



STATISTICS DIRECTORATE

National Accounts and Economic Statistics - International Trade Statistics

THE TREATMENT OF MERCHANTING IN BALANCE OF PAYMENTS STATISTICS

**OECD INTERNATIONAL TRADE STATISTICS MEETING (ITS) AND OECD-EUROSTAT
MEETING OF EXPERTS IN TRADE-IN-SERVICES STATISTICS (TIS)**

**Château de la Muette, Paris
26-29 April 2004
Room 6**

This document has been prepared by Eika Yamaguchi - Bank of Japan under Item 13 v) of the Draft Agenda: Discussions and presentations of issues related to both trade in goods and trade in services.

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THE TREATMENT OF MERCHANTING IN BALANCE OF PAYMENTS STATISTICS

A Introduction

- The IMF Balance of Payments Manual Fifth Edition (BPM5) views cross-border merchanting¹ trade as the provision of merchant services involving the resale of goods by resident commodity brokers and others in countries other than the country of their residence. Hence, although ownership of the pertinent goods is temporarily transferred to the resident merchant providing the merchanting service, the transaction is not recorded in the balance of payments of the country of residence of the merchant in gross basis as an import and re-export of goods. Rather, the IMF recommends that the difference between the value of goods when acquired and the value when sold be recorded under “Other Services”, a sub-component of “Services.” (BPM5 Paragraphs 207, 262)²

Note: Merchanting services that straddle different accounting periods due to time lags in acquisition and resale of the goods are treated as follows under BPM5: “...an import of goods is recorded in the first period, and a negative import entry is recorded in the later period” (Paragraph 262). Thus, it is recommended that the pertinent goods be treated as merchandise for a certain period of time. However, because of the difficulty of following this recommendation, not all countries have adopted this approach. (Those countries that have not adopted the approach include Japan and such major European countries as France, Germany and Italy. As for the United States, merchanting is not treated as a component of its balance of payments.)

- The above recommendations in BPM5 (Paragraph 207, 262) contain several significant problems. Therefore, it should be reviewed, with serious consideration given to the treatment of merchanting, not as a service but as a component in the trade of goods. In this case, the balance of payments statistics should account imports (acquisitions) and exports (resale) on a gross basis, rather than only recording the difference between acquisition and resale values. Moreover, among goods subject to merchanting, non-monetary gold should be accorded different treatment for the reasons outlined later.
- In examining the treatment of merchanting in balance of payments statistics, the purposes of this paper are the followings. (1) To compare the relative advantages and disadvantages of a method in which the margin on transactions is recorded as a service and a method in which transactions are recorded on gross basis as trades in goods, and to show the superiority of the latter method (excluding non-monetary gold). (2) To identify certain points that should be considered in discussing the treatment of merchanting of non-monetary gold.

1 BPM5 defines merchanting as follows. “Merchanting is defined as the purchase of a good by a resident (of the compiling economy) from a nonresident and the subsequent resale of the good to another nonresident; during the process, the good does not enter or leave the compiling economy” (Paragraph 262).

2 Note that merchanting was treated under BPM4 as a sub-component of “Other goods and services” and was accounted on net basis. Thus, the treatment was essentially the same as under BPM5.

B Net vs. Gross, or Services vs. Goods

- The relative advantages and disadvantages of the treatment of merchanting in balance of payments statistics as (1) a service (margin) recorded on net basis (as per recommendation of BPM5), and as (2) a trade in goods recorded on gross basis are summarized in the following table. Going directly to the conclusion, in light of the following advantages and disadvantages, it would be appropriate to discuss the treatment of merchanting as goods and the shift to gross basis accounting.

Table:

	Services (Margin) (net basis)	Goods (gross basis)
Advantages	—	(5) Exception to the change of ownership principle can be avoided. (6) Other disadvantages noted to the left can be avoided.
Disadvantages	(1) Requires exception to the change of ownership principle. (2) Results in discrepancies in global totals. (3) Difficulty in regional breakdowns of merchanting services will generate discrepancies in bilateral statistics. (4) Losses incurred at resale will generate negative service output, which may conflict with the concept of service as output.	(7) Freight and insurance charges and services generated by merchanting may become mixed in with goods. (8) Because of the large volume of merchanting on gross basis, revising the treatment may affect the perception of merchandise trade statistics.

- Explanations of the relative advantages and disadvantages follow.
 - (1) Requires exception to the change of ownership principles to record goods
 - The principles concerning change of ownership constitute one of the fundamental principles of BPM5 regarding treatment of goods. BPM5 states: “Goods not crossing frontiers should be included in exports and imports if changes of ownership occur.” (BPM5 Paragraph 208)
 - Regarding merchanting, BPM5 accepts an exceptional treatment as follows: “This Manual recommends that the country of the temporary owner exclude such goods from the *goods* item....” (BPM5 Paragraph 207) However, the demarcation between “temporary” transactions and other transactions is not clear.

- If the line of demarcation is unclear, given that it is clear that ownership of the pertinent goods has been transferred to a resident, the rationale for changing the treatment to that of the normal import and re-export of goods is somewhat weak.
- (2) Results in discrepancies in global totals
- Take a case in which a resident of country A acquires goods from a nonresident and subsequently resells this to another nonresident. If the goods never leave the country, which is not country A, services will be recorded only on the credit side of country A. As a result, statistics will be asymmetrical and result in discrepancies in global totals.
 - Next, take another case in which in the course of a similar transaction to the above case, the goods move across frontiers from country B to country C. In this case, services will be recorded on the credit side of country A, exports will be recorded on the credit side of country B, and imports will be recorded on the debit side of country C. In this case, there would be no discrepancy from the viewpoint of global totals.
- (3) Difficulty in regional breakdowns of merchanting services will generate discrepancies in bilateral statistics
- Take a case in which a resident of country A acquires goods from a resident of country B and subsequently resells this to a resident of country C. In this case, it is difficult to determine at what ratio the services provided by the resident of country A should be assigned to countries B and C.
 - Pertinent transactions are treated as follows by Japan. (a) If the goods are physically transferred from the country of acquisition to a third country, the transaction is registered to the country of resale. (b) If the goods remain in the country of acquisition, the transaction is recorded as a payment to the country of acquisition and a receipt from the country of resale. Consequently, when the residence of initial seller and final purchaser differ in case (b), this results in a negative receipt under merchanting services in regional breakdown statistics. For example, residents of Japan frequently buy petroleum from the Middle East and subsequently resell this to another nonresidents. Such transactions are the primary reason why Japan's "Other Business Services" vis-à-vis the Middle East shows very large negative receipts (minus 121 billion yen in 2002). Not only is this confusing for users of the data, but it contradicts the concept of service as output.
- (4) Losses incurred at resale will generate negative service output, which may conflict with the concept of service as output
- In merchanting transactions, it is not unusual for losses to be incurred at resale. Therefore, the problem of negative output cannot be eliminated.
- (7) Freight and insurance charges and services generated by merchanting may become mixed in with goods.
- Services involving merchanting transactions will become mixed in with goods.

- Given that it is difficult to strictly eliminate freight and insurance charges from CIF values, freight and insurance charges may become mixed in with goods if a shift is made to accounting on gross basis³ (see Figures III and IV in attached Figures).
 - However, it is recognized that, in reality, it is unavoidable for some goods to become mixed in with the service component (BPM5 Paragraphs 223, 228, etc.). Similarly, part of service flows among nonresidents may become included in goods (BPM5 Paragraph 227). On the other hand, net accounting also creates problems of over-estimation of merchanting services (see Figure II in attached Figures). Therefore it appears that the above problems related to gross basis accounting are relatively minor ones.
- (8) Because of the large volume of merchanting on gross basis, revising the treatment may affect the perception of statistics on trade in goods
- How would a shift to gross accounting affect the balance of payments? In the case of Japan, based on the 2003 preliminary figures, such a shift would increase merchandise exports and imports by 32.5% and 40.6%, respectively (including non-monetary gold).
 - However, this problem can be significantly ameliorated through the following measures: (1) separate merchanting from other transactions in goods by creating a sub-component for goods in merchanting; (2) create a time series covering a sufficiently long retroactive period.

C Treatment of Non-monetary Gold

- Non-monetary gold should be treated differently from other goods in merchanting, primarily for the following two reasons.
 1. Gold is special goods in that it has characteristics of both goods and financial assets.
 2. As in the case of financial assets, in reality, dealing transactions in gold are widely undertaken without any physical exports and imports of gold through use of the books of the London gold dealers.
- The volume of gold merchanting⁴ reported in Japan amounts to substantial sums.⁵ However, a large portion of these transactions consists of dealing transactions undertaken to get capital gains or to collateralize loans. The inclusion of these amounts in the accounting of goods on gross basis can obscure trends and developments in the entire merchandise trade and the merchanting, a sub-component of goods.
- Transactions in non-monetary gold not involving physical exports and imports can be treated in various ways as outlined below. Therefore, it is necessary to deepen the discussions of the treatment of non-monetary gold in order to record these transactions appropriately. These

³ Note that in case of net basis accounting, the mixing in of freight and insurance payments made to residents of countries other than the country of the residence of the merchant will be netted out and will not affect merchanting services (see Figure I in attached Figures).

⁴ BOP Compilation Guide indicates that, for non-monetary gold that does not cross frontiers, the difference between the value of goods when acquired and resold should be recorded under merchanting services (Paragraph 138).

⁵ During 2003, Japan's gross transactions of non-monetary gold not involving the crossing of frontiers amounted to 7341 billion yen in imports and 7373 billion yen in re-exports. These amounts were equivalent to 45.6% and 43.7% of gross merchanting transactions, respectively. Similarly, these amounts were equivalent to 18.5% and 14.2% of total merchandise exports and imports, respectively.

discussions should not be restricted to the perspective of merchanting but should consider the special characteristics of gold as a good.

[1] Accounting the margin on acquisition and resale price as a service.

Note: In case of dealer-led dealing, consideration must be given to determining who is providing a service to whom.

[2] Separating transactions in non-monetary gold into real-demand transactions (jewelry, industrial uses) and dealing transactions aimed at getting capital gain, and apply different accounting methods to the two categories.

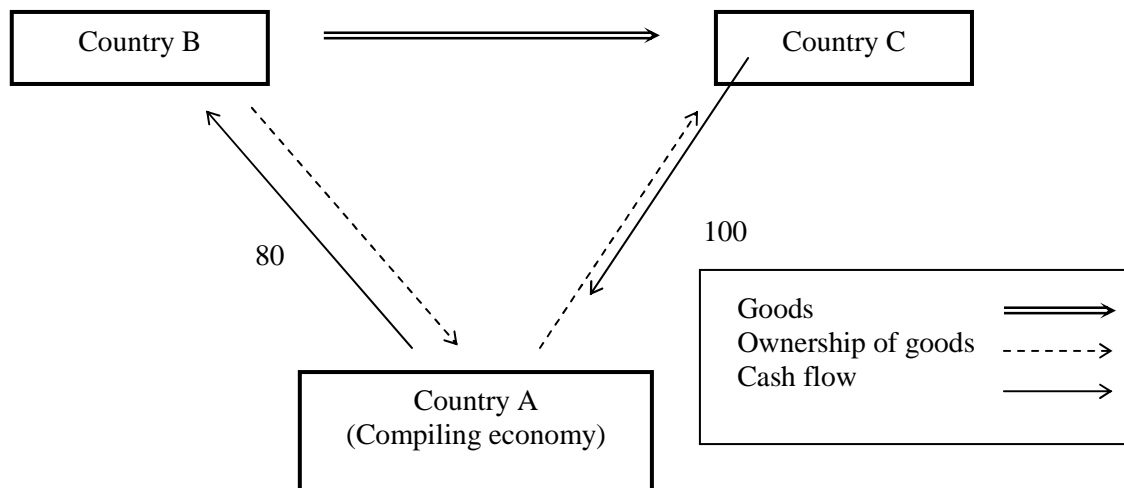
Notes: 1. For example, categorize the former as goods and account on gross basis, and treat the latter as margin and account on net basis. Alternatively, treat transactions in non-monetary gold as financial transaction and create “Financial Gold” as new component of “Financial Account” to be accounted on net basis.

2. In connection with “Financial Account,” it will be necessary to clarify the definition of “Financial Gold.”

(Attachment)

Case in Which Merchanting Includes Freight

Normally, merchanting⁶ is accounted as follows: Country B, export = 80; Country C, import = 100; Country A, merchanting service receipts = 20 (see diagram below).



Assume that freight =10 is added to the resale value = 100, and that Country C bears the freight cost (in principle, importer bears freight charges). In this case, the impact on net basis and gross basis accounting of merchanting can be divided into the following four possibilities depending on the residence of the transport company.

	Services (Margin) (net basis)	Goods (gross basis)
Transporter is a resident of Country B	I. $110 - 90 = 20$ No impact	III. Import 90, Export 110 Transport services between Countries B and C (among nonresidents) become mixed in with merchandise trade of Country A.
Transporter is a resident of Country A	II. $110 - 80 = 30$ Value of merchanting service is over-estimated.	IV. Export 110 Transport service exports become mixed in with merchandise exports of Country A.

⁶ According to the Manual on Statistics of International Trade in Services (Box 6), merchanting transactions include commodity arbitrage and wholesale trading. This attachment concerns only the latter involving physical movement.

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