Recording Factoryless Goods Production Arrangements in the National Accounts

Task Force on Global Production

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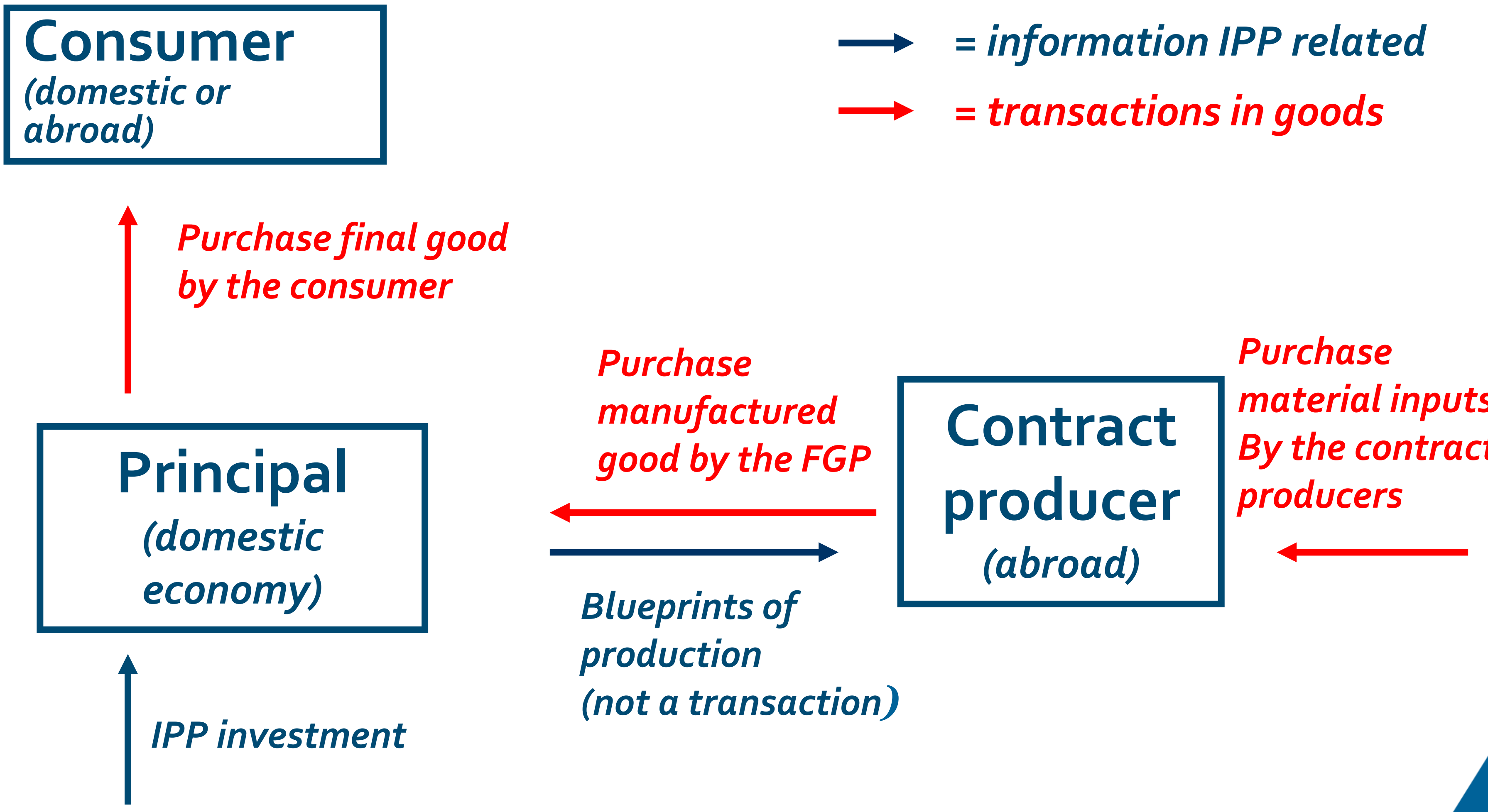
2008 SNA and BPM6

- Began to tackle the difficulties raised by new forms of global production
  - With new accounting rules for *goods sent abroad for processing* and *merchanting*, reflecting a strict interpretation of the change of ownership principle
  - with further implementation guidelines developed by Globalisation in the National Accounts and more recently the TFGP's Guide to Measuring Global Production.

Typology of Global Production

- The Guide lays out a typology
  - Goods sent abroad for processing
  - Goods under merchanting
  - Factoryless goods production
- But, it appears that further guidelines are needed on factoryless goods production

A factoryless goods producer arrangement



The issue - Classification

- ISIC guidelines provide detailed recommendations for units that outsource the entire production process:

- *A principal who completely outsources the transformation process should be classified into **manufacturing** if and only if it owns (some of) the input materials to the production process—and therefore owns the final output. …..(goods sent abroad for processing arrangements)*

- *A principal who completely outsources the transformation process but does not own the input materials is in fact buying the completed good from the contractor with the intention to re-sell it. Such an activity is classified in Section G (**wholesale and retail trade**), specifically according to the type of sale and the specific type of good sold……(merchanting)….*

- ***An outdated view of production?***

Factoryless goods producers: why defined narrowly?

- A unit (principal) that is factoryless in nature (i.e., does not maintain a manufacturing plant) may or may not own material inputs
- However, TF focuses on the narrow view because units that do not maintain a manufacturing plant but **own material inputs** are already considered as **manufacturers** by ISIC
- TF defines factoryless goods producers (narrowly)
  - Units (principals) that **control** the outcome of production of a good by undertaking the entrepreneurial steps and **supplying inputs of intellectual property** products (IPPs), concentrating on innovation and marketing decisions. FGPs usually **control** access and delivery of the final output to consumers and do not purchase nor supply any material inputs into the production process.

The role of intangible capital

- ....often the considerable part of the value of the final product ......with the value added through pure distribution activities only marginal

And so….

- The TF took the view that FGPs should not be classified as distributors but instead took a ‘contemporary’ view of production

    ….the value of a good increasingly reflects the underlying IP

    ….the business of the FGP is fundamentally about producing the good

    …ergo the FGP is a **manufacturer**

To be or not to be….

- However, the TF view implies changes to the framework and so, for now, the **guidance remains as is**…with **FGPs classified to distribution sectors**…
- ….But…..recognising that FGPs differ from conventional distributors, the TFGP recommends that FGPs are shown as a **separate ‘of-which’** item.

Defining FGPs

- …substantive IPP investors…
- more than 50% of value added originates on **IPP activities** such as R&D and design, innovation, supply chain management, including activities related to **non-produced assets**, such as market research and marketing.
- Because a company **must be a substantive IPP investor** most companies that are only involved in branding would be excluded.

Identifying FGPs in practice

- A significant investor in IP (either via production or acquisition)
- A higher than average 'trade' margin
- A staff profile that is far from the norm
  - Researchers, higher average salaries etc.

FGPs as manufacturers….issues and consequences

- Output of the FGP; good or trade margins?
- Output of the contract producer under a factoryless arrangement; a good or a service?
- Recording of international trade flows?

Output of the FGP; good or trade margins?

- Special case of manufacturing;
- Which implies the FGP's main activity is connected to physical transformation (providing the blueprints);
- BPM6 (par.10.42): merchant as organiser of a global manufacturing process.....
- IPP services dominate substantially the value added of FGPs which exceeds the notion of a trade margin

→ ***The FGP's output is a good***

Purchases from the contract producer are intermediate consumption

Output of the contract producer under a factoryless arrangement; a good or a service?

- The contractor
  - The contact producer faces additional risks with regard to input prices and holding inventories.
  - But doesn't 'control' the process
  - In economic terms the contract producer's output differs from the final consumer good (however, not in physical terms)
- A thorny issue….with a majority of the TF opting for the contractor **is not a processor….**

→ ***The output of the contractor is a good (and not a service)***

Recording of international trade flows

Recording of international trade flows

2 options:

1. Goods under general merchandise?
2. …or net exports of goods under merchanting?

- Net recording does not align very well to a gross recording of output and intermediate consumption
- BPM6, par.10.42 (referring to merchanting) does not really apply to FGPs

→ ***The international flows are to be recorded under general merchandise***

A summary of recommended decision points if FGPs are to be considered manufacturers (in future international standards):

- Output of the FGP reflects full value of the manufactured good;
- Contractor owns the good prior to being transacted;
- The international flows are to be recorded under general merchandise;
- Delineating FGPs from traders: FGPs are substantive IPP investors and >50% of value added is connected to IPP, innovation, supply chain management and marketing;

Conclusions

- The Guide presents FGPs as a (special case) of distributers, following the current international standards

Future work:

- Flag for FGP activity is needed to help better track these activities
  - Need support from classification and business register experts in developing more precise criteria
- Collect more practical experience
- A need for more elaborate guidelines for FGPs
- and potentially, future changes to international standards…