

**11th Meeting of the Advisory Expert Group on National Accounts,
5-7 December 2017, New York, USA**

Agenda item: 7.2

Informal Activity

Introduction

An exhaustive measurement of the size of the informal sector and the contribution of informal sector activities and informal employment to GDP is particularly challenging. Data collected for understanding the informal sector are often not sufficient for measuring economic activity. The SUT framework, with a possible distinction between formal and informal activities, provides the greatest potential in which available source data are combined and balanced to arrive at exhaustive estimates of economic activity.

Documentation

A paper on **Informal Activity**

Main issues to be discussed

The AEG is requested to take note of the ongoing work and provide feedback on:

- New guidance on the use of new data sources, such as big data, to estimate some components of the non-observed economy.

INFORMAL ACTIVITY¹

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1. INTRODUCTION

1. A leading cause of imperfections in national accounts 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 by households—and not business units—that are not required to adhere to the regulations that may be applied to businesses.

2. The size of the informal sector²—especially in developing countries—is of interest to policymakers because a large or growing sector is associated with increasing poverty. Further, the sector may not respond the same way to the macroeconomic stimuli designed for the formal economy. 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

3. 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, including the degree of overlap between informal activities and other NOEs. Section IV examines current work that the IMF is undertaking to cover informal activities.

¹ This is an amended version of a paper presented at the Thirtieth Meeting of the IMF Committee on Balance of Payments Statistics, October 2017.

² Also referred to as the informal economy in the literature. “Sector” in this case, does not denote an institutional sector, as defined in the *System of National Accounts, 2008*.

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.

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2. NON-OBSERVED ACTIVITIES

4. The *Handbook on Measuring the Non-Observed Economy*⁵ 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. Informal activities therefore represent one group of NOE activities.

Informal Activities

5. The *System of National Accounts, 2008 (2008 SNA)* and the Handbook on the Non-Observed Economy 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. Labor relations—where they exist—are based mostly on casual employment, kinship or personal and social relations..."⁶

6. The informal sector therefore reflects economic activities that are undertaken by individuals and households as a source of income and are not formally registered as a separate business enterprise. 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.

7. The informal sector is considered a subset of the household sector and the assets associated with informal activities are usually not differentiated from household consumer durables. 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.

Underground Activities

8. 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: 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.

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

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

Illegal Activities

9. The *2008 SNA* 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.

3. CHALLENGES IN COMPILING STATISTICS ON INFORMAL ACTIVITY

10. Methods of estimating informal activities vary across countries. While broad in coverage, the methods are not always based on consistent statistical methodologies. The ILO has released a technical manual to assist in compiling statistics on the informal sector and informal employment.⁷ Although not exhaustive, this section addresses some of the challenges related to the compilation of statistics on informal activities.

Boundary Problems and Overlaps

11. 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.

12. 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.

13. 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.

⁷ International Labour Office, *Measuring Informality: A Statistical Manual on the Informal Sector and Informal Employment* (Geneva, 2013)

Measurement Framework

14. 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 sector 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).

15. 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. The techniques associated with macro-economic estimation techniques 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.

4. INFORMAL ACTIVITY AND IMF SURVEILLANCE

16. Understanding and measuring components of the non-observed economy (NOE), particularly informal activities, have been of interest to the Fund in part because the size of the informal sector in member countries has implications for the accuracy and reliability of the statistics used in Fund surveillance. Measurement of the informal sector is important for policy analysis and is critical in compiling exhaustive estimates of GDP and other macroeconomic statistics. For these reasons, the Fund, through capacity development and surveillance efforts, continues to work with member countries to improve the measurement of the NOE and to implement various reforms aimed at reducing informal activity. One example of this is the recent implementation of the Taxpayer Registration Expansion Program (TERP) in Uganda that focuses on increasing tax compliance in the informal sector.⁸

17. In general, non-observed activities are a significant part of low and middle income economies. Both the size and nature of the NOE vary across countries. For example, the unweighted average share of the informal economy for the period 2010 to 2014 was 40 percent of GDP in Latin America and the Caribbean, 38 percent of GDP in Sub-Saharan Africa, 34 percent of GDP in South Asia, 23 percent of GDP in Europe and 17 percent in OECD member countries.^{9,10} This suggests that countries with higher income tend to have lower levels of informal activity which may reflect stronger government and institutional capacity to enforce regulations and greater motivations for

⁸ *IMF Staff Report, 2017: No EBS/17/68*

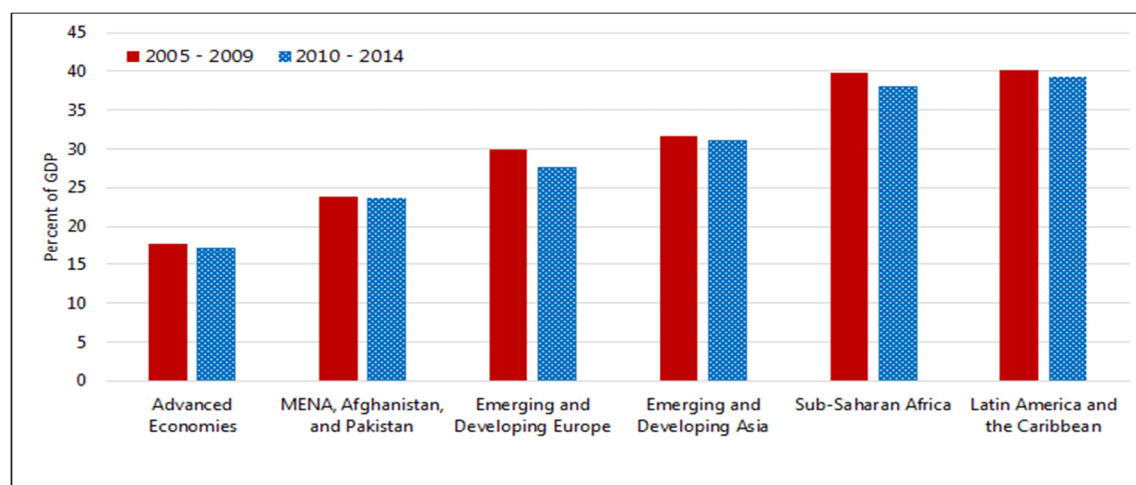
⁹ *IMF, October 2017, Regional Economic Outlook: Sub-Saharan Africa*

¹⁰ See Medina, L., A. Jonelis, and M. Cangul, 2017, "The Informal Economy in Sub-Saharan Africa: Size and Determinants," *IMF Working Paper 17/156*, IMF, 2017.

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households to formalize business activities. Although the share informal economy remains high across these regions, there has been a small global decline over time. Figure 1 below shows slight decline in the size of informal economy for the period 2005 -2009 and 2010 – 2014. One example is the decline in the share of informal employment in Mexico from 59 to 57 percent during 2012 – 2016.¹¹

Figure 1: Estimates of the Informal Economy: Selected Regions (simple average)



18. The existence of large proportion of informal activity has implications for Fund surveillance because high levels of informal activity is generally associated with tax evasion, the economic tax base and social welfare effects (minimum wages, maximum hours etc.). Furthermore, the informal sector represents an important part of the economy and the labor market in many countries. For instance, in Tunisia, informal activity accounts for approximately 39 percent of GDP and 51 percent total employment. Those who are unemployed or underemployed in the informal sector have limited opportunities to improve their economic livelihoods.¹²

5. FURTHER DEVELOPMENTS

19. As part of the ongoing work, the IMF is currently conducting a survey non-observed activity over 100 economies, through the Fund’s Regional Technical Assistance Centers. The survey, which will be completed in Mid-December 2017, will provide information on the measurement, size, prevalence, and gender differences in employment in the informal sectors of these economies. The sample questionnaire is presented below.

¹¹ IMF Staff Report, 2017: No. SM/17/278

¹² IMF Staff Report, 2017: Tunisia

IMF Survey of the Nonobserved Economy

Please answer the questions below by selecting appropriate responses from the dropdown lists where provided. Multiple options may be selected from a dropdown. However, if you wish to change your response, please clear the contents of the cell and select the desired options. Please ensure that you "Enable Macros" to be able to select multiple options from the dropdowns.

<i>Please select the economy for which you are providing information :</i>	<i>Please select</i>
1 In what year was any element of the nonobserved economy last measured in your country?	2017
2 Which elements of the nonobserved economy were measured?	Please select
3 Which type(s) of nonobserved activity is included your country's national accounts?	Please select
4 In which industries are nonobserved activities most prevalent?	Please select
5 What are the sources and indicators used to compile estimates of the nonobserved economy?	Please select
6 Which methods are used to compile the informal sector?	Please select
7 Does the country use different indicators to extrapolate the nonobserved economy? If yes, please provide the indicators used.	No
8 What are the sources of financing for the work on the nonobserved economy? If donor-financed, please indicate the donor.	Own Funding
9 What is the size of the nonobserved economy as a percentage of GDP?	
10 What is the size of employment in the nonobserved economy as a percentage of total employment?	
10 (a) By gender as a percentage of the employment of the nonobserved economy	
Female	
Male	
11 Are any of the data compiled on the nonobserved economy disseminated ? If yes, please explain.	Yes
12 Are any of the estimates of nonobserved economy compiled for national accounts purposes integrated into the balance of payments? If yes, please explain.	Yes