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GOODS FOR PROCESSING – COMMENTS OF THE TASK FORCE ON INTERNATIONAL

MERCHANDISE TRADE STATISTICS

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GOODS FOR PROCESSING – COMMENTS OF THE TASK FORCE ON INTERNATIONAL MERCHANDISE TRADE STATISTICS

By Andreas MAURER

The Task Force on International Merchandise Trade Statistics met in Bangkok from 15 to 17 March 2005 and discussed the impact of revisions of the System of National Accounts (SNA) and the Balance of Payments Manual (BPM) with respect to international merchandise trade statistics, notably the treatment of goods for processing.

In 2004, the Task Force had forwarded a letter to IMF commenting on Chapter 9 (Goods and Services Account) of the BPM Annotated Outline. The Task Force reinforced the position taken in existing merchandise trade statistics concepts and definitions (International Merchandise Trade Statistics - IMTS, Rev.2), such as the inclusion of goods for processing on a gross basis.¹ However, the Task Force pointed out that "...showing separately information on goods through the application of the change of ownership principle would be useful additional information for analysts". It also stated that "...it would be useful to review all these categories comprehensively together (re-exports, goods in transit, processing, etc.) to help understanding the underlying rationale for their different statistical treatment and to facilitate greater harmonisation across different conceptual frameworks. "

Current treatment of goods for processing

BOP/SNA

In the 5th edition of the Balance of Payments Manual (BPM5) and the System of National Accounts 1993 (SNA93) processing is defined as any activity performed under contract and both distinguish "...goods sent abroad for processing that involves a substantial physical change...from other processing" [BPM5, para.120]: processed goods re-classified in a different 3-digit CPC group should be recorded as goods and those not falling in a different group, as services. However for practical purposes BPM5 recommends to record all processing as "goods".

In BOP and SNA the current exception to the change of ownership principle is for the recording of goods for processing where the goods are returned to the country of the owner once the processing has been performed: although there is no change of ownership processed goods sent by economy A to a processing country B are recorded as economy A's exports of goods (respectively B's imports) and goods sent back to A after processing are recorded as A's imports (B's exports) valued when re-imported at total estimated value including the value of processing. No processing fee is recorded in the services account.

It is the above exception to the change of ownership principle that SNA and balance of payments statisticians are currently envisaging to terminate. That is, the imports and exports of goods for processing

¹ The Task Force's letter also reinforced the position taken in IMTS, Rev.2 for the treatment of re-exports (separate reporting) and merchanting (exclusion from international merchandise trade statistics).

will no longer be included in the balance of payments and instead a fee for the processing service will be recorded.²

Merchandise trade statistics and IMTS Rev.2

The most prevalent source for measuring merchandise trade is customs declarations. Guidelines for customs procedures and declarations are provided by the WCO and the Kyoto Convention. Additional information can be drawn from GATT, the WTO Customs Valuation Agreement and WTO Rules of Origin.

The fundamental difference between IMTS and the BPM5/SNA93 concepts is that the former "recommends the use of crossing the border (...) as the basic principle for compilation of trade statistics..." (IMTS, Compilers Manual, Chapter 1, para.9) whereas the latter recommend the change of ownership as the basic principle. IMTS adds in para.10 that "... customs-based data collection systems run by most countries are unable to apply a change of ownership approach."

According to the Kyoto Convention, goods crossing the border for inward processing (into a free circulation area or industrial free zone) or temporary exportation for outward processing need to be included in merchandise trade statistics. This requires a separate registration of the imported goods under the respective customs regime and the registering of the country of origin in accordance with the country's rules of origin. Countries normally use either the value added (a specific percentage of the value of the product need to be added through processing in the country of origin, e.g. 40%) or the result of the processing as a principle to determine the country of origin. If the result of the processing requires a change in the tariff classification for the processed product, that is, if the product's physical properties are changing, the processing country will become the new origin.

As merchandise trade statistics are used as the main source for BOP and due to above considerations, the current treatment requires to separately identify goods sent (or received) for processing either by customs or through using other sources for estimating goods for processing (e.g., enterprise surveys).

Issues raised by proposed changes for the treatment of goods for processing

Proposed change

Both BPM and SNA aim at the change of ownership as dominant principle. The current proposal for both frameworks is to stop the exception and to consider the processing related trade (the exports of goods for processing and the subsequent re-import or vice-versa) as trade in processing services instead of trade in goods. (i.e. "manufacturing services provided under contract or fee basis", CPC Ver.1.1 Division 88 Manufacturing services on physical inputs owned by others)

Classifications

However a question could be raised: should it be the change of ownership principle, the "substantial change of a product" or the industrial origin that should be used as a predominant criterion for deciding to

² There will be no change envisaged for the treatment of goods which are sent abroad for processing and which are not re-imported by the sending country (either sold to a resident of the processing country or exported to a third country): the sending country records goods exports under the general merchandise item (value of the processed good including value of processing) and the payment for processing is entered as a debit under services (credit for country providing the service).

classify the transactions as a good (total estimated value of the processed good including processing fee) or a service (processing service).

Alternative treatments have various consequences for different statistical frameworks such as IMTS, SNA (production account, input/output tables, etc.) or BPM (which has also consequences for the Manual on Statistics of International Trade in Services). Each treatment has its own pros and cons and depending on where data consistency focuses on, statisticians prefer either of the alternatives. A number of arguments can be found on the respective websites of the BPM and SNA revision and will not be repeated here.

However, a related question could be posted on the negotiation and dispute settlement side, which is relevant whatever recommendation is chosen. Is a considered processing activity an activity falling into one of the ISIC groups of manufacturing or of services? Would the industrial origin be a determining criterion to consider a product stemming from the same assembly line once as a good, once as a service, depending on the change of ownership in raw materials? Sectors concerned are frequently textiles and apparel or also the car industry where large assembly lines are used to manufacture a final product from various components. It may often be benefits drawn from the fiscal or tax system only that forces the manufacturer to identify himself as owner of the raw materials or as a manufacturer on contract basis. In dispute settlements, depending on the classification of goods for processing, either GATT or GATS rules may apply which could lead to quite different results.

Data collection

A number of countries are not in a position to separate goods temporarily imported for processing from other imported goods, which is also true on the exports side. For those able to identify goods for processing, a difficulty may arise for identifying whether products after processing are returned to the country of the owner or are exported to a 3rd country or are cleared for use in the processing country: they may not be able to identify these circumstances in customs documents which could lead to reporting asymmetries

If the practice were to be changed in the new BPM and SNA, additional information would have to be collected, not only on the value of goods for processing but also on the value of the processing fee, which could be obtained either through separate sources such as enterprise surveys or eventually international transactions reporting systems. Depending on the accounting practices, this may lead to an additional response burden for enterprises (and additional burden for national statistical compilers). On the other hand, this information could be very useful for validating customs flow data of processed goods.

Countries face severe resource problems and their enterprise accounting rules may not easily lend themselves to the surveying of the information on processing. A possible solution could therefore be for merchandise trade statistics to continue the current practice of reporting goods for processing. Those countries (with large processing zones?) that can (or already) survey enterprises to identify goods for processing activities and related fees could do so. Against this information, BOP/SNA statisticians would then need to derive estimates for processing fees.

An important issue that requires further consideration is the capture of trade between related parties. The countries' customs documents should normally include the option of registering trade between related parties, however, as countries use different criteria for identifying related parties this option is not always included. Further guidance on compilation of adequate trade flows between related parties through customs need to be developed as this combines a number of aspects. Enterprises that send goods for processing abroad to related enterprises could accumulate several benefits such as minimising corporate taxes, using cheap labour and transfer pricing.

Possible implications for data users

It should also be highlighted that a change in current practices would limit the availability of information in case of trade dispute settlements when the case is considered a good by the involved parties and also drastically change the character of economies with large processing zones while the underlying economic relations remain the same. For example, Mexico's exports consist of more than 40% of exports from the maquiladoras. A net treatment would result in a considerable change of the trading position of Mexico which, for example, would have a big impact on WTO budget contribution calculations and also on a large number of derived trade indicators (openness, etc.).