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MERCHANTING

Note by Central Statistics Office, Ireland[1]

Summary

The paper will consider recent discussions at international fora associated with the revision of the System of National Accounts 1993 (SNA 93 Rev.1) and the sixth edition of the Balance of Payments Manual (BPM6) as they relate to merchanting activities. The paper will firstly cover how the treatment of merchanting activities has developed looking back as far as the first edition of the Balance of Payments Manual and to previous editions of the SNA. It will then synopsise the current international discussions where the emphasis seems to be on treating merchanting as an activity involving transactions in goods exclusively whereas it is shown that over time the BPM and the SNA appear to have considered the possibility of the merchanting of services in addition to that of goods. The approach to the treatment of merchanting followed in Central Statistical Office (Ireland) is outlined including situations where a considerable amount of services based merchanting transactions are recorded in the BOP under Business Services (merchanting). The paper concludes by emphasising the growing importance of merchanting of services and the implications of adopting new proposals for the recording of merchanting of goods exclusively in the goods account.

[1] Prepared by Michael Connolly, Central Statistics Office of Ireland at the invitation of the UNECE secretariat.

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I. INTRODUCTION

1. The statistical treatment for Merchanting is defined in Balance of Payments Manual, fifth edition (BPM5) as follows[2] :
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…
(In this definition it is clear that no possibility of merchanted services is being considered).

2. The recording requirements for merchanting activities are remarkably straightforward. Merchanting is calculated as being the difference between the value of goods when acquired by the merchant and the value when the goods are sold. 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 compiling country and are therefore not covered by the official trade statistics.

II. BACKGROUND

3. Historically, merchanting involved transactions in goods associated with commodity trading. However, this activity now takes a different form where 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.

4. The treatment of merchanting also covers international wholesale/retail activities where the merchant is earning the margin by purchasing wholesale from one non-resident supplier and selling to another non-resident retailer/distributor. Compared to commodity trading this activity is, relatively speaking, a more recent phenomenon.

5. At present we find merchanting activities also include aspects of global manufacturing (see appendix 1 for an example) where such activities aim to make profits from sourcing goods from one non-resident affiliate (the manufacturer) and selling them 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.

6. The three activities described above (commodity trading, retail/wholesale and global manufacturing) normally involve the merchanting of goods. However, to complete the picture, at least as it relates to the recording of merchanting in Ireland's Central Statistical Office (CSO), the following activities should also be included. These involve either the merchanting of goods and associated services or the merchanting of services:

(a) The booking of receipts and expenditure by an enterprise in a compiling economy in respect of transactions of its affiliates in other economies (see appendix 5). Services

[2] IMF Balance of Payments Manual, Fifth edition 1993 par 262

which are sourced abroad by a resident trader and associated with the supply of merchanted goods to a customer resident abroad, and then delivered to the customer by a non-resident entity are currently included on a net basis under merchanting in the Services account.

(b) The outsourcing of services (abroad) delivered to a non-resident customer where the situation involves transactions in services which are not associated with the supply of goods (see appendix 6). *These services are provided to foreign customers by foreign affiliates of a resident enterprise and all receipts and expenditure are recorded in the books of the resident operation. It seems appropriate to apply a net treatment for recording the relevant transactions of the resident enterprise. If, within a multi-national group, the resident entity is the 'principal' through which the receipts and expenditure of the various affiliates are routed, then 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.*

III. STATISTICAL TREATMENT

9. 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.
Activities described in the previous section are recorded under the heading of Merchanting in the BOP or National Accounts once they meet the relevant criteria.

10. In the five editions of the Balance of Payments Manual, we see merchanting activities initially classified under "*transactions in merchandise abroad*"[3] and subsequently under "*intermediary trade*"[4] 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:

[3] IMF Balance of Payments Manual, Second edition, January 1950 p19 Table II(c)
[4] IMF Balance of Payments Manual, Third edition, July 1961 paragraph 472, 137,157

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 Income**	Other Goods Services and Income
BPM 5th Edition - 1993	**Record net under Services**	Business Services

11. For National Accounts, the treatment of merchanting follows the same approach as that of the BPM and is outlined in the SNA'93 paragraph 14.60 as follows:

…...the third exception 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.…..

12. 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".*

13. It can be seen that the thinking behind the instructions in the BPM for the recording of Merchanting has changed from net to gross recording and back again to net. Moreover, it is surprising to see that the same argument currently being put forward in relation to recording merchanting in the goods account was already outlined 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*[5]*."* 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 can be seen in the instructions to record merchanting under services in BPM5.

[5]IMF Balance of Payments Manual, Third Edition 1961 p. 43 par.(4)

A. CSOs Approach to Merchanting of Services[6]

14. For the sake of clarity it should be noted that the CSO approach 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 initially related to the treatment of services outsourced and delivered abroad in association with the supply of goods. They have recently been extended to the treatment of services out-sourced and delivered abroad where goods are not involved.

15. 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.

16. The treatments for outsourced services adopted by CSO and described in Appendices 5 & 6 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. The Manual on Statistics of International Trade in Services[7], however, does refer to the requirement for gross recording of services purchased by the merchant connected to the delivery of the merchanted goods (e.g. transport, insurance, etc.). Similarly, there appears to be very little guidance on the treatment of goods and services provided by affiliates abroad but invoiced by a resident enterprise.

B. International Discussions and Difficulties with the Current Treatment

17. Merchanting has been extensively discussed in various fora as part of the drafting of SNA93 Rev.1 and BPM6. These fora include the Advisory Expert Group on National Accounts (AEG), Intersecretariat Working Group on National Accounts (ISWGNA) Balance of Payments Technical Expert Group (BOPTEG), IMF Balance of Payments Committee (BOPCOM) and Interagency Task Force on Statistics of International Trade in Services (ITFSITS).

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[6] 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

[7] UN Manual on Statistics of International Trade in Services 2002 p48 box 6

18. These 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., merchanting services are recorded only in the economy in which the merchant is resident, whereas the non-resident counterparty compiler records the related transactions in the goods account. This method of recording merchanting activities results in a global imbalance in the goods account and creates an asymmetry. See Appendix 2[8] for a full discussion of this issue.

(b) The treatment is inconsistent with inventories data and balance sheets both for the merchant and for supplier. 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 they may not be recorded in the statistical aggregates as owned by the merchant in its balance sheet, 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[9] and BPM5[10], the actual implementation of the proposals 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, then receives gross payment from another, and these gross transactions are recorded in the Financial Account.

(d) The valuation principles are not consistent with supply and use tables. 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.

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

[9] 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…*

[10] 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*

(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.

C. Proposals for Merchanting in BPM6 and SNA93 Rev.1

25. The revised treatment for merchanting has not yet been finalised for incorporation in the SNA 93 Rev.1 and the forthcoming BPM6. However recent documents from the IMF[11] and postings to the SNA 93 Rev.1 database[12] give draft recommendations and can be summarised as follows:

(a) The proposed treatment will apply to merchanting of goods only;

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

(c) The sale of goods is to be shown under goods sold under merchanting as a positive export of the economy of the merchant;

(d) The difference between sales and 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;

(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.

26. The proposals can be summarised as requiring merchanting transactions in goods to be recorded in the Goods Account rather than the Services Account (current recording convention) in the BOP and the Expenditure Method of calculating GDP. The recording requirement is gross, however all recording both of purchase and sale is on the credit (export) side with purchases being recorded as negative exports. In the supply and use tables the net surplus earned by the merchant is shown as a service.

D. Impact of the New Proposals

27. The extent to which the new proposals resolve the difficulties associated with the current recording regime 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

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[11] Draft Sixth Edition of the IMF's *Balance of Payments and International Investment Position Manual – Presented at ECB Frankfurt January 2008*

[12] *Issue 41 – Merchanting (Final draft) UN Statistics website for revision of SNA 93 - January 2008*

in Appendix 2 where we review the treatment based on the current approach and the new proposals.

(b) *The treatment is inconsistent with inventories data and balance sheets both for the merchant and for supplier.* If we consider the bullet point (d) above in the new proposals 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 proposals should resolve the difficulties with inventories and holding gains (see Appendices 3&4[13]).

(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 exports of goods 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.* In the details of the proposals there is discussion on the economic nature of merchanting and includes the three headings discussed earlier in this paper :

(i) *Commodity Dealers*
(ii) *International Wholesale / Retail*
(iii) *Global manufacturing*

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

E. Difficulties with the Proposed Treatment – Extension of the Treatment to Cover Merchanting of Services

28. The new proposals, 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. However, to the extent that merchanting activities relate to the merchanting of services, the new proposals may create some new difficulties. Firstly under the BPM6 proposals, there will no longer be a services category labeled "merchanting." If services are sourced and delivered in a merchanting type arrangement how can the merchanting of services be recorded in the goods account? 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[14] …..

29. Therefore as far back as 1961 the merchanting of services was being considered in addition to the merchanting of goods. CSO considers this is a legitimate view and is supported by the nature of some activities captured in our Balance of Payments compilation system and in our approach to the compilation of merchanting activities.

30. Regrettably, it seems as if the current debate on merchanting never really looked beyond the merchanting of goods. It might also be said that merchanting of services and services type activities in general are an area where considerable growth in activity is expected over the coming years. 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[15]:

……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.

31. As part of this so called third era of globalisation we have seen an explosion in the merchanting of services through outsourcing enabled by innovations in telecommunications and the internet.

32. In this context it was interesting to see the most recent proposals for merchanting included in the draft BPM6 recently circulated do include some reference to the merchanting of services. In paragraph 10.146 of the draft BPM6 the following is outlined:

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[14] IMF Balance of Payments Manual, Third edition, July 1961 Par. 472
[15] 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

Services, particularly business services, may be purchased and resold. It is similar in concept to merchanting of goods. ……..Service merchanting of this kind is a small but growing activity in some economies…….

33. The recording requirement is a gross recording approach and it goes on to say “net data could be provided on a supplementary basis.”

34. In our view this doesn’t really address the issue as argued in this paper. The scale of the gross flows involved in this type of merchanting activity, for Ireland at least, warrant a net treatment under a separate classification in Business Services. In our view as compilers this would represent a practical and pragmatic approach to a particularly difficult aspect of international trade in goods and services.

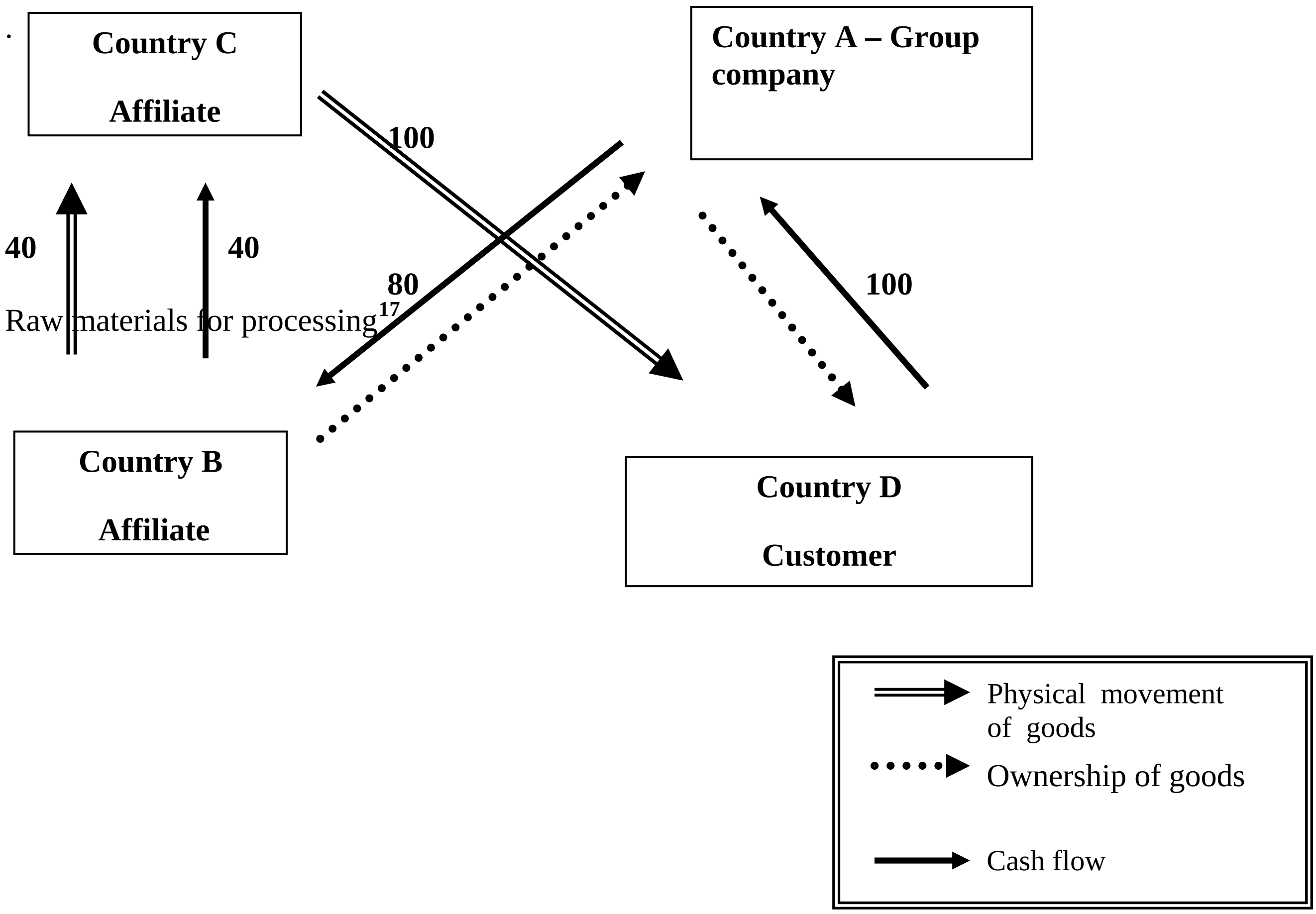
IV. CONCLUSION

35. The international recommendations for the statistical recording of merchanting activities being finalised at present do not consider the possibility of merchanting of services and its recording in a sufficiently meaningful way. This misses, as has been argued, some major developments in how companies trade. In particular we instance the increasing importance of telecommunications and the internet and the impact that these developments will have on trade in services in general but also on the merchanting of services. It is clear that the thinking at IMF and UN has changed over time in relation to merchanting activities. The merchanting of services is spoken of as early as 1961 in BPM3, consequently it is difficult to understand the extent of the focus on merchanted goods in the current proposals or conversely the extent to which the merchanting of services has been overlooked or ignored. In one sense one could even argue that the developments in derivatives markets are reducing the importance of merchanting of goods and the focus in the manuals for this activity should now be directed more on services. It should be remembered that merchanting of services falls within the definition of merchanting, i.e. the purchase of a service by a resident from a non-resident and the resale of this service to another non-resident. Therefore, in the context of more meaningful statistics the manuals should cater for merchanting of services along with merchanting of goods. This would be facilitated by allowing the inclusion of the merchanting of services under Business services on a net basis. Merchanting of goods should follow the recommended treatment outlined in BPM6 and SNA 93 Rev.1, and be recorded gross under exports in the goods account.

APPENDIX 1.

GLOBAL MANUFACTURING[16] - MERCHANTING

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. 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.



[16] 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

[17] 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

Current recording **Proposed recording BPM6 & SNA Rev.1**

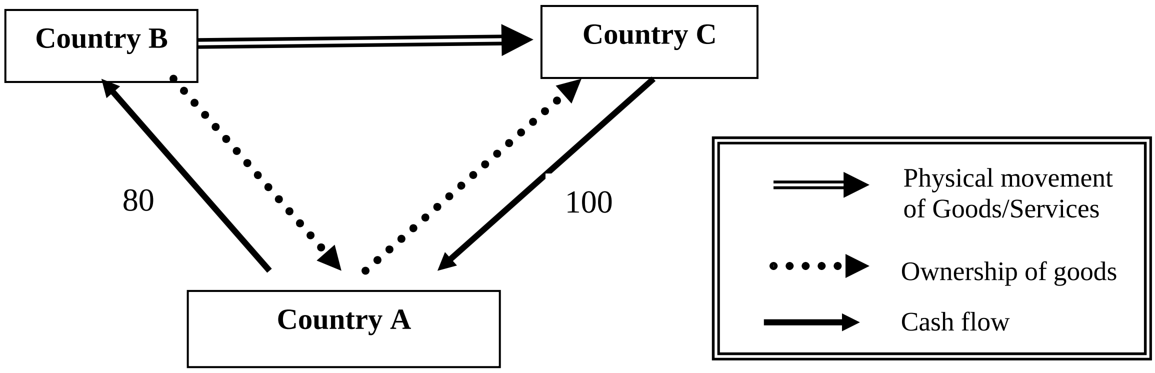
		Credit	Debit				Credit	Debit
A	Services Merchanting Cash & Deposits	20	100 -80		A	goods (under global manufacturing) Cash & deposits	100 -80	100 -80
B	Goods Exports Services Goods under merchanting and other trade related Cash & Deposits	80	40 40		B	Goods exports goods (under global manufacturing) Cash & deposits	80	40 40
C	Services Goods under merchanting and other trade related Cash & Deposits	40	40		C	Manufacturing services on physical inputs owned by others Cash & deposits	40	40
D	Goods Cash & Deposits	100	100		D	Goods Cash & Deposits	100	100
Global balance	Services merchanting	60	40		Global balance	Goods Goods under merchanting	140 60	140 40
	Goods Cash & Deposits	80 100	100 100			Cash &Deposits	100	100

APPENDIX 2. [18]

MERCHANTING OF GOODS - CURRENT PRACTICE VERSUS NEW PROPOSALS OF BPM6/SNA 93 REV.1

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



Present treatment

	Credit	Debit
Country A		
Services: Merchanting	20	
Currency & deposits		20
Country B		
Goods	80	
Currency & deposits		80
Country C		
Goods		100
Currency & deposits	100	
Global balance[19]		
Goods	80	100
Merchanting	20	
Currency & deposits	100	100

Proposed recording BPM6 & SNA Rev.1

	Credit	Debit
Country A		
Goods under merchanting	100	
Goods under merchanting	-80	
Currency & deposits		20
Country B		
Goods	80	
Currency & deposits		80
Country C		
Goods		100
Currency & deposits	100	
Global balance		
Goods	100	100
Goods under merchanting	20	0
Currency & deposits	100	100

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

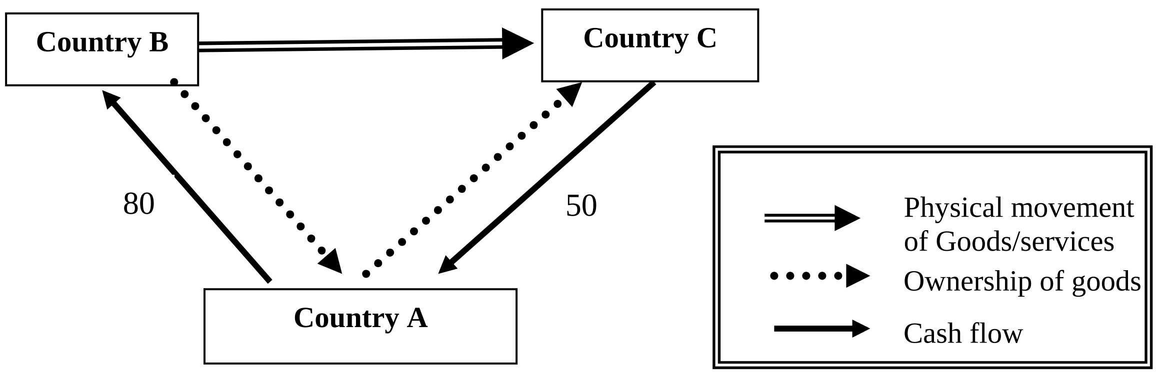
[19] Merchanting is recorded only in the country A (the exporter of merchanting services). This causes global imbalances in goods and services as no debit entry in merchanting is recorded.

APPENDIX 3. [20]

HOLDING GAINS/LOSSES (INCLUDING CHANGES IN INVENTORIES)[21]

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 analagous 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



Present treatment	**Credit**	**Debit**	**Proposed recording BPM6 & SNA Rev.1**	**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

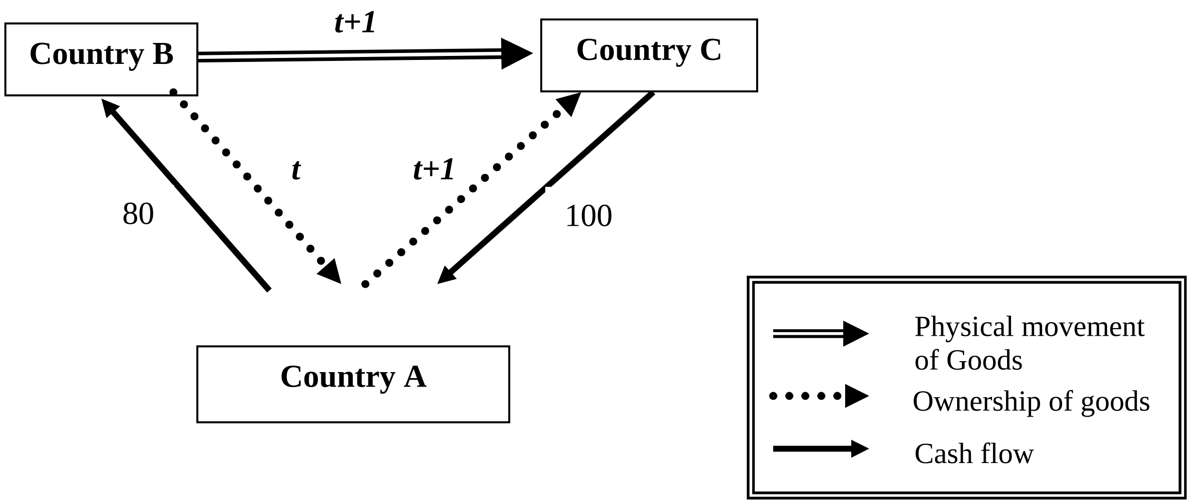
[20] Taken from: Hidetoshi Takeda Merchanting, Update of the 1993 SNA - Issue No. Issues paper for the July 2005 AEG meeting

[21] The above case treats holding losses; the recording principles are the same for a holding gain.

APPENDIX 4.

CHANGES IN INVENTORIES - TRANSACTIONS THAT STRADDLE RECORDING PERIODS

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.



Present treatment

a) period t	**Credit**	**Debit**
Country A		
Goods		80
Currency & deposits	80	
Country B		
Goods*	80	
Currency & deposits		80
Global balance		
Goods	80	80
Currency & deposits	80	80

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

Proposed recording BPM6 & SNA Rev.1

a) period t	Credit	Debit
Country A		
Goods under merchanting	-80	
Currency & deposits	80	
Country B		
Goods	80	
Currency & deposits		80
Country C		
Global balance		
Goods	0	
Goods under merchanting	-80	
Currency & deposits	80	80

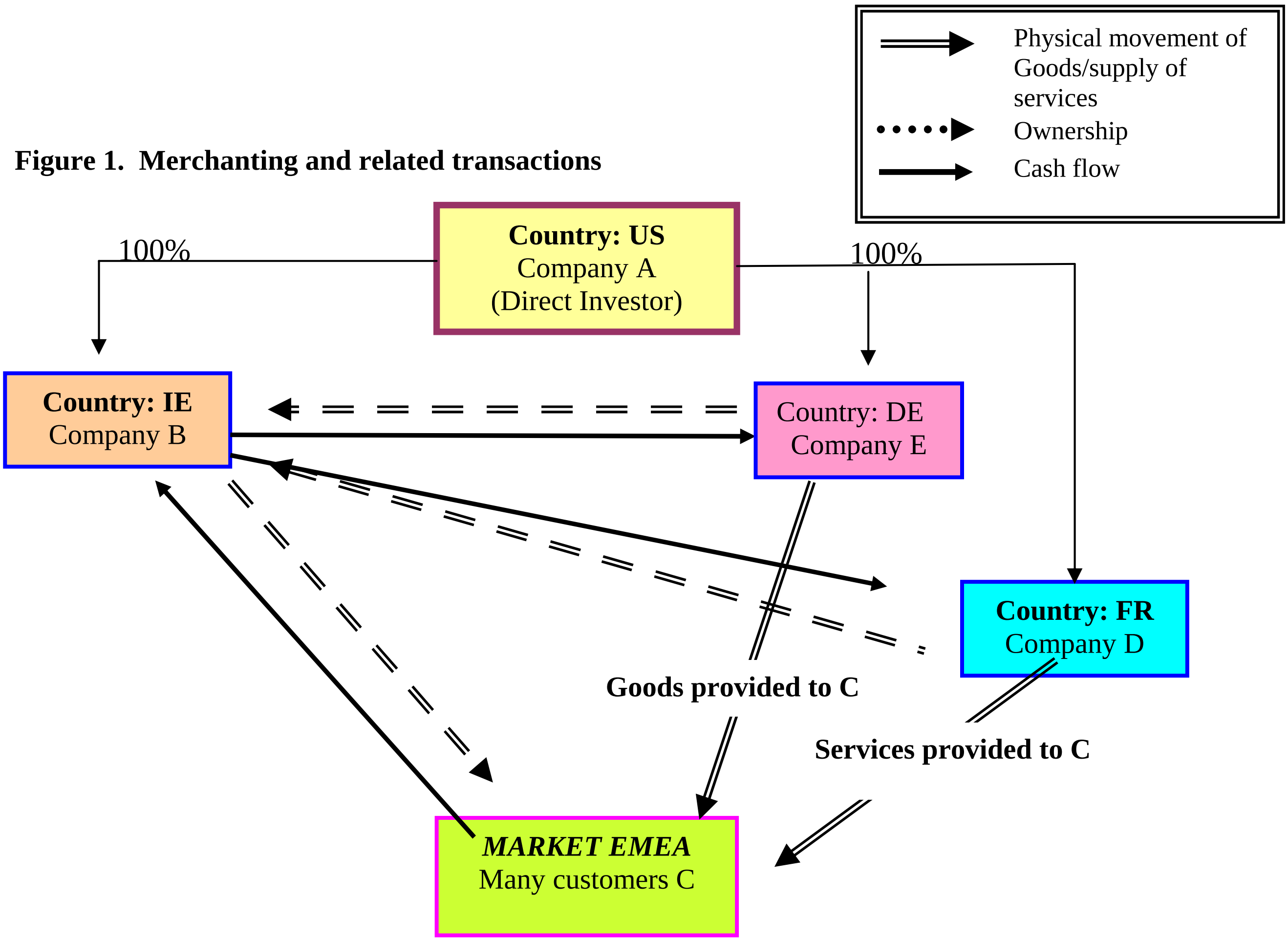
b) period (t +1)	Credit	Debit
Country A		
Goods under merchanting	100	
Currency & deposits		100
Country B		
Country C		
Goods, debit		100
Currency & deposits	100	
Global balance		
Goods	100	100
Goods under merchanting	100	
Currency & deposits	100	100

APPENDIX 5. [22]

MERCHANTING OF GOODS AND SERVICES

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



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[22] Taken from : 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

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 1 below).

Table 1. Recommended recording treatment (current recording regime)

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

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 2).

Table 2. CSO, Ireland recording treatment

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

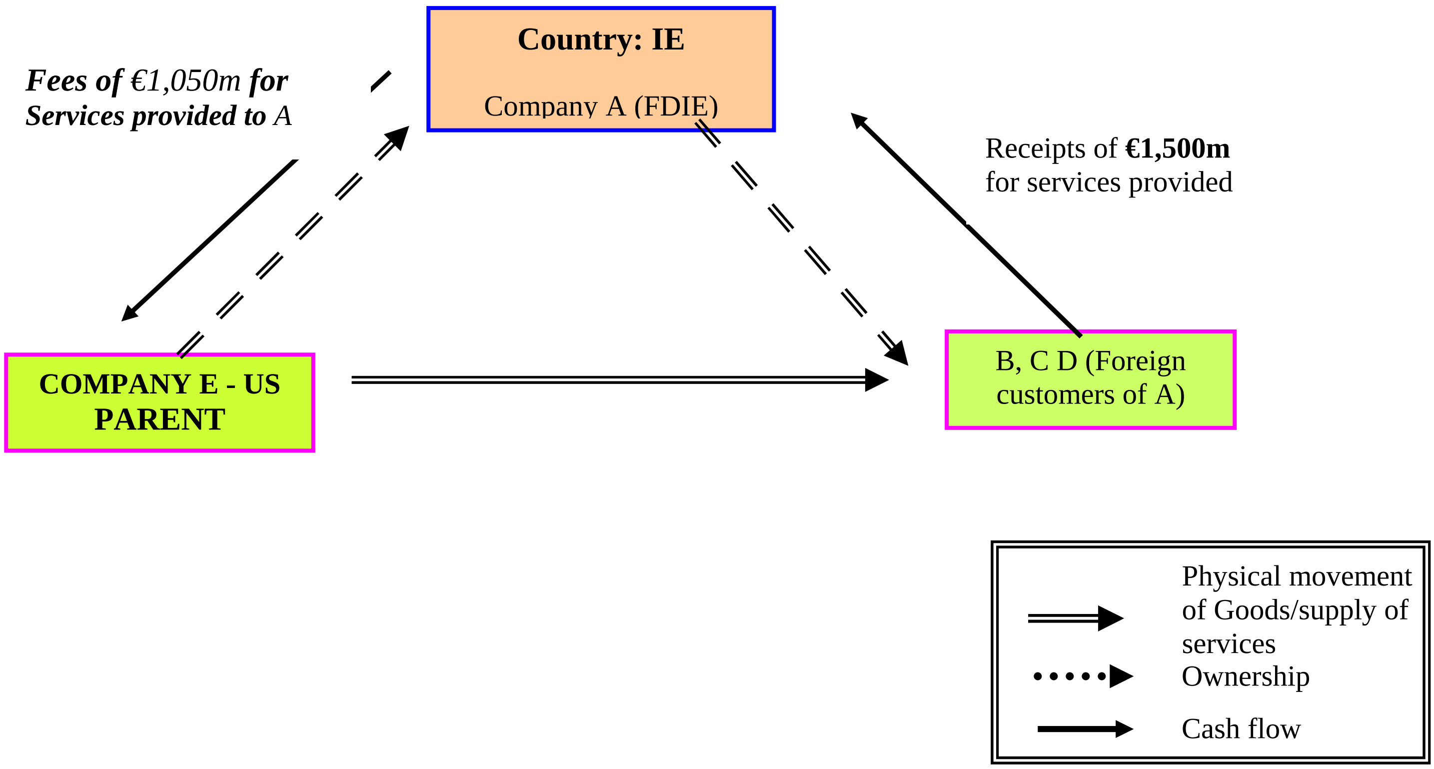
The new proposals for treatment of merchanting do not allow for the merchanting of services and hence Table 1 reflects what the recording of these transactions in goods and services would be for BPM6 and SNA93 Rev.1.

APPENDIX 6.

MERCHANTING OF SERVICES

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 totalling €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



The CSO records the above transactions in its BoP statement as shown in Table 3.

Table 3: CSO, Ireland recording treatment for merchanted services

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

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 4. BPM6/SNA 93 Rev.1 recording treatment for this example

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

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.

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