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"Impact of Globalisation on National Accounts:
Practical Guidance"

Merchanting

Note by the Central Statistics Office of Ireland

Summary

This paper examines how merchanting has been affected by globalization and describes the 2008 System of National Accounts recommendations on the treatment of international merchanting of goods. Guidance is given on the identification of merchanting activities in the country of residence of the merchant, and this is important for international recording of trade in goods and services, given the apparent under-recording of merchanting activity across all countries. The treatment of merchanting of services is also discussed, with a view to improving consistency of approach across the world.

I. Introduction

1. The statistical treatment for Merchanting is defined in Balance of Payments Manual, fifth edition (BPM5) as follows *(International Monetary Fund's Balance of Payments Manual, Fifth edition 1993 par 262)*: *the purchase of a good by a resident (of the compiling economy) from a non-resident and the subsequent resale of the good to another non-resident; during this process the good does not enter or leave the compiling economy...*

2. The recording requirements for merchanting activities are remarkably straightforward. Merchanting is calculated as the value of the goods sold (estimated at basic prices) less the cost of purchasing these same goods at that point in time. In the BPM5 and in the System of National Accounts 1993 (SNA 93) this merchanting margin is classified as the export of merchanting services. However, as most compilers will know, the detection and regular recording of these activities is extremely challenging for the country where the merchant is resident. This is because the goods in question never cross the frontier of the country where the merchant is resident and are therefore not covered by the official trade statistics there.

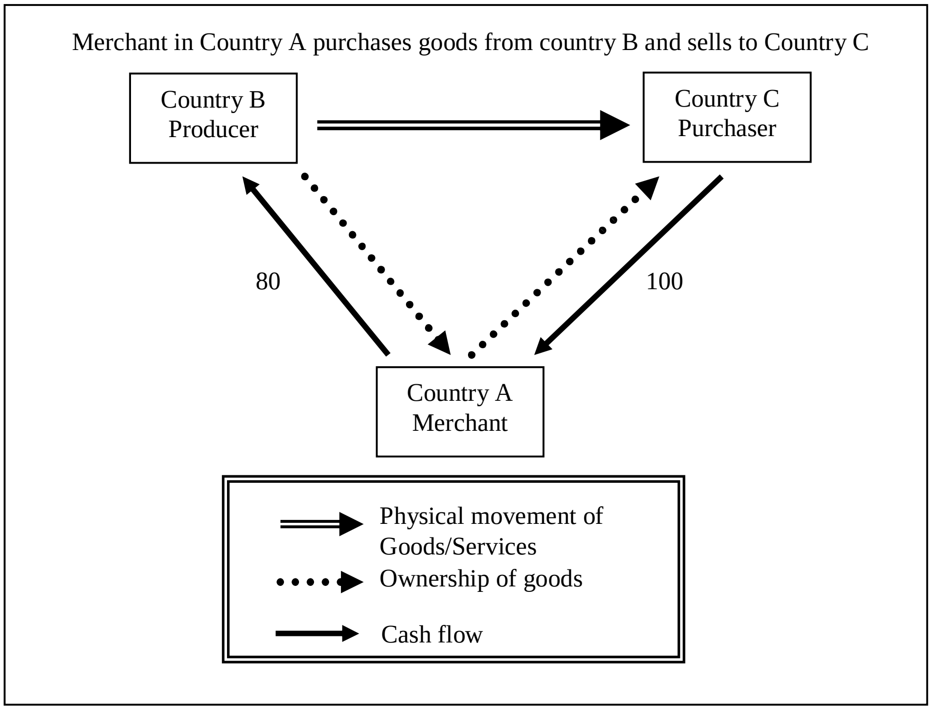
3. The value of merchanting transactions reported in the IMF Balance of Payments for 2006 amounted to $40 billion and five economies accounted for about three quarters of this viz. Ireland, Belgium, Finland, Sweden and Switzerland. However, as merchanting is reported on a net basis the gross value of the transactions in the underlying products may possibly amount to about $60 billion Credit (exports) and $100 billion debits (imports) using the gross merchanting flows for Ireland as a basis for this estimation. Moreover, the absence of any reporting of Merchanting activity for economies such as US, Japan, Netherlands, Hong Kong and Singapore suggest that there is a considerable under reporting of merchanting globally.

4. In this chapter the recommendations of System of National Accounts (SNA) 2008 and BPM6 for merchanting of goods will be outlined. Some guidance on identification of merchanting activities is also included given the likely significant under reporting of this activity globally. In addition, merchanting in its broadest sense is discussed from the perspective of the Central Statistical Office (CSO) in Ireland where the phenomenon of merchanting of services is significant.

II. Background

5. No clear definitions, based on the economic nature, are provided for "merchanting" and "merchant" in the BPM5 and SNA '93 and other current international standards. For example, in the BPM5 treatment as outlined above, the difference between the value of goods when acquired and the value when sold is recorded as the value of merchanting services provided (see Box 1 below for an illustration of a typical Merchanting transaction).

Box 1
Merchanting



6. However, there is a discussion on the case of commodity arbitrage (Balance of Payments Textbook paragraph 361) and the description of 1993 SNA on this issue (paragraph 14.60) is, along the same lines as BPM5. In addition the Balance of Payments Compilation Guide (paragraphs 138-139), Balance of Payments Textbook paragraphs 189-194, 361-362) and Manual on Statistics of International Trade in Services (paragraph 3.123, Box 6) deal with the treatment of merchanting. Nevertheless, various kinds of activities are included without any distinction into the current definition of merchanting. They include:

(a) Transactions resulting from global manufacturing.

(b) Global wholesaling services (and some retailing services).

(c) Commodity arbitrage (dealing).

7. In addition, holding gains and losses are also included as part of services.

8. However, the economic nature of the transactors/transactions does in fact differ and can be distinguished as follows:

A. Global Manufacturing

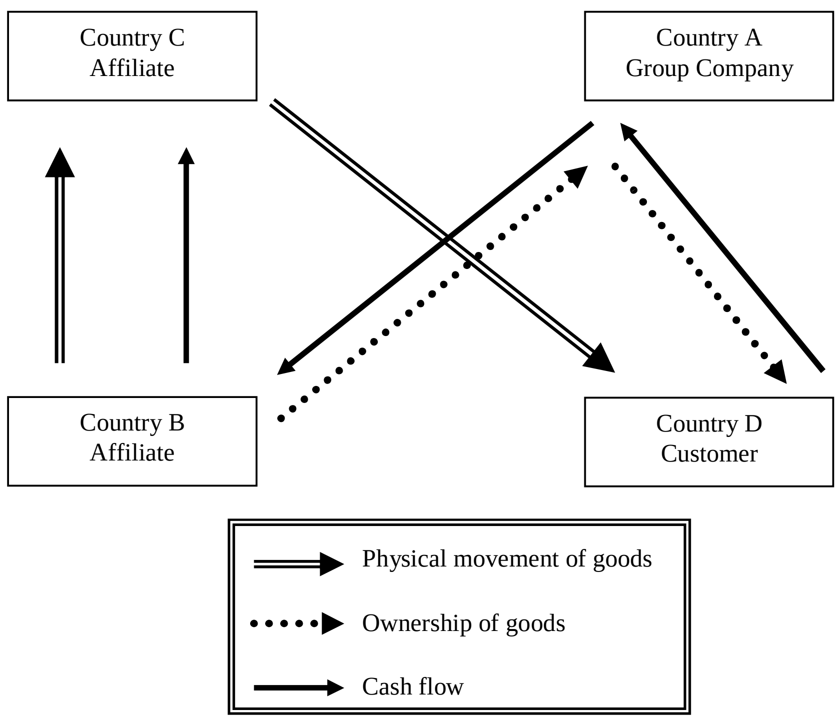
9. Many transactions between enterprises within a multinational Group (MNC) may fall within the definition of merchanting. In reality, the merchanting service is a return for marketing, research and development, financing, process management, etc. provided by an enterprise that does not physically handle the goods. Although, the Manual on Statistics of International Trade in Services, when discussing merchanting (see paragraph 3.123 Box 6) which speaks of commodity arbitrage and wholesale trading but not transactions arising from global manufacturing. Merchanting activities also include aspects of global

manufacturing (see Section 6 A for an example) where goods are sourced from one non-resident affiliate (the manufacturer) and then sold on to another non-resident affiliate. This activity results in international transactions between resident and foreign affiliates which fall under the heading of merchanting for the resident affiliate. See Box2 below for an illustration of Global manufacturing:

Box 2

Merchanting - Global Manufacturing

Merchant in country A is part of MNC, engages affiliate in country B to produce a product and deliver it to Customer in Country D. Affiliate in Country C sends raw materials for further processing to Affiliate in Country C and pays C the processing fee also. When the processed good is available it is shipped from country C to Country D



B. Global Wholesale/Retail

10. The treatment of merchanting also covers international wholesale/retail activities where the merchant is earning a margin by purchasing wholesale from one non-resident supplier and selling to another non-resident retailer/distributor.

C. Commodity Trading

11. These activities aim to earn profits from the difference between purchased price and resale price of the relevant goods. Historically, merchanting involved transactions in goods associated with commodity trading. However, transactions in the underlying commodities

have in many cases been replaced by transactions in derivatives (options, futures, swaps etc.), to achieve the same trading objectives.

III. Statistical Treatment

12. Reporting of merchanting type activities has been discussed in all versions of the BPM since the first edition in the late 1940s. Over time, as both the nature of globalised business activities has broadened and as the detailed methodology for the Balance of Payments Current Account has expanded, more and more activities have been reported under the heading of merchanting.

13. In the five previous editions of the Balance of Payments Manual, we see merchanting activities initially classified under "transactions *in merchandise abroad*" *(IMF Balance of Payments Manual, Second edition, January 1950 p19 Table II(c))* and subsequently under "*intermediary trade*" *(IMF Balance of Payments Manual, Third edition, July 1961 paragraph 472, 137,157)* and by the 5th edition there is a separate heading within *Services* for Business Services including *merchanting*. The recommended treatment in the various editions of the IMF Balance of Payments manual are summarised below:

Table 1
Treatment of merchanting activities in the IMF Balance of Payments manuals

Edition of the Manual	*Required recording*	*Classified in the BPM Methodology*
BPM 1st Edition - 1948	Record net under Merchandise	Other Transactions in Merchandise
BPM 2nd Edition - 1950	Record gross under Merchandise	Other Transactions in Merchandise
BPM 3rd Edition - 1961	Record net under Merchandise	Merchandise transactions abroad
BPM 4th Edition - 1977	Record net under Other Goods Services and	Other Goods Services and Income
BPM 5th Edition - 1993	Record net under Services	Business Services
BPM 6th Edition - 2009	Record gross under Goods (imports recorded as negative exports)	Goods under Merchanting

14. For National Accounts, the treatment of merchanting follows the same approach as that of the BPM and is outlined in SNA 93 paragraph 14.60 as follows:...*the third exception (to the change of ownership principle) is one in which a change of ownership may occur but is ignored in the accounts. The exception relates to merchants or commodity dealers who buy commodities or other goods from non-residents and then sell them again to non-residents within the same accounting period without the commodities actually entering the economy in which the merchants are resident. The difference between the receipts and the sales of such dealers is treated as measuring the value of the services they provide and recorded under exports or imports of services...*

15. While not mentioned explicitly in previous SNA manuals, the treatment to be followed for merchanting activities is a generalised one for all cross border transactions in

goods and services. For example the SNA 68 paragraph 6.138 says *"the scheme of classification (of SNA 68) is also aligned as much as is possible with the classification of goods and services in the third edition of Balance of Payments manual of the International Monetary Fund"*.

16. It can be seen that the thinking behind the instructions in the BPM for the recording of Merchanting from BPM1 to BPM5 have changed from net to gross recording and back again to net. Moreover, it is surprising to see that the motivation in BPM6 and SNA 2008 for the required recording of merchanting in the goods account rather than the services account of the BOP is in line with the treatment in BPM3 where merchanting was to be recorded under the goods heading so that the net balance on merchanting "*must be added to exports to make world exports equal world imports" (IMF Balance of Payments Manual, Third Edition 1961 p. 43 par.(4)).* Subsequent editions seem to be more preoccupied with the recognition of the services aspects of merchanting activities at the expense of global additivity within the goods account. This is reflected in the instructions to record merchanting under services in BPM5.

A. International Discussions on the Current (BPM5 /SNA93) Treatment of Merchanting

17. Merchanting has been extensively discussed in various fora as part of the drafting of SNA2008 and BPM6. These include the Advisory Expert Group on National Accounts (AEG), the Intersecretariat Working Group on National Accounts (ISWGNA), the Balance of Payments Technical Expert Group (BOPTEG), the IMF Balance of Payments Committee (BOPCOM) and the Interagency Task Force on Statistics of International Trade in Services (ITFSITS).

18. The discussions have tended to focus exclusively on the merchanting of goods and in this context they have highlighted a number of difficulties caused by the current treatment of Merchanting. These difficulties can be summarised as follows:

(a) The recording of merchanting transactions is asymmetrical, i.e., the merchanting margin is recorded under **services** for the economy in which the merchant is resident, whereas the non-resident counterparty compilers record the related gross transactions in the **goods** account for both the exports and imports. This method of recording merchanting activities results in a global imbalance in the **goods** account and creates an asymmetry. See Section VI B *(Taken from: Hidetoshi Takeda Merchanting, Update of the 1993 SNA - Issue No.41 Issues paper for the July 2005 AEG meeting)* for a full discussion of this issue.

(b) The treatment is inconsistent with *inventories* data and *balance sheets* both for the merchant and for the supplier. Currently an actual change of legal and economic ownership occurs but is imputed as not occurring, the treatment results in data on assets that are inconsistent with the enterprise accounts and with balance sheets that show the actual positions of the merchant. As these stocks may not be recorded in the *value of inventories in the National Accounts* as owned by the resident merchant, in such a scenario the inventories may be without an owner. Although there is a clear treatment to avoid such a situation arising in both SNA '93 *(UN System of National Accounts 1993 par. 14.60 ....If however, the goods are not resold within the same accounting period, the purchases have to be recorded as imports of goods which are temporarily held as inventory...)* and BPM5 *(Balance of Payments Manual, Fifth edition 1993 par 262 & par 213 ....if the commodities are not resold by the merchant in the same accounting period, an import of goods is recorded in the first period and a negative import entry is recorded in the later period)*, the actual implementation of these particular guidelines is extremely problematic for the compiler resulting in the possibility as already stated of inventories not being attributed to any owner.

(c) The treatment is also inconsistent with financial account transactions. The trader pays a gross amount for the goods to one country, and receives gross payment from another, and both of these gross transactions are recorded in the Financial Account.

(d) The valuation principles are not consistent with supply and use tables. Ignoring taxes, the supply and use tables are valued at either basic prices (i.e., goods transactions and margins are shown separately) or purchasers' prices (i.e., goods transactions valued at basic prices plus corresponding margins). The existing treatment of merchanting is not consistent with either pricing approaches as the merchants' margin is recorded under wholesale trade with no corresponding goods transaction. Consequently the treatment also undermines the relationship between distribution industries and the corresponding goods transactions as the latter are omitted.

(e) All other goods transactions in the balance of payments are recorded gross including any retail and wholesale margins arising up to the National Frontier and not simply reduced to showing these margins alone.

(f) No clear definitions, based on the economic nature, are provided for "merchanting" and "merchant" in the BPM5 and SNA 93 and other current international standards.

B. Merchanting in BPM6 and SNA 2008

19. The revised treatment for merchanting in the SNA 2008 and BPM6 can be summarised as follows:

(a) The acquisition of goods by merchants is to be shown under goods as a negative export of the economy of the merchant.

(b) The sale of goods is shown under goods sold under merchanting as a positive export from the economy of the merchant.

(c) The difference between sales over purchases of merchanted goods is shown as the item *"net exports of* goods *under merchanting."* This item includes merchants' margins, holding gains and losses and changes in inventories of goods under merchanting. As a result of losses or increases in inventories, net exports of goods under merchanting may be negative in some cases.

(d) Merchanting entries are valued at transaction prices as agreed by the parties, not "free on board" (FOB) prices.

(e) In the Supply and Use tables the difference between the sales and purchases of merchanted goods appears as the production of a service in the merchant's economy, consistent with margins applied to domestically produced goods.

20. The new treatment can be summarised as requiring merchanting transactions in goods to be recorded in the Goods Account rather than the Services Account (SNA 93 and BPM5 recording convention) in the BOP and the National Accounts. The recording requirement is gross, however all recording both of purchase and sale is on the credit (export) side with purchases (imports) being recorded as negative exports. In the supply and use tables the net surplus earned by the merchant is shown as a service.

C. Impact of BPM6 and SNA 2008

21. The extent to which the new guidelines resolve the difficulties associated with the recording regime in BPM5 and SNA '93 for merchanting of goods is now discussed, item by item:

(a) *The recording of merchanting transactions is asymmetrical.* If we assume that all merchanting transactions are in the goods account, the changed reporting requirements would help the overall balance of the goods account. This is illustrated in Section VI B where we review the treatment based on the current approach compared to the new standard.

(b) *The treatment is inconsistent with inventories data and balance sheets both for the merchant and for supplier.* If we consider the bullet point 19 (c) above we see that *.... The difference between sales over purchases of merchanting is shown as the item "net exports of goods under merchanting." This item includes merchants' margins, holding gains and losses and changes in inventories of goods under merchanting.* The new standards should resolve the difficulties with inventories and holding gains (see Sections 6 C and D). However, it should be noted that by convention holding gains and losses are excluded from trade margins in National Accounts. In practice, particularly in the case of merchanting where data is scarce, the manual foresees that data sources may not allow the separation out of all holding gains and losses.

(c) *The treatment is also inconsistent with financial account transactions. The trader pays a gross amount for the goods to one country, then receives gross payment from another, and these gross transactions are recorded in the financial account.* This difficulty is resolved by the gross treatment within the goods (exported) account.

(d) *The valuation principles are not consistent with supply and use tables.* The inclusion of the wholesale/retail margin and the holding gains/losses accruing while in inventory, in the gross value of exports by the merchant is consistent with the measurement of supply and use of these margins in the SNA and the BPM.

(e) *All other goods transactions in the balance of payments are shown including any retail and wholesale margins arising up to the international boundary, not with these margins separated.* At the individual country level this drawback remains and it is difficult to see how this issue could be resolved while at the same time attributing the surplus to the country of the merchant.

(f) *No clear definitions, based on the economic nature, are provided for "merchanting" and "merchant" in the BPM5 and 1993 SNA and other current international standards.* The BPM6 contains a discussion on the economic nature of merchanting.

IV. Identification and Recording of Merchanting Activities

22. According to the IMF there is a strong possibility that the level of merchanting activity is under reported globally. It is easy to understand that such a situation could arise given the nature of merchanting, where the goods being merchanted do not cross the border of the merchant. The objective for compilers is therefore firstly to identify merchanting activities and then to establish a system of regular reporting through business surveys. So how can these activities be captured in the Balance of Payments statistics and by extension included in the National Accounts?

23. Merchanting activities can be identified in a number of ways:

(a) First, when an entity or company is solely involved in merchanting it normally has a relatively small number of persons employed while at the same time having substantial turnover and therefore turnover per person tends to be very large. In such cases an NSI could use its Central Business Register (CBR) to identify these cases using ratio analysis.

(b) Multi National Corporations (MNC)with affiliates are sometimes engaged in merchanting activities in conjunction with the production of other goods or services. These merchanting activities can be captured through a specific question on the *Balance of Payments Surveys of International Trade in Services and Royalties* on sales and purchases of merchanted goods.

(c) The analysis of Administrative data such as Corporation Tax records from the Tax Authorities or Dividend Tax payments can also be used to identify merchanting activities. Again, in these cases firms having large taxable profits with no substantial physical presence in the economy i.e. typical characteristics for merchants, need to be identified.

(d) An awareness of MNC practices and recording conventions is also helpful in identifying these activities. For example Merchanting is also called "Drop Shipping" or "Virtual Sales" by these companies. In addition we have found that a company name ending in "EMEA" which is a short form for "Europe, Middle East and Africa" can sometimes be involved in Merchanting.

(e) Another key way of indentifying Merchanting activities arises when company visits are organised by the NSI. As part of the preparation and the recording of these meetings with MNCs, statistical staff need to retain an awareness of the possibility that merchanting may be carried out by the MNC they are visiting and that questions on this activity are addressed to the company.

24. In general the detection of Merchanting activities requires that the staff of the Business Services survey areas and National Accountants and BOP compilers is aware of the phenomenon and also the likely scenarios where Merchanting might occur. It should be clear in this context that the term "merchanting" is generally not used by MNEs or any companies as far as I am aware which adds another dimension to the detection of these activities.

25. As regards the recording of Merchanting in National Accounts, as mentioned earlier, the recording of trade margins, such as the merchanting margin, require that holding gains and losses are excluded from the calculation of this margin. In practice, this exclusion is extremely difficult to do, merchanting activities are recorded in Balance of Payments statistics and sometimes by a separate institution i.e. National Central Bank and it is an almost impossible task to exclude these gains/losses if they are not already excluded. This is particularly true as the merchanting activities recorded will be on an aggregate basis covering a myriad of transactions both at the company and an aggregate level.

26. The recording of Merchanting activites is detailed in the Sections VI A - D, however the recording for National Accounts purposes needs to be discussed from a practical perspective:

(a) On the Expenditure side of the National Accounts in most cases the Merchanting margin should have the same impact as in the Balance of Payments i.e. the Net export of Goods should be identical in both sets of accounts. However, when we come to transactions that straddle periods, what is required is that the initial transaction i.e. the negative export is also recorded as an increase in inventories, otherwise GDP is reduced by the purchase of the goods. In period two the sale of the goods is recorded under exports and this is largely offset by a reduction in inventories leaving the net addition to GDP of the margin earned on the transaction.

(b) Should there be a fall (or rise) in the price of the goods that are being mechanted in these periods the recording requirements are complicated because of these effects. In this case the recording of the Merchanting Margin, Changes in Inveentories and Net Exports of Goods may result in some inconsistency between the Expenditure ands Output Accounts of GDP. This would be due to the absence of the detailed holding gains/losses associated with the merchanting transactions.

V. Extension of the Treatment to Cover Merchanting of Services

27. The new standards, which relate to the recording of merchanting (of goods) activities in the goods account of the BOP and National Accounts should resolve most of the existing problems associated with statistical recording of this type of merchanting activity.

28. However, to the extent that merchanting activities relate to the merchanting of services, the new guidelines may create some new difficulties. Under the BPM6 guidelines, there will no longer be a services category labelled "merchanting." If services are sourced and delivered in a merchanting type arrangement these services transactions must be recorded gross in the relevant services category. In this context it should be noted that merchanting of services is not a new idea and as far back as BPM3 we see a reference to merchanting type activities involving services as can be seen in the following quote: "...*the compiling country's residents may carry out international transactions in goods and services that are entered only on a net basis. Such transactions involve the purchase of goods or services in one foreign country and the sale or granting of them to another foreign country*..." *(IMF Balance of Payments Manual, Third edition, July 1961 Par. 472)*

29. Moreover, merchanting of services and services type activities in general are an area where considerable growth in activity has already been observed. In a recent paper on "*Transportation Costs and International Trade in the Second Era of Globalisation*," the author David Hummels develops this point in the following quote *(Hummels, David 2007 Transportation Costs and International Trade in the Second Era of Globalisation in Journal of Economic Perspectives Vol 23 Number 3 Summer 2007, pp131 - 154)*:*...There is perhaps a third era in cross border trade unfolding even now, again driven by rapid improvements in a technology for connecting people across great distances. Clearly the telecommunication and internet revolution has already affected international integration, leading to a growing rate of transformation and technology outsourcing and in migration of highly skilled professionals. The impact of these changes and the extent to which they displace older forms of integration bear close watching in the years to come.*

30. As part of this so called third era of globalisation, there has been an explosion in the merchanting of services through outsourcing enabled by innovations in telecommunications and web enabled (internet) services. Although BPM6 does include reference to the merchanting of services. Paragraph 10.160 says:

Business and other services such as transport, construction computing may be subcontracted. This arrangement may be called "outsourcing." For example a specialist service arranger may be paid to provide back-office functions for a customer, which the service arranger subcontracts to another contractor. Thus, subcontracting is similar in some ways to merchanting of goods as the services are purchased and resold... ..."Service merchanting" of this kind is an important activity in some economies...

31. Accordingly, the requirement is for a gross recording approach for these services, although it does allow the possibility of net data being provided on a supplementary basis.

32. So the BPM6 recognises the issue of merchanting of services but there is no distinct treatment for such transactions in the new manual. The scale of the gross flows involved in this type of merchanting activity, at least for the countries identified earlier in this chapter do seem to warrant a net treatment under a separate classification in Business Services.

VI. Numerical Examples

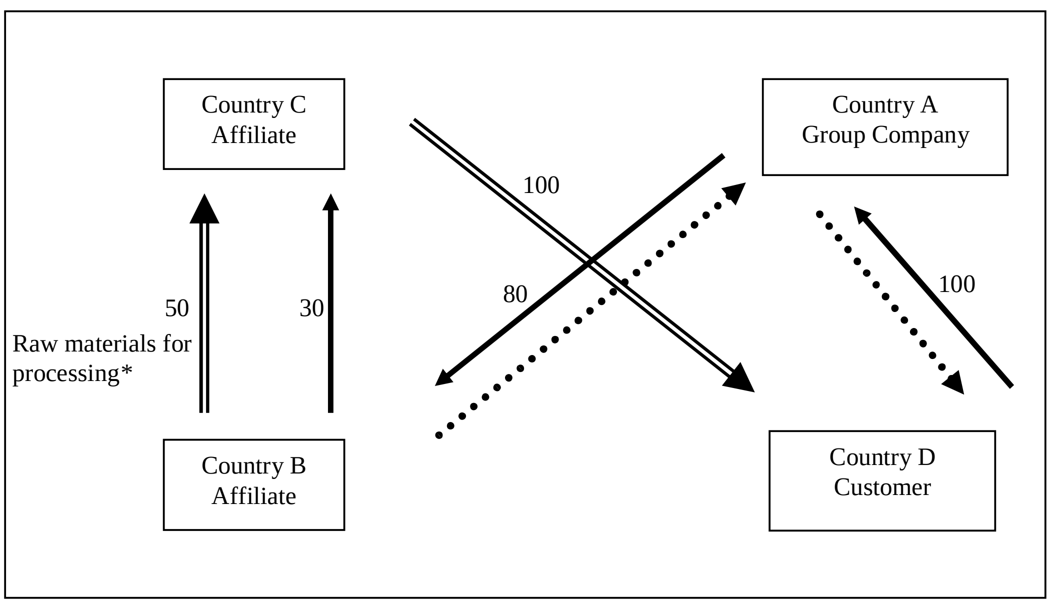
A. Global Manufacturing - Merchanting

33. BPM5 Par 199 and revised proposals in BPM6 par 10.63 are similar and differ on where the merchanting item is recorded i.e. goods or services

34. A group company resident in country A is contracted to deliver a finished product to a customer in country D. An affiliate of the company resident in country B supplies the raw materials to another affiliate in country C (goods for processing) who completes the production of this product required by the customer in country D. Ownership of the raw materials remains with B and B retains ownership of the finished product until it is exported to D. The merchanting element of these transactions comes into play once the good is exported the ownership passes to the company in country A and then passes to the customer following the sale of the product.

Box 3

Merchanting Activities within Global Manufacturing



* See BPM5 par.199 for current treatment and for proposed treatment see BPM6 draft presented at ECB Frankfurt on January 2008 par 10.60 -10.63

Table 2

Current recording and proposed recording BPM6 & SNA 2008

1993 SNA / BPM5 treatment				*2008 SNA / BPM6 treatment*			
Country	*Transaction Type*	*Credit*	*Debit*	*Country*	*Transaction type*	*Credit*	*Debit*
A	Services Merchanting	20		A	Goods (under merchanting)	100 -80	
	Cash & Deposits	80	100		Cash & deposits	80	100
B	Goods Exports	80		B	Goods exports	80	
	Services Goods under merchanting and other trade related		30		Manufacturing **services** on physical inputs owned by others		30
	Cash & Deposits	30	80		Cash & deposits	30	80
C	Services Goods under merchanting and other trade related	30		C	Manufacturing **Services** on physical inputs owned by others	30	
	Cash & Deposits		30		Cash & deposits		30
D	Goods		100	D	Goods		100
	Cash & Deposits	100			Cash & Deposits	100	
Global balance	Services merchanting	50	30	Global balance	Goods	100	100
					Of which Goods under merchanting	20	
	Goods	80	100		Services	30	30
	Cash & Deposits	210	210		Cash &Deposits	210	210

B. Merchanting of Goods - Current Practice versus New Proposals of BPM6 and SNA 2008[1]

35. The following example illustrates the basic principles of the present and proposed treatments. All transactions occur within a recording period, with the goods physically moving from Country B to Country C directly, and not entering into Country A. It is assumed that all transactions are settled by currency and deposits.

- Value of goods purchased by a resident of country A' from a resident of B' = 80
- Value of goods A' resells to a resident of C' = 100

[1] Taken from: Hidetoshi Takeda Merchanting, Update of the 1993 SNA - Issue No.41 Issues paper for the July 2005 AEG meeting.

Box 4
Merchanting

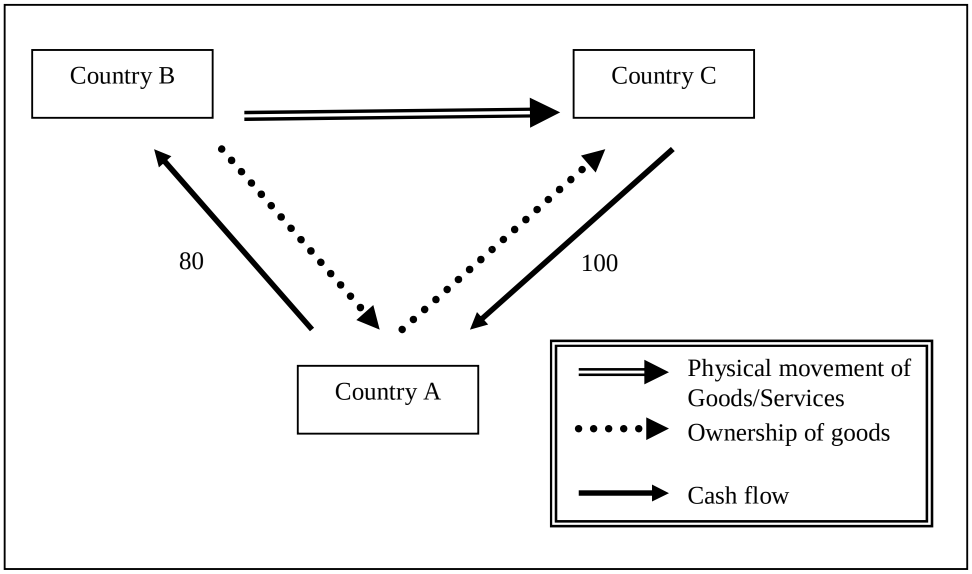


Table 3
Present treatment and proposed recording BPM6 & SNA 2008

1993 SNA / BPM5 treatment			*2008 SNA / BPM6 treatment*		
	Credit	*Debit*		*Credit*	*Debit*
Country A			**Country A**		
Services: Merchanting	20		Goods under merchanting	100	
Currency & deposits		20	Goods under merchanting	-80	
			Currency & deposits		20
Country B			**Country B**		
Goods	80		Goods	80	
Currency & deposits		80	Currency & deposits		80
Country C			**Country C**		
Goods		100	Goods		100
Currency & deposits	100		Currency & deposits	100	
Global balance*			**Global balance**		
Goods	80	100	Goods	100	100
Services:			Incl. Goods under merchanting	20	0
Merchanting	20				
Currency & deposits	100	100	Currency & deposits	100	100

* Merchanting is recorded only in the country A (the exporter of merchanting services). This causes global imbalances in goods and services as no debit entry in merchanting is recorded

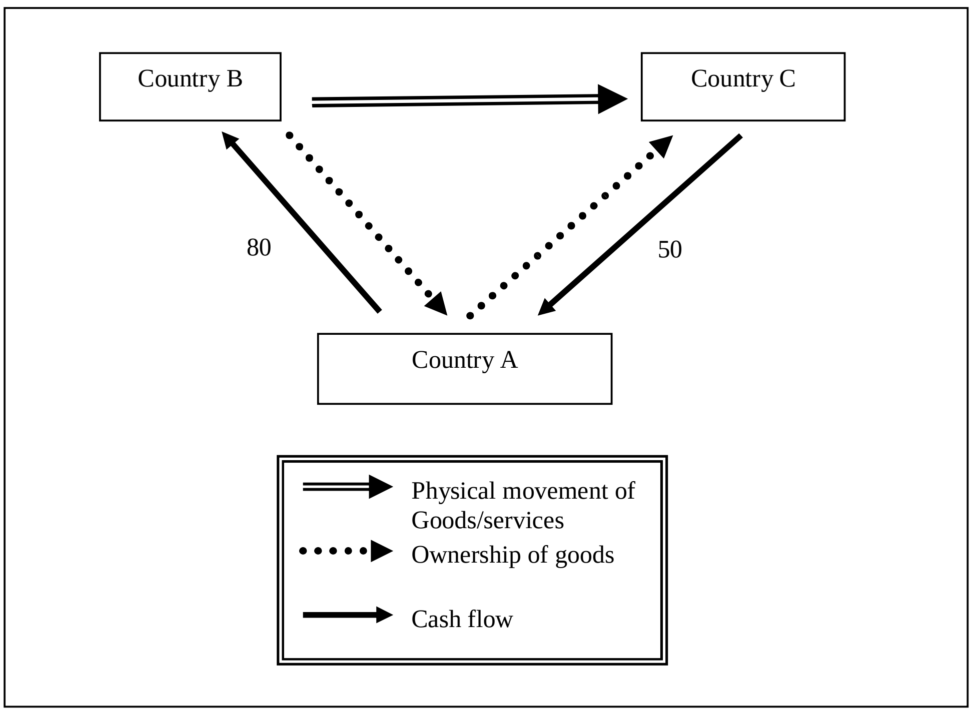
C. Holding Gains or Losses (Including Changes in Inventories)[2]

36. This case treats holding losses; the recording principles are the same for a holding gain.

37. The following example illustrates the principles of the present and proposed treatments if holding gains and losses occur. Before A' resells the goods to B', the price decreases by up to 30. All transactions occur within a recording period, with the goods physically moving from Country B to Country C directly, and not entering into Country A. It is assumed that all transactions are settled by currency and deposits. An analogous situation emerges when the purchase of goods occurs in period t and the sale of these goods takes place in period t+1 i.e. in period t we have negative exports and also in the National Accounts an increase in stocks is recorded. In period t+1 positive exports are recorded in the goods account and a reduction in stocks in the National Accounts.

- Value of goods purchased by a resident of country A' from a resident of B' = 80
- Value of goods A' resells to a resident of C' = 50

Box 5
Merchanting (holding gains and losses)



[2] Taken from: Hidetoshi Takeda Merchanting, Update of the 1993 SNA - Issue No. Issues paper for the July 2005 AEG meeting

Table 4
Present treatment and proposed recording BPM6 & SNA 2008

1993 SNA/BPM5 treatment			*2008 SNA/BPM6 treatment*		
	Credit	*Debit*		*Credit*	*Debit*
Country A			**Country A**		
Services: Merchanting	-30		Goods under merchanting	50	
				-80	
Currency & deposits	30		Currency & deposits	30	
Country B			**Country B**		
Goods	80		Goods	80	
Currency & deposits		80	Currency & deposits		80
Country C			**Country C**		
Goods		50	Goods		50
Currency & deposits	50		Currency & deposits	50	
Global balance			**Global balance**		
Goods	80	50	Goods	50	50
			Goods under merchanting	-30	
Services: Merchanting	-30				
Currency & deposits	80	80	Currency & deposits	80	80

D. Changes in Inventories - Transactions That Straddle Recording Periods

38. The following example illustrates the principles of the present and proposed treatments if transactions straddle the recording period. The value of the transactions is the same as in the basic case. However, resident of A purchases from the resident of B in time **t** and resells the goods to a resident of C in time ***(t+1)***. Goods physically move from Country B to Country C directly, and not entering into Country A. It is assumed that all transactions are settled by currency and deposits.

Box 6
Merchanting (when transactions straddle the recording period)

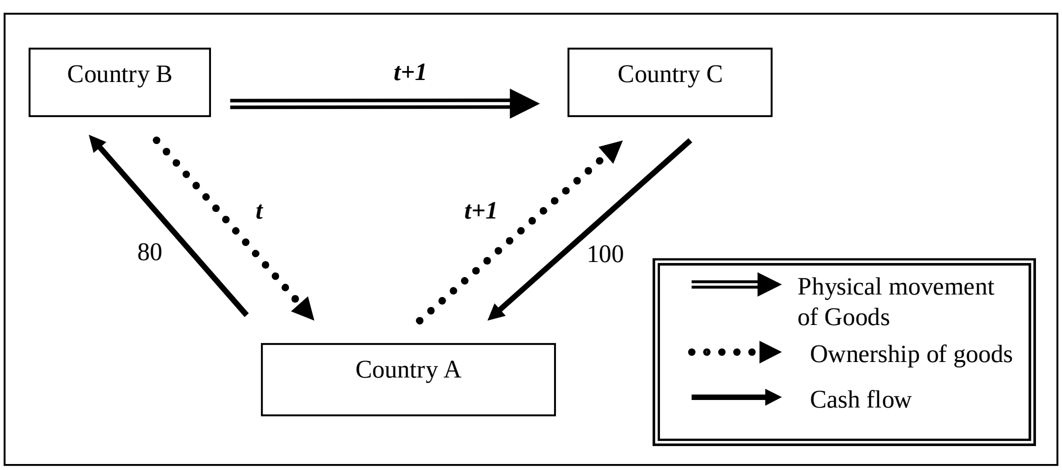


Table 5

Present treatment

a) period t	*Credit*	*Debit*	*b) period (t+1)*	*Credit*	*Debit*
Country A			**Country A**		
Goods		80	Goods		-80
			Services: Merchanting	20	
Currency & deposits	80		Currency & deposits		100
Country B			**Country B**		
Goods	80				
Currency & deposits		80			
Country C			**Country C**		
			Goods		100
			Currency & deposits	100	
Global balance			**Global balance**		
Goods	80	80	Goods		20
			Services: Merchanting	20	
Currency & deposits	80	80	Currency & deposits	100	100

Table 6

Proposed recording BPM6 & SNA 2008

a) period t	*Credit*	*Debit*	*b) period (t+1)*	*Credit*	*Debit*
Country A			**Country A**		
Goods under merchanting	-80		Goods under merchanting	100	
Currency & deposits	80		Currency & deposits		100
Country B			**Country B**		
Goods	80				
Currency & deposits		80			
Country C			**Country C**		
			Goods, debit		100
			Currency & deposits	100	
Global balance			**Global balance**		
Goods	0		Goods	100	100
Gods under merchanting	-80		Goods under merchanting	100	
Currency & deposits	80	80	Currency & deposits	100	100

E. Country Practice[3]

39. As outlined in the introduction to this chapter on Merchanting (Par 3), Ireland is one of the five most important countries for merchanting activities on account of its highly globalised economy. However, when recording Merchanting for Ireland, activities involving either the merchanting of goods together with associated services or just merchanting of services are included. This broader scope for merchanting activities is a

[3] References to CSO treatment of merchanting is based on : The Irish approach towards treatment of merchanting and related transactions by John Fitzpatrick , Prepared for the joint EFTA/UNECE/SSCU Seminar"Economic Globalisation: A Challenge for Official Statistics" 3-6 July 2007, Kiev, Ukraine

country specific treatment developed on account of the scale of these activities and also reflect the experience of CSO in a highly globalised economy.

40. The CSO approach in compiling these statistics on merchanting activities is fundamentally based on the recommendations of the BPM5 in relation to merchanted goods. However, certain significant modifications are made where considered necessary in the interest of the clarity and understandability of the results. These modifications were initially related to the treatment of services outsourced and delivered abroad in association with the supply of goods. However, they have recently been extended to the treatment of services out-sourced and delivered abroad where goods are not involved.

41. The main reason for CSO's adoption of this approach is to reduce the potential for statistical distortion arising from these very large transactions in both goods and services sourced and delivered abroad. Some statistical users, particularly trade associations or representatives, may be seriously misled by service export statistics which are significantly inflated where a gross recording of merchanted services is applied. It does not seem appropriate or meaningful to inflate the services exports and imports data by including such transactions, particularly when such large aggregate flows in the statistics presented are referenced against employment levels in a particular industrial activity in Ireland. In saying this, it is acknowledged that net recording by one compiler can lead to distortions or asymmetries where counterpart compilers may have no option but to record the transactions on a gross basis in their BoP statistics.

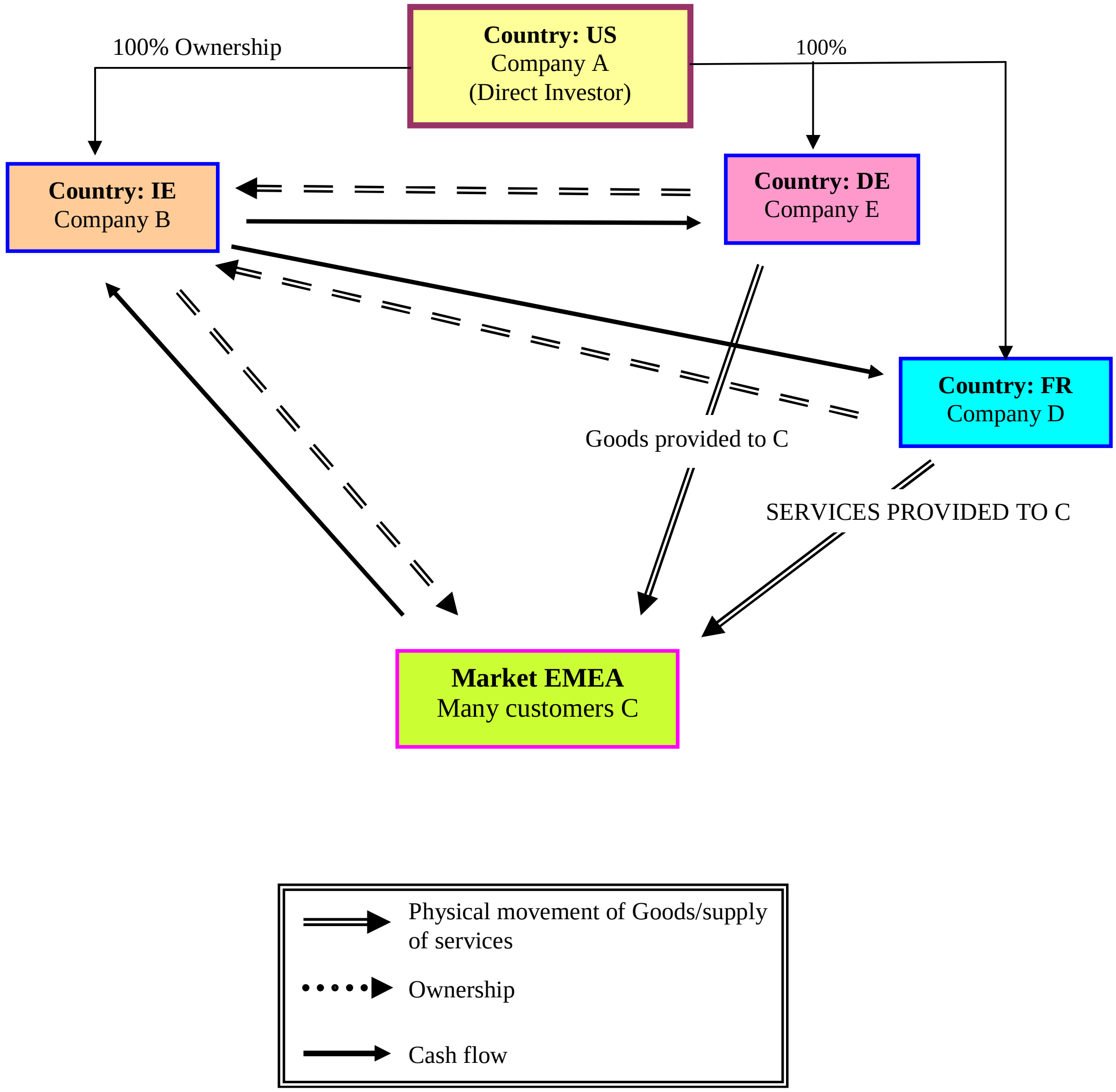
42. The treatments for outsourced services adopted by CSO and described below might be considered to be a departure from the recommendations of the international statistical standards. Moreover, while a gross treatment of outsourced services delivered to a non-resident customer may be implicit in BPM5, there appears to be no explicit discussion of such delivery of services in the Manual documentation or any explicit reference as to how the relevant transactions should be treated.

43. There are two examples set out below, the first relates to merchanting of goods and associated services and the second relates to merchanting of services only. The details are as follows:

1. Merchanting of Goods and Related Services

44. Consider the following fictitious situation (which is a simplified version of more complicated activities and practices). A foreign direct investment enterprise located in Ireland (B) is owned by a US investor (A). B in Ireland arranges for the supply, installation and maintenance of goods/equipment to a number of unrelated customers (C) in the Europe, Middle East and Africa (EMEA) market, as well as the provision of staff training programmes, etc. concerning the operation of the goods/equipment. The goods and services supplied are not sourced in Ireland by B. The goods/equipment are purchased for €2 billion by B from its affiliate (E) located in Germany while the various services are purchased for €3.5 billion from another affiliate D in France. The two affiliates deliver the goods and services to the customers (C). These customers pay B a total of €6 billion for the goods (€2.2 billion) and services (€3.8 billion) they receive. The Irish trader, B, records in its accounts all payments and receipts arising from the order. Figure 1 describes the situation.

Figure 1
Merchanting and related transactions



45. Under the BPM5 and other international recommendations, the above transactions would (normally) be recorded in the BoP statement under service imports and exports, with, in the case of the goods element, only the net margin (€0.2 billion) being recorded as a merchanting service credit. The related service transactions would appear under services: a credit of €3.8 billion and a debit of €3.5 billion (see Table 7 below).

Table 7

Recommended recording treatment (current recording regime)

BoP Item	*Credit* *€ million*	*Debit*	*Net*
Merchanting service	200		200
Other services	3,800	3,500	300
Total	4,000	3,500	500

46. As both the goods and services delivered to the EMEA customers (C) have been sourced from and delivered by a non-resident of Ireland (i.e. a French D and a German E foreign affiliate of the Irish entity B), the CSO treats the combined transactions for goods and services described above on a net basis. It records the overall net margin of €0.5 billion as a credit (service export) under merchanting services in the 'Services' part of the BoP Current Account (see Table 8).

Table 8

CSO, Ireland recording treatment

BoP Item	*Credit* *€ million*	*Debit*	*Net*
Merchanting services	500		500
Other services	-		-
Total	500		500

47. The new proposals for treatment of merchanting do not allow for the merchanting of services and hence Table 9 reflects what the recording of these transactions in goods and services would be for BPM6 and SNA93 Rev.1.

Table 9

Recommended recording treatment -BPM6/ SNA 2008

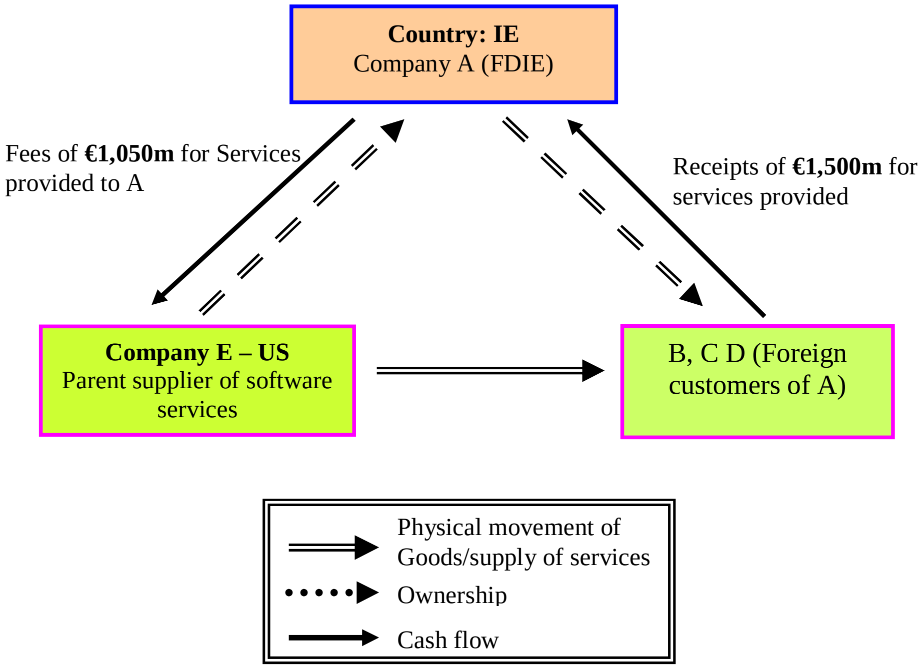
BoP Item	*Credit* *€ million*	*Debit*	*Net*
Goods - Merchanting	2200 -2000		200
Other services	3,800	3,500	300
Total	4,000	3,500	500

2. Merchanting of Services

48. For example, an Irish resident Foreign Direct Investment Enterprise, A has EMEA customers located abroad in countries B, C and D. A purchases the software services from its parent in the US and supplies these services valued at €1,500m (€500M each) to such customers. Invoices are issued from the parent on behalf of A i.e. A essentially invoices all of the customers B, C and D for €350m each totaling €1,050m. A records all turnover and expenditure as well as the profits generated. Figure 2 describes the situation.

Figure 2

Treatment of receipts and expenditure of Irish FDIE for services partly provided by foreign affiliates



49. The CSO records the above transactions in its BoP statement as shown in Table 10.

Table 10

CSO, Ireland recording treatment for merchanted services

BoP Item	*Credit* *€ million*	*Debit*	*Net*
Merchanting services	450	-	450
Profits		450	-450
Total	450	450	0

50. The €450m recorded under merchanting services results from the netting of A's services imports of €350m paid to the US parent with the services exports totalling €1500m. We assume that the operation in IE is little more than a "brass plate" and local costs approximate zero. The merchanting surplus goes entirely to profits earned and are attributed to the US parent. If we applied the proposed treatment for merchanting to this example the result would be as follows:

Table 11
BPM6/SNA 2008 recording treatment for this example

BoP Item	*Credit € million*	*Debit*	*Net*
Other services	1500	1050	450
Profits		450	-450
Total	1500	1500	0

51. The example shows (as has been argued in this paper), that a net treatment for the recording of transactions in merchanting of services is appropriate. This is particularly important if the resident entity is the 'principal' enterprise within a multi-national group through which the receipts and expenditure of the various affiliates are routed, because a change in this arrangement can have a significant impact on the data before and after the change. If, for example, the ultimate parent company decides to no longer have the resident entity as the 'principal' but to transfer this role to an affiliate in another country then significant discontinuities can result in the service data and the profit/loss when the change occurred. A net treatment limits the extent of the discontinuity.

VII. Conclusion

52. BPM6 and SNA 2008 guidelines for the recording of merchanting activities address the shortcomings in the treatment of these activities in BPM5 and by extension in SNA 93. These shortcomings relate to the global additivity of the goods account and the treatment of inventories and holding gains and losses. BPM6 also recognises the issue of merchanting of services and its recording in the Balance of Payments. However, the recommended approach for the "merchanting of services" is a gross treatment under the relevant services category, the manual goes on to allow for a net presentation of these services related activities on a supplementary basis. This recommendation goes some way towards recognising the impact of globalisation and the consequent increase in the importance of telecommunications and web enabled (internet)services and the impact that these developments will have on trade in services in general but also on the merchanting of services.