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Items 3 and 4 of the provisional agenda

FOLLOW-UP DISCUSSION OF THE REVISED ISSUE PAPERS

IMPLEMENTING THE NEW STATISTICAL STANDARDS

FOR GOODS FOR PROCESSING AND MERCHANTING IN HONG KONG, CHINA

Note by Hong Kong Special Administrative Region, China

I. INTRODUCTION

1. As a major trading hub in the world, Hong Kong Special Administrative Region, China (Hong Kong) plays a pivotal role in the global production of goods and services. Its involvement in the activities of goods sent abroad for processing and merchanting is one of the largest in the world. As early as the 1980s, many manufacturing companies in Hong Kong had started to relocate their production processes to the mainland of China (the Mainland) to take advantage of the geographical proximity and lower production cost there. Hong Kong's traders also engage in a substantial amount of "merchanting" activities because of their extensive network of buyers and sellers in the global market. Also, with the rapid infrastructural development in the Mainland, particularly ports and related transportation facilities, traders in Hong Kong have diversified their exporting channels by exporting processed goods manufactured in the Mainland directly to overseas markets.

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2. The new international statistical standards for recording “goods for processing” and “merchandising” based on the “change of ownership” principle, which will be promulgated in the *Balance of Payments and International Investment Position Manual, sixth edition (BPM6)*, would have a substantial impact on the presentation, compilation and interpretation of external trade statistics of Hong Kong. In particular, the adoption of the “change of ownership” principle in place of the existing basis of “physical movements of goods crossing the boundary” in compiling trade statistics would have a profound impact on Hong Kong’s goods and services accounts.

3. In the paper presented at the 2007 Committee meeting (BOPCOM-07/20) as well as a similar and modified version of the paper presented at the 2008 Conference of European Statisticians¹ (ECE/CES/2008/12) and at the First Meeting of the Organisation for Economic Co-operation and Development (OECD) Working Party on International Trade in Goods and Trade in Services Statistics² (STD/SES/WPTGS(2008)19), the significant impact of the new standards on compilation of statistics on trade in goods and trade in services of the Hong Kong economy was highlighted. With the implementation of the new standards on “goods for processing” and “merchandising”, the balance of trade in goods of Hong Kong would be revised from a persistent deficit over time to a persistent surplus, while the balance of trade in services would be revised from a persistent surplus to a persistent deficit. The new standards would significantly affect the absolute magnitudes of both trade in goods and trade in services for the Hong Kong economy (Table 1).

4. The paper presented at the 2007 Committee meeting (BOPCOM-07/20) discussed preliminary ideas regarding the plans of Hong Kong in implementing the new statistical standards under the BPM6, and addressed some specific issues relating to data collection and dissemination of statistics. This paper presents in more detail the plans of Hong Kong in implementing the new statistical standards for recording “goods for processing” and “merchandising” under the BPM6, highlights the development work being undertaken by the Census and Statistics Department (C&SD) of Hong Kong over the past year, elaborates on the practical difficulties encountered, and discusses some important conceptual issues relating to the implementation of the new statistical standards.

¹ At the Conference of European Statisticians (CES) plenary session in June 2008, Hong Kong was invited to present a paper on “The Changed treatment of goods for processing and merchandising in the Revised System of National Accounts (2008 SNA) and the Sixth Balance of Payment Manual (BPM6)” in the Seminar on Strategic Issues Linked to the Measurement of International Transactions.

² The First Meeting of the OECD Working Party on International Trade in Goods and Trade in Services Statistics (WPTGS) was held on 22-24 September 2008. Conference Centre in Paris, France. Hong Kong was invited to present the paper on “The Changed treatment of goods for processing and merchandising in the Revised System of National Accounts (2008 SNA) and the Sixth Balance of Payment Manual (BPM6)”.

Table 1. Balances of trade in goods and trade in services of the Hong Kong economy, 1995-2007

(US\$Bn)

Reference Year	Balance of Trade in Goods		Balance of Trade in Services	
	Balance	Balance (Adjusted figures) ³	Balance	Balance (Adjusted figures) ³
1995	-16	12	9	-18
1996	-15	20	12	-22
1997	-17	21	11	-27
1998	-8	32	9	-31
1999	-3	36	12	-28
2000	-8	37	16	-30
2001	-8	37	16	-29
2002	-5	39	19	-25
2003	-6	38	20	-23
2004	-9	41	24	-26
2005	-8	48	30	-26
2006	-14	51	36	-29
2007	-20	43	42	-21

II. PLANS OF HONG KONG IN IMPLEMENTING THE NEW STATISTICAL STANDARDS

A. Goods for processing

5. Hong Kong will adopt a pragmatic modular approach to implement the new statistical standards for recording “goods for processing” by flexibly combining the three options, viz. applying new data models; conducting enhanced surveys; and expanding trade declaration documents, at different stages of implementation, and for different levels of statistical detail.

B. Applying new data models

6. First, for supporting timely compilation of major macroeconomic aggregates, such as gross domestic product (GDP) and balance of payments (BoP) statistics, new data models and imputation procedures will be constructed based on existing information to produce preliminary estimates at an aggregate level under the new standards within short time lags. The data models will be designed specifically to produce estimates of the proportion of goods related to outward processing trade in the overall trade, taking into account historical trends, relevant proxy indicators and external information, such as change of Mainland policies on processing activities⁴. Regression involving a set of explanatory variables and proxy indicators, with

³ Figures adjusted for “goods for processing” and “merchandising” based on BPM6 standards.

⁴ Change of Mainland policies on processing activities, such as adjustment of export value added tax (VAT) rebate rates for certain products and expansion of the prohibited category under processing trade, will be taken into account in the data models by way of dummy variables.

appropriate time lag structures, will provide a basis for developing the relevant data models for application.

7. Preliminary testings of the potential explanatory variables for estimating Hong Kong's exports and imports of goods involving outward processing in the Mainland at an aggregate level have been conducted. The relationships between the exports/imports of goods involving outward processing in the Mainland and each individual explanatory variable are examined using the quarterly time series for the period 1997-2007. Specifically, the general form of the regression model, with appropriate time lag structures, is as follows:

$$EXOP_t = \alpha + \sum_{i=0}^n a_i EX_{t-i} + e_t$$

$$IMOP_t = \beta + \sum_{i=0}^n b_i IM_{t-i} + e_t$$

where $EXOP_t$ is the exports of goods from Hong Kong to the Mainland for outward processing at time t ,

$IMOP_t$ is the imports of goods from the Mainland to Hong Kong after outward processing at time t ,

EX_{t-i} is the explanatory variables⁵ at time $t-i$ for estimating Hong Kong's exports of goods involving outward processing in the Mainland,

IM_{t-i} is the explanatory variables⁶ at time $t-i$ for estimating Hong Kong's imports of goods after outward processing in the Mainland,

α , β , a_i and b_i are coefficients to be estimated,

e_t is the error term.

⁵ Explanatory variables for estimating exports of goods from Hong Kong to the Mainland for outward processing are:

- (a) Hong Kong's imports of raw-materials/ semi-manufactures from the world;
- (b) Hong Kong's imports of raw-materials/semi-manufactures from major suppliers of raw-materials/ semi-manufactures for Hong Kong's outward processing;
- (c) Hong Kong's re-exports of raw-materials/ semi-manufactures to the Mainland.

⁶ Explanatory variables for estimating imports of goods to Hong Kong from the Mainland after outward processing are:

- (a) Hong Kong's exports of goods to the Mainland for outward processing;
- (b) Hong Kong's imports of major processed commodities of Mainland origin;
- (c) Hong Kong's re-exports of major processed commodities of Mainland origin;
- (d) Hong Kong's re-exports of goods of Mainland origin to major destinations of goods returned to Hong Kong after processing;
- (e) Mainland's exports of goods to Hong Kong after processing and assembling operations in the Mainland.

8. Empirical results of the models show that Hong Kong's exports and imports of goods involving outward processing in the Mainland are positively correlated with the specified explanatory variables. The adjusted R-squares of the models are well over 0.8 and the Durbin-Watson statistics are close to 2.0, indicating that the regression models should adequately fit the data series. The coefficients of all explanatory variables fitted have the expected signs and are statistically significant at the 5% confidence level. Overall, the estimation results appear robust and stable.

9. In addition, preliminary study indicates that the values of goods exported from Hong Kong to the Mainland for processing and the values of goods returned to Hong Kong from the Mainland after processing may have seasonal patterns, which have to be taken into account in the data models. Consistency checking of coherence of the estimates produced by data models against relevant news and information available in the public domain will be conducted to help identify estimates that appear to be inconsistent with common perception and external information, and evaluate the appropriateness of the data models and overall data quality of the estimates.

10. These data models, with appropriate input assumptions, will also produce estimates on processing fee for inclusion into trade in services statistics. Benchmark ratios of processing fee to the value of goods involved by commodity group can be collected from benchmark surveys once every few years to supplement the model estimates.

C. Conducting enhanced surveys

11. At present, a survey on outward processing trade activities is conducted on a monthly basis to delineate outward processing in the Mainland from conventional trade. The survey provides estimates of the value and proportion of trade involving outward processing in the Mainland based on a sample of import/export declarations. In order to implement the new statistical standards on "goods for processing", additional information will have to be collected for Hong Kong's outward processing activities in the Mainland without change of ownership⁷.

12. The existing survey on outward processing trade activities will be enhanced to collect additional information for compiling external trade statistics under the new standards.

⁷ According to China Customs' definitions, there are two types of inward processing trade, viz.: processing and assembling and processing with imported materials. Processing and assembling refers to the type of inward processing in the Mainland in which foreign suppliers provide all or part of the raw materials, parts or components under a contractual arrangement for the manufacture or assembling of products, which are for subsequent exportation and sales by the foreign suppliers. Under this type of processing, the imported inputs and the finished outputs remain property of the foreign suppliers throughout the whole process. Processing with imported materials refers to the type of inward processing in the Mainland in which the raw materials, parts and components are purchased with foreign currencies and imported by the processing units for the manufacture of products or semi-manufactures, which are for subsequent exportation to foreign markets from the Mainland. Under this type of processing, the ownership of the imported inputs has been transferred to the Mainland processing units. For purpose of Hong Kong's BoP account compilation, only Hong Kong's outward processing in the Mainland under processing and assembling contracts are covered in the survey.

Enhancements include collecting additional information on the value of processing fee paid by Hong Kong, and the value of raw materials/semi-manufactures procured from sources other than Hong Kong and delivered directly to the Mainland for processing without going through Hong Kong. To support compilation of more detailed trade statistics under “change of ownership” principle and the conduct of more in-depth trade analysis, detailed breakdowns of Hong Kong’s outward processing trade statistics by broad commodity group will be compiled. A preliminary proposal of the broad commodity breakdowns is given in Annex I.

13. Information collected from the survey will be available only with longer time lag but it can be used to revise the preliminary estimates of the trade aggregates produced by the data models and imputation procedures, and to support more in-depth analysis. The enhanced survey will also provide the information necessary for regularly updating the parameters of the data models used for estimating the preliminary trade aggregates.

D. Expanding trade declaration documents

14. A longer term target is to produce external trade statistics based on “change of ownership” principle with comprehensive breakdowns by commodity group and by country in a reliable and timely manner. This will require collecting additional data through expanding the trade declaration documents. This method is however very likely to be strongly opposed by various stakeholders who may see this as a move against the government’s policy of trade facilitation. Collecting additional data in trade declarations will impose a heavy reporting burden on virtually all traders. Support and co-operation of traders in the business community is not easy to solicit. Moreover, expansion of the trade declaration documents will involve a series of complex legal procedures and overall revision in customs legislations. The electronic submission system currently used for trade declarations of Hong Kong would have to be modified accordingly.

15. A strong policy support of the initiative from Hong Kong Government is essential but this is difficult to attain as such a move is against the government’s policy of trade facilitation. In addition, as some 20 million trade declarations are processed each year, a huge amount of additional resources will be required for processing new data items collected from a large number of declarations. This will make the declaration procedures more costly and time-consuming. As considerable resistance is expected from the stakeholders, it is not likely that additional reporting requirements could be imposed on import/export declarations in the near term.

E. Merchanting

16. At present, data required for the compilation of “merchanting” of Hong Kong are collected from an annual survey on trade in services. Data on the sales of goods and cost of goods sold for “merchanting” are collected to compile the value of merchanting services provided, which is the difference between the two components.

17. In order to implement the new statistical standards on “merchanting”, the frequency of the existing survey on trade in services will be enhanced for compiling quarterly statistics on “merchanting” with a reasonable time lag to support compilation of quarterly BoP statistics. The survey, with sample size enlarged appropriately and questionnaire enhanced with additional

questions, will collect quarterly breakdown on values of sales and cost of goods involved in “merchanting”. A supplementary survey will be conducted on a trial basis so that the feasibility of collecting such detailed data from respondents and the additional reporting burden on respondents may be more thoroughly assessed before making the final implementation.

18. To facilitate the compilation of trade statistics under “change of ownership” principle and the conduct of related trade analysis, it is planned that detailed breakdowns of merchanting statistics (values of sales and costs of goods involved) by broad commodity group will be compiled. A preliminary proposal of the broad commodity breakdowns is given in Annex II.

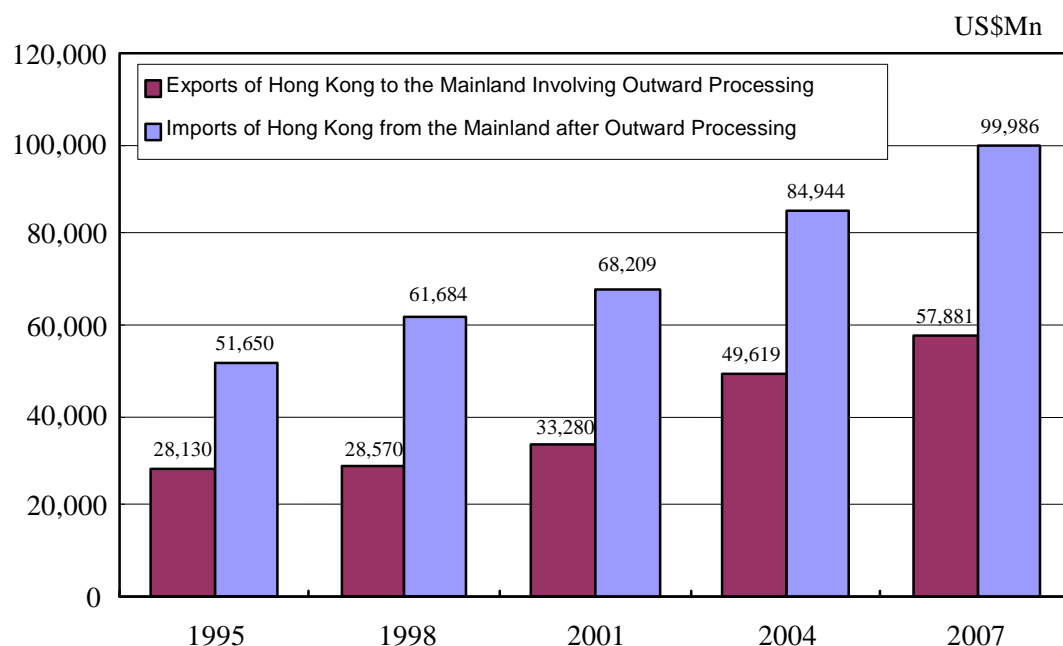
19. Compared with the survey on outward processing activities, the survey on trade in services can only support a rather limited breakdown of merchanting statistics by commodity group. The reason is that detailed information on commodities can be obtained from data reported in trade declarations sampled in the survey on outward processing activities, whereas for the survey on trade in services which is an enterprise survey, only information by broad commodity category is available.

III. SOME IMPORTANT ISSUES TO CONSIDER WHEN IMPLEMENTING THE NEW STANDARDS

A. Treatment of raw materials/semi-manufactures delivered to the Mainland not via Hong Kong

20. Chart 1 shows the historical trend of outward processing trade of Hong Kong in the Mainland. It can be seen from the chart that the difference between the value of raw materials/semi-manufactures exported from Hong Kong to the Mainland for processing and the value of finished goods returned to Hong Kong from the Mainland after processing, which is conceptually equal to the processing fee paid, accounts for 40-50% of the value of finished goods imported from the Mainland over the past decade. Normally, the processing fee accounts for 15%-25% of the value of finished goods imported, depending on the commodity category of the processed goods.

21. The C&SD has spent considerable resources and time in the past year on research and empirical studies to analyse this phenomenon. It has been noted that a significant amount of raw materials/semi-manufactures required for processing are not delivered through Hong Kong to the Mainland. These raw materials/ semi-manufactures are procured domestically in the Mainland or imported directly from sources other than Hong Kong to the Mainland. This business practice explains the large gap between the value of goods exported from Hong Kong to the Mainland for processing and the value of goods returned to Hong Kong from the Mainland after processing, as both the processing fees paid by Hong Kong and the value of these other procurements of raw materials/semi-manufactures are embedded in the value of processed goods imported back into Hong Kong from the Mainland.

Chart 1. Outward processing trade of Hong Kong in the mainland of China

Note: The difference between the value of goods exported from Hong Kong to the Mainland for processing and the value of goods returned to Hong Kong from the Mainland after processing is equal to the processing fees paid by Hong Kong, plus the value of any other raw materials/semi-manufactures used in processing which are procured domestically in the Mainland or imported directly from sources other than Hong Kong to the Mainland.

22. For illustration, a hypothetical numerical example is shown in Diagram 1 in Annex III which depicts all the typical trade flows related to outward processing trade of Hong Kong. Take for example the production of 100 headphones which are arranged by Hong Kong producers (the owners) for assembling in the Mainland. The finished products are then imported back into Hong Kong for subsequent re-exportation to Country Z.

23. In Diagram 1, we can see that the raw materials/semi-manufactures required for production come from diversified sources. Part of the raw materials/semi-manufactures (i.e. (b), valued at US\$280) are provided by the Hong Kong producers and delivered through Hong Kong to the Mainland for assembling. Part of the raw materials/semi-manufactures (i.e. (M_{HK}), valued at US\$50) are procured by the Hong Kong producers and delivered directly from Country Y to the Mainland for assembling. Part of the raw materials/semi-manufactures (i.e. (M_{China}), valued at US\$15) are procured by the Mainland processing units themselves and imported directly from Country W to the Mainland for assembling. The remaining raw materials/semi-manufactures (i.e. (D_{China}), valued at US\$25) are procured domestically in the Mainland by the Mainland processing units. The processing fee paid by the Hong Kong producers to the Mainland processing units (P) is US\$90, which is embedded in the value of the finished products imported back into Hong Kong from the Mainland (i.e. (e), valued at US\$460).

24. The processing fee paid by the Hong Kong producers to the Mainland processing units (i.e. (P)) are embedded in the value of the finished products imported from the Mainland (i.e. (e)), together with the total value of raw materials/ semi-manufactures required for assembling (i.e.

$(b)+(M_{HK})+(M_{China})+(D_{China})$). Thus, the gap between the value of raw materials/semi-manufactures delivered from Hong Kong to the Mainland for assembling (i.e. (b)) and the value of finished goods returned back into Hong Kong after processing (i.e. (e)) is equal to the processing fees plus the value of other procurements of raw materials/semi-manufactures (i.e. $(e)-(b)=(P)+(M_{HK})+(M_{China})+(D_{China})$).

25. Under the new statistical standards, (b) and (e) will no longer be included in Hong Kong's exports and imports of goods. While the processing fees would be recorded as imports of services under the new standards, proper statistical treatment is required for those other procurements of raw materials/semi-manufactures (i.e. raw materials/semi-manufactures procured domestically in the Mainland (D_{China}), and those imported directly from sources other than Hong Kong to the Mainland ($M_{HK})+(M_{China}$)) in order to ensure that the overall balance of trade in goods and trade in services would not be affected under the new standards.

26. The issue of treatment in this particular situation was raised and discussed during the seminar on "Balance of Payments Statistics" held by the IMF in Singapore in March 2008⁸. It was considered, and subsequently clarified in the July 2008 version of the BPM6, that such other procurements of raw materials/semi-manufactures will be recorded as imports of goods of Hong Kong if they are procured by the Hong Kong owners. For those raw materials/semi-manufactures procured by the Mainland processing units, it was considered that they should be a component of the value of imports of services by Hong Kong from China.

27. Based on the data having so far been collected from the enhanced survey on outward processing trade activities, it is preliminarily estimated that around 20% of the value of processed goods returned back to Hong Kong from the Mainland after processing is attributable to the processing fee payment to the Mainland processing units. Though raw materials/semi-manufactures required for processing are mainly supplied and delivered from Hong Kong, accounting for over around 60% of the import value of goods returned back to Hong Kong after processing, a significant proportion of them, around 20% of the import value of goods returned back to Hong Kong after processing, are procured in the Mainland domestically or delivered directly from places other than Hong Kong to the Mainland for processing.

28. The proportions of processing fees and procurement of raw materials/semi-manufactures vary across commodities. The differences between the value of raw materials/semi-manufactures exported from Hong Kong to the Mainland for processing and the value of finished products returned to Hong Kong from the Mainland after processing are relatively large for "clocks and watches", "textile garments" and "base metals and metal products". The large gap for "clocks and watches" is attributable to the relatively high proportion of the required raw materials/semi-manufactures sourced and delivered from places other than Hong Kong, particularly procured by

⁸ The Seminar on "Balance of Payments Statistics" was held during 3-7 March 2008 at the Singapore Regional Training Institute of the IMF. The Seminar, attended by senior managers involved in the compilation of balance of payments statistics and international investment positions, introduced and elicited comments from experts on the new BPM6 before it is finalized.

the Mainland processing units. The relatively large gaps for “textile garments” and “base metals and metal products” are attributable to the relatively high payment of processing fees in terms of the import value of finished products.

B. Impact of the new international statistical standards on Hong Kong

29. As discussed in the paper presented at the 2007 Committee meeting, implementing the new statistical standards on “goods for processing” and “merchandising” would result in significant downward revision in the figures in respect of Hong Kong’s exports of goods and exports of services. As “goods for processing” and “merchandising” are very significant to the Hong Kong economy compared with other major trading economies, this revision would change the relative ranking of Hong Kong in world exports of goods and exports of services, as well as total trade in goods and trade in services.

30. Based on some recent consultations conducted by the C&SD, it was found that many major data users in Hong Kong are concerned about the profound impact of the new statistical standards on the interpretation of Hong Kong’s trade figures. In particular, the revision of Hong Kong’s visible trade balance from a persistent deficit to a persistent surplus and invisible trade balance from a persistent surplus to a persistent deficit would dramatically change the economic interpretation and analyses of Hong Kong’s external account that local and international economists and analysts have long recognized. The change in the relative ranking of Hong Kong in world trade of goods and trade of services would also arouse concerns on trade policy formulation and trade negotiations.

C. Presentation and interpretation of trade statistics

31. In the light of the profound impact of the new statistical standards on interpretation of Hong Kong’s trade figures, the plan of Hong Kong at this stage is that the conventional merchandise trade statistics and trade in services statistics, which have a long history of international development and have been used extensively to serve a variety of needs including particularly trade policy formulation, trade negotiations and international comparisons, will continue to be compiled. To meet the new international statistical standards, a supplementary set of trade in goods and trade in services statistics based on the “change in ownership” principle will also be compiled to facilitate analysis and international comparison of the international trade flows of Hong Kong. The two sets of trade statistics shall complement each other and will have their own specific uses in different contexts.

32. Nevertheless, compilation of merchandise trade statistics based on “change of ownership” principle with detailed commodity breakdowns by partner country may give rise to profound data collection issues in Hong Kong. As imposing additional reporting requirements in import/export declarations seems to be unlikely in the near term, the additional data required for implementing the new standards could only be obtained through surveys on traders. Nonetheless, the survey approach can only support a limited breakdown of statistics by commodity group owing to resource and reporting burden considerations. Therefore, the plan of Hong Kong is that the supplementary trade statistics would be provided at aggregate level and for broad commodity groups only.

33. Under the new statistical standards, the conventional trade statistics and the supplementary trade statistics will show greater discrepancies since the former statistics are not compiled based on the “change of ownership” principle. To minimize confusion to data users, provision of bridge tables explaining the gaps between the two sets of figures on trade in goods would be considered.

34. Past experience with the implementation of major modifications to various statistical compilation systems tells how important it is to ensure the data users at all levels of the community are aware of and understand the way and implications of the changes. It is impossible for data users to understand and properly use statistical figures without understanding how they have been compiled. Therefore, it is the belief of the C&SD that the success of implementation of new statistical standards on “goods for processing” and “merchandising”, as well as other recommendations promulgated in the BPM6, depends, to a large extent, on whether the data users have a proper understanding of the change in statistical concepts and the correct interpretation of the data. This presentational aspect of bridge tables, which explain the gaps between the two sets of figures on trade in goods, would help enhance the understanding of data users of the way and implications of changes, and hence reduce misinterpretation of the figures.

IV. PROGRESS OF THE DEVELOPMENT WORK UNDERTAKEN IN HONG KONG

A. Goods for processing

35. Enhancement to the existing survey on outward processing trade activities is now in full swing. The survey questionnaire has been revised to collect the following additional information:

- (a) Value of processing fee paid by Hong Kong; and
- (b) Value of raw materials/semi-manufactures used for processing in the Mainland which are not delivered through Hong Kong, with the following breakdowns:
 - (i) procured domestically in the Mainland by the Mainland processing units;
 - (ii) procured by the Hong Kong producers and delivered directly from sources other than Hong Kong to the Mainland;
 - (iii) procured by the Mainland processing units and delivered directly from sources other than Hong Kong to the Mainland.

36. It has been planned to collect the newly required data through the survey on a trial basis from June 2008 to May 2009 (for data of reference months from April 2008 to March 2009). Meanwhile, the size of the monthly sample will be doubled to support compilation of more detailed outward processing trade statistics by broad commodity group. This trial arrangement could fully test the viability of obtaining the new data through survey and assess the data quality before the plans go into formal implementation. The first set of new statistics, which covers the reference period for April-June 2008, is expected to be available in end 2008/early 2009. It is expected that the evaluation report of the trial exercise will be available in the second half of 2009.

37. While the trial survey has been conducted for a few months, some difficulties have been encountered in data collection. Fieldwork experience indicates that most respondents do not have readily available information about the new data required. One reason is that the Mainland processing units rather than the Hong Kong traders possess the best information about the processing operations and the associated expenses. Another reason is that a considerable proportion of the respondents (around 30-40%) are logistics companies⁹ rather than the owners of the processed goods imported. It is a common phenomenon in Hong Kong that logistics companies are delegated by the owners of processed goods to handle the delivery of finished products from the Mainland processing units to the overseas buyers. These logistics companies make all necessary arrangements, including submission of trade declarations and arranging both internal transportation and international shipments. As they know very little or nothing about the processing operations, they have either to acquire the relevant information from owners of the goods concerned, or provide contact details of the owners of the goods concerned for subsequent follow-up.

38. The practical difficulty of data collection arising from logistics companies has long been existing in the current survey on outward processing activities. Initially, these logistics companies showed strong resistance to the survey and refused to co-operate in giving response. Because of the specialised nature of their business, they opined that they have no obligation to provide information about the goods consigned as they are not owners of the goods. The C&SD has made considerable effort to solicit their support and co-operation through communication, liaison meetings, courtesy visits and education in the past years. Meanwhile, the logistics companies are in general more cooperative and the resistance from them has more or less relieved. However, as more detailed information about the processing operations will be collected in the enhanced survey on outward processing activities, the scale of difficulties and complexities will be augmented considerably.

B. Merchanting

39. While the existing annual survey on trade in services will be enhanced to collect quarterly breakdown on values of sales and cost of goods involved in merchanting, a supplementary survey will be conducted on a trial basis to assess thoroughly the feasibility of collecting such detailed data from respondents and the additional reporting burden on them. The supplementary survey will be conducted during October to December 2008 to collect the quarterly breakdowns for the reference year of 2007. Preparatory work including consultation with traders, and development of the statistical framework/compilation system is in now full swing. The results of the supplementary survey are expected to be available in the first half of 2009 for analysis.

⁹ Logistics companies are those engaged in logistics activities, involving warehousing, freight transportation, physical distribution, procurement, marketing and sales, customer services and materials management. Respondents sampled in the survey on outward processing trade activities which are logistics companies are mainly freight forwarders/cargo consolidators, carriers (e.g. airline and transportation companies) and couriers.

V. WAY FORWARD

40. The new methodology of recording goods for processing still remains a controversial topic amongst the international communities. Some international groups, such as World Trade Organization, still have some degree of reservation regarding the new recommendation on treatment of goods for processing. The C&SD will keep track of all the latest developments of the issue and assess the possible impact on the compilation of Hong Kong's national accounts statistics.

41. Meanwhile, the United Nations Statistics Division (UNSD) is conducting a global consultation with national compilers of international merchandise trade statistics seeking member economies' comments and suggestions on the proposed recommendations of the updated *International Merchandise Trade Statistics: Concepts and Definitions, Revision 2 (IMTS Rev.2)*, in particular the adoption of "change of ownership" principle in compiling merchandise trade statistics. The C&SD has expressed concerns about the substantial impact on Hong Kong's merchandise trade statistics, and practical difficulties in data collection and compilation of merchandise trade statistics with breakdowns by detailed commodity and by country/territory.

42. The work of the C&SD in this area in the near future will focus on the construction of new data models and imputation procedures for producing preliminary estimates of the data required under the new standards for purpose of supporting timely compilation of GDP and BoP statistics. This would be another major challenge. Moreover, the data quality of the additional information collected in the enhanced surveys will be closely monitored. In addition, the dissemination practices and presentation of the two sets of external trade figures, viz. trade in goods compiled based on "change of ownership" principle; and conventional merchandise trade statistics compiled based on physical movements of goods crossing the boundary, will be carefully deliberated to minimize confusion to data users. Consultations and discussion sessions with major data users will continue to be organized to solicit their views and suggestions.

ANNEX I

**Proposal of breakdown of Hong Kong's outward processing trade statistics
by broad commodity groups**

Existing commodity groups	Proposed commodity groups¹⁰
1. Textile materials, yarn, fabrics and textile articles other than textile garments	1(a) Textile materials, yarn, fabrics 1(b) Textile articles other than textile garments
2. Articles of apparel and clothing accessories (textile garments)	2(a) Articles of apparel (textile garments) 2(b) Clothing accessories
3. Plastics and articles	3. Plastics and articles
4. Machinery and mechanical appliances, electrical equipment	4(a) Machinery 4(b) Mechanical appliances 4(c) Electrical equipment
5. Sound recorders and reproducers, television image and sound recorders and reproducers	5(a) Sound recorders and reproducers 5(b) Television image and sound recorders and reproducers
6. Clocks and watches	6. Clocks and watches
7. Toys, games and sports requisites	7(a) Toys and games 7(b) Sports requisites
8. Base metals and metal products	8(a) Iron and steel 8(b) Base metal other than iron and steel 8(c) Metal products
9. Others (excluding commodities and transactions not classified according to kind)	9(a) Footwear 9(b) Telecommunications equipment 9(c) Travel goods and handbags 9(d) Others (excluding commodities and transactions not classified according to kind)

¹⁰ The proposed commodity breakdowns are preliminary ideas only and are subject to modifications with reference to the experimental outcome, the results of the enhanced survey on outward processing trade activities, which are expected to be available in end 2008/early 2009, and constraints

ANNEX II

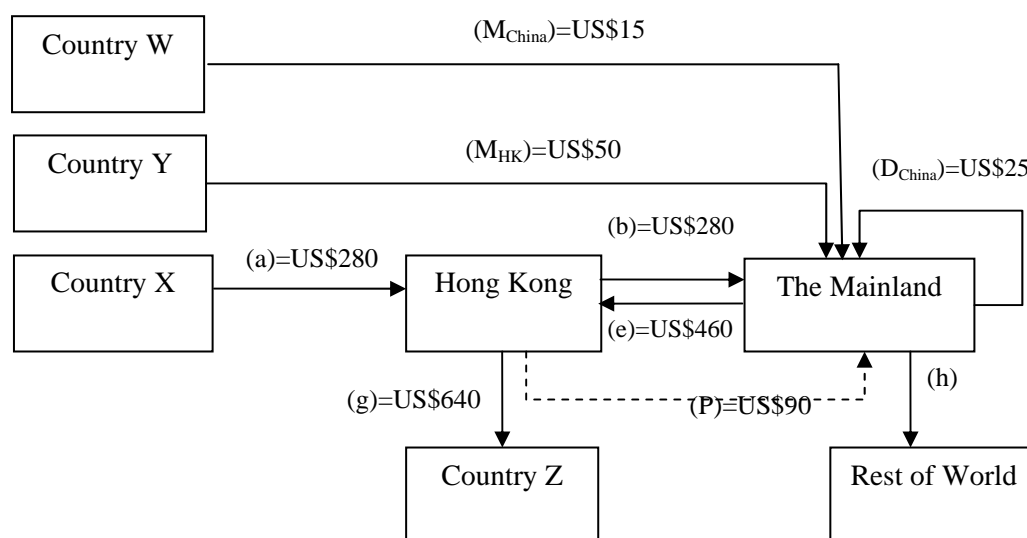
**Proposal of breakdown of Hong Kong's merchanting statistics
by broad commodity groups**

Existing commodity groups	Proposed commodity groups¹¹
1. Food	1. Food
2. Consumer goods	2(a) Clothing and footwear 2(b) Audio-visual equipments and electrical appliances 2(c) Watches and clocks 2(d) Toys, games and sporting goods
3. Raw materials and semi-manufactures	3(a) Electronic components 3(b) Plastic materials 3(c) Base metal 3(d) Cotton, and man-made fibres 3(e) Chemical elements and compounds
4. Fuels	4. Fuels
5. Capital goods	5(a) Machinery and transport equipment 5(b) Telecommunications equipment
	6. Others

¹¹ The proposed commodity breakdowns are preliminary ideas only and are subject to modifications with reference to the experimental outcome, the results of the enhanced survey on trade in services, which are expected to be available in the first half of 2009, and constraints.

ANNEX III

Diagram 1. Typical Flows of Outward Processing Trade of Hong Kong



- (a) Raw materials/semi-manufactured goods imported by Hong Kong from Country X for outward processing of (e) in the Mainland (US\$280)
- (b) Raw materials/semi-manufactured goods delivered from Hong Kong to the Mainland for processing of (e) (US\$280)
- (D_{China}) Raw materials/semi-manufactured goods procured domestically in the Mainland by the processing units themselves for processing of (e) (US\$25)
- (M_{HK}) Raw materials/semi-manufactured goods procured by Hong Kong producers and delivered directly from Country Y to the Mainland for processing of (e) (US\$50)
- (M_{China}) Raw materials/semi-manufactured goods procured by the Mainland processing units themselves and delivered from Country W to the Mainland directly for processing of (e) (US\$15)
- (P) Processing fee paid by Hong Kong to the Mainland for processing of (e) (US\$90)
- (e) Processed goods returned back into Hong Kong from the Mainland after processing (US\$460)
- (g) Processed goods of (e) exported from Hong Kong to Country Z (US\$640)
(Total profit=US\$180)
- (h) Processed goods exported directly from the Mainland to areas other than Hong Kong
(The existing outward processing trade flows of Hong Kong exclude cases where (h) has any positive value. Relevant data related to any positive (h) is covered by another separate survey on Merchanting activities)

ANNEX IV

Relevant entries in the BoP account of Hong Kong (compiling economy)

(US\$)

Hong Kong trade flows	Current practice <i>(BPM5)</i>	New standard <i>(BPM6)</i>
Current account		
Goods		
Exports	(b): \$280 (g): \$640	(g): \$640
Imports	(a): \$280 (e): \$460	(a): \$280 (M _{HK}): \$50
<i>Balance</i>	<i>\$180</i>	<i>\$310</i>
Services		
Exports		
Imports		(D _{China}): \$25 (M _{China}): \$15 (P): \$90
<i>Balance</i>		- \$130
Goods and Services Balance	\$180	\$180
