



## The Error And Omissions Issue: A Comparison Between Turkey And India

### KEYWORDS

Errors and Omissions, Balance of Payments, Transparency, Illicit Financial Flows

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**ABSTRACT** *The statistical discrepancy or balancing item of the Balance of Payments Statistics, which is called "Errors or Omissions, Net (E&O)", reflect transactions that are known to have occurred in the country, however could not be detected and measured. So, it has great potential to underline the problems of an economy, such as the lack of transparency and illicit financial flows. Regardless of their reasons, it can be said that there is a reverse relationship between the increases in the E&O and transparency of the country, hence instability. In this regard, in this paper it was found out that for both countries, Turkey and India, there seems a problem in the transparency, hence in the reliability of the BOP statistics, proven by the upward trend of E&O over time. Moreover, it was proven that the crisis periods have potential to trigger unrecorded outflows.*

### INTRODUCTION

The balance of payments (BOP), which constitutes one of the most significant statistical statements for countries, is defined as "a statistical record of all the economic transactions between residents of the reporting country and residents of the rest of the world during a given time period" (Pilbeam, 2006). So, all the international economic transactions including goods and services trade, unilateral transfers and financial flows between the open economies are recorded in these statements. According to this, the BOP generally has three main accounts as follows: Current Account (CA), Capital and Financial Account (KA), which are generally classified as autonomous transactions, and the Official International Reserves Account ( $\Delta RFX$ ), which is generally classified as the accommodating transactions. Moreover, there is also one more item in the BOP, called "Statistical Error" or "Errors or Omissions, Net (E&O)", which constitutes the main subject of this paper. Although it is a statistical discrepancy or balancing item that should be incorporated in the BOP to restore the balance between the credit and debit items, it can worth actually more than this. It has great potential to underline the problems of an economy, such as the lack of transparency and illicit financial flows. It can stem from several reasons. However, regardless of their reasons the continuing increases in the E&O of the BOP over time have potential to indicate the lack of or diminishing transparency of the country.

It is put as "Errors and omissions reflect transactions that are known to have occurred but for which no specific measure was made" (Colorado University). In this regard, in this paper the E&O of the BOP of Turkey and India are tackled in order to analyze the E&O issue and compare the two countries in terms of their transparency for the periods of 2005-2013 and 1990-2013. In order to make these analyses, the average absolute values of the related variables of BOP, such as E&O, CA, KA,  $\Delta RFX$ , and also GDP are calculated and the percentages ratios of E&O over such variables are determined for both countries for the period of 2005-2013. And also an additional analysis of E&O of both countries is conducted in order to catch the time dimension of E&O for the period of 1990-2013. After the introduction, the paper tackles a brief theory part regarding the E&O item of the BOP and then it analyses the

E&O of Turkey and India through the related calculations and tries to detect their possible reasons.

### THE POSSIBLE REASONS OF THE E&Os of the BOP

The net balance of the autonomous transactions, which are defined as those "undertaken for their own sake" and the reverse signed of the net balance of the accommodating transactions, which are defined as those "that take place because other (autonomous) transactions are such as to leave a gap to be filled? (Chacholiades, 1990), should be equal. Namely,

$$\text{Sum of Autonomous Transactions} + \text{Sum of Accommodating Transactions} = 0$$

However, in practice, due to several reasons this equality or balance cannot be sustained. So, E&O is incorporated as a balancing item as follows:

$$CA + KA + E\&O + \Delta RFX = BOP = 0$$

**The possible reasons of the E&O of the BOP can be classified as follows:**

**(a) Some errors are unavoidable:** Many of the reported statistics are based on sampling estimates derived from separate sources, such as tourism.

**(b) Desire to avoid taxes:** Some of the transactions in the capital account are underreported and some dishonest firms may deliberately under-invoice their exports and over-invoice their imports in order to artificiate their profits.

**(c) Leads and Lags:** Receipts and payments of a transaction can be recorded in the BOP but it cannot be happen at the same time period (Pilbeam, 2006).

**(d) Illicit financial flows:** According to Global Financial Integrity (GFI), which defines the illicit money as money that is illegally earned, transferred, or utilized, such illicit financial flows can be classified as follows:

**Corrupt:** Proceeds of bribery and theft by government officials.

**Criminal:** Proceeds of drug trading, human trafficking, counterfeiting, contraband, and myriad forms of additional activities.

**Commercial:** Proceeds arising from import and export transactions conducted so as to manipulate customs duties, VAT taxes, income taxes, excise taxes, or other sources of government revenues.

Although having accepted that not all of the unrecorded transactions are illicit GFI maintains that the vast majority of unrecorded transactions are illicit due to, apart from entry errors, there is not often a reason why legitimate transactions should go unseen. GFI puts the issue that "the greater part of money moving across borders in an unrecorded, undetected manner has an illicit component, intentionally violating the letter or the intention of laws and regulations of countries out of which the money comes, through which the money passes, or into which the money arrives" (GFI). Seyidoglu (2013) maintains that the econometric works on several countries show that compared to current accounts capital accounts involve much greater errors.

**TABLE – 1**  
**AVERAGE ANNUAL ILLICIT FINANCIAL FLOWS, 2003-2012, BRICS COUNTRIES and TURKEY**

| Rank | Country               | Average Annual Illicit Financial Flows, 2003-2012 (in millions of U.S. dollars, nominal) |
|------|-----------------------|--|
| 1    | China, P.R.: Mainland | 125,241.90   |
| 2    | Russian Federation    | 97,385.75  |
| 3    | India                 | 43,958.67  |
| 4    | Brazil                | 21,710.31  |
| 5    | South Africa          | 12,214.49  |
| 6    | Turkey                | 3,560.07   |

**Source: Global Financial Integrity Statistics**

Notes: GFI uses E&O items of the BOP of the countries in calculating the illicit financial flows.

**ANALYSING THE E&Os of the BOP of TURKEY AND INDIA**

Although there is not a "critical value or ratio" of E&O accepted in the literature (Some says it should not be over 5% of foreign trade, Ciplak, 2005) it should be paid attention to its ongoing increases in terms of absolute terms or its increasing rates as percentages of some fundamentals in an economy. In this regard, the following Table 2 compares Turkey and India in terms of their E&Os as percentages of some fundamentals such as Foreign Trade (FT), CA, and Financial Account (FA). Due to for comparison of two countries it is better not to compare the values of E&O directly, the ratios of them over some fundamentals are used. Since the aim here is the evaluation of E&O in terms of their sizes the absolute values are used ignoring signs.

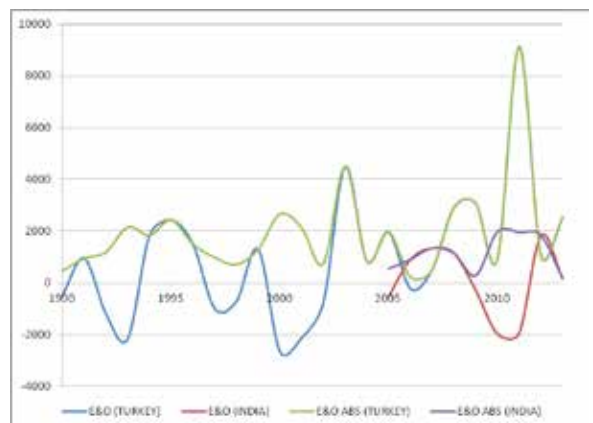
**TABLE – 2**  
**E&O (AS PERCENTAGES)**  
**2005-2013 AVERAGE ABSOLUTE VALUES**

|        | E&O/FT | E&O/CA | E&O/FA | E&O/GDP | E&O/ΔR |
|--------|--------|--------|--------|---------|--------|
| Turkey | 1%     | 6%     | 6%     | 0%      | 23%    |
| India  | 0%     | 3%     | 3%     | 0%      | 5%     |

**Source: World Bank, World Development Indicators**

Notes: The percentages ratios are calculated by using the absolute values of the variables. (FT: Foreign Trade, CA: Current Account, FA: Financial Account as which shows net acquisition and disposal of financial assets and liabilities. GDP: Gross Domestic Product, ΔR: the net change in a country's holdings of international reserves resulting from transactions on the current, capital, and financial accounts.) Due to the lack of data of India the time period starts with 2005.

According to Table 2 for both countries the ratios give some information about the possible reasons of the E&O. First of all when compared E&O/FT with the other ratios such as E&O/CA and E&O/FA for both countries it can be said that the possible reasons of E&O do not seem to stem from the fraud activities related to FT. Rather, they seem related to the other items of the CA such as tourism and unilateral transfers, which are likely to have errors or omissions in recording. Moreover, they seem more related to the items of FA such as unrecorded hot money. In this regard, when the information in Table 1 pointing to the ranking of India and Turkey in illicit financial flows among BRICS countries for the same period is considered, it seems such E&O has potential to be related any illicit activities, such as criminal or corrupt activities. Although for both countries the percentages ratios of E&O over GDP remain at 0%, at average, for the period of 2005-2013, they are big enough to be considered in terms of BOP items such as CA, FA and ΔR. In this regard, for both countries there is a problem in the transparency, hence in the reliability of the BOP statistics, which in turn has potential to make country instable and vulnerable. Moreover, when compared two countries it seems that India has better percentages ratios compared to Turkey in terms of all ratios.



**Figure 1: Errors and Omissions of Turkey and India (annual, million dollars, 1990-2013)**

**Sources: World Bank, World Development Indicators and the Statistics of the Central Bank of the Republic of Turkey (CBRT).**

Notes: ABS: Absolute values of the variables.

As seen in Figure 1, the item of E&O in absolute terms, which indicate the size of the transactions, whether inflows or outflows, that are known to have occurred but could not be measured, have an upward trend over the period of 1990-2013 for Turkey and relatively, lower but still an upward trend over the period of 2005-2013 for India. When the item of E&O is considered with its sign, then it seems that Turkey had unrecorded outflows during or at the wake of her crises such as 1993, 2000-2001 and global crises such as 1997 Asian Crisis and 1999 Russian Crisis as expected due to the crisis periods have potential to trigger unrecorded outflows. On the other hand, after 2002 it is clearly seen that there are continuously unrecorded inflows, possibly having stemmed from the war conditions in the neighbour countries and the unrecorded hot money, which is widely speculated in the Turkish press that it has entered into the country from the Gulf Region countries. In terms of India, unrecorded outflows match with the Global Financial Crisis, 2009-2011 as well as the unrecorded inflows seem to occur in the global bubble era at the wake of such Global Financial Crisis.

### CONCLUSIONS

It can be said that the items of the E&O of the BOP statistics of the countries can stem from several reasons, including internal and external factors. However, regardless of their reasons, it can be said that there is a reverse relationship between the increases in the E&O and transparency of the country, hence instability. In this regard, in this paper it was found out that for both countries, Turkey and India, there seems a problem in the transparency, hence in the reliability of the BOP statistics, which in turn has potential to make country instable and vulnerable, proven by the upward trend of E&O over time. Moreover, it was proven that the crisis periods have potential to trigger unrecorded outflows.

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