

PROPOSED TERMS OF REFERENCE

A. Background

The discussion during the recent IMF Balance of Payments Statistics Committee (the Committee) meeting of October 2017 focused on the need to address the issues associated with covering informal economy in cross-border statistics. The informal economy covers a broad typology comprising informal, underground, and illegal activities. These activities are generally outside the scope of the regular data collection programs because they are, for example, undertaken by, but not only, households or small-scale nonfinancial corporations and with a relatively low level of organization. They may not be registered and are therefore difficult to measure. Further, the boundaries of informal economy are not always clear as the informal activities may overlap with other activities that units may attempt to conceal because they are illegal or incentives exist to evade government regulations. Therefore, covering informal economy in cross border statistics poses numerous challenges, including the lack of a consistent measurement framework across countries and the cost of data collection.

B. Objectives

The Task Force will have the primary objective of taking stock of country practices with a view to identifying data collection methods and compilation techniques that are feasible for addressing the coverage and consistency of informal economy in cross border statistics. This assessment would underpin the design of appropriate strategies to enhance the coverage of informal economy in cross-border statistics.

In line with the IMF's commitment to foster data accuracy and availability particularly in low income countries, the Task Force's deliberations and outputs would inform the broader work on the informal economy being undertaken by the IMF's Statistics Department (STA). In undertaking its work, the Task Force will build upon the work done by the *International Labor Organization* and the *Expert Group on Informal Sector Statistics (Delhi Group)*⁹ on measuring the informal sector and informal employment. The Task Force will also

⁹ The Expert Group on Informal Sector Statistics, commonly known as the Delhi Group was established by the UN Statistical Commission in 1997 to exchange views on the measurement of the informal sector, document the data-collection practices, including definitions and survey methodologies followed by member countries, and recommend measures for improving the quality and comparability of informal sector statistics.

collaborate with the *Advisory Expert Group on National Accounts* and the *Inter-Secretariat Working Group on National Accounts*.

C. Rules of Procedure

The Task Force will meet and discuss by electronic means (i.e., mostly via email and occasionally, via teleconferences).

D. Governance and Participation

The IMF will chair the Task Force and provide secretarial support. It will comprise Committee Members representing economies and international organizations with an interest and relevant experience in compiling cross-border statistics on informal economy. Representatives from non-Committee member economies, where informal economy may represent a significant proportion of cross-border economic activity, will also be invited to participate in the Task Force.

E. Timeframe and Deliverables

The work will take place during November 2017–August 2019. The following deliverables and timetable are currently envisaged:

1. Preparation of a work plan including timetable, actions and expected deliverables by end-January 2018.
2. Preliminary report submitted at the next Committee meeting (draft report to be sent to the IMF by mid-September 2018).
3. Final report to be presented at the October 2019 Committee meeting (draft report to be prepared by mid-September 2019).