SNA/M1.13/08

8th Meeting of the Advisory Expert Group on National Accounts,
29-31 May 2013, Luxembourg

Agenda item: 08
Topic: The treatment of freight and insurance in international trade

Introduction

It has been pointed out that the 2008 SNA and BPM6 differ in the way freight and insurance are treated in recording international trade in goods. Both manuals recommend valuing export of goods at Free On Board (FOB) value. It seems that the 2008 SNA did not fully reconcile the FOB principle for valuation of exports with the principle of output valuation at basic prices. The 2008 SNA explains the treatment of freight and insurance costs associated with imports and valuation of imports of goods at FOB in more detail compared to the 1993 SNA. However, its recommendation that “the question of whether the value of goods covers the cost of transportation or not depends on whether the exporter or importer is responsible for transport (2008 SNA, paragraph 14.68)” is not consistent with the FOB valuation of export. There is a need for clarifying and articulating the treatment of freight and insurance, output valuation at basic prices, and the FOB valuation of exports in the 2008 SNA.

Guidance on documentation provided

A paper on the treatment of freight and insurance in international trade is attached

Main issues to be discussed

The AEG is requested to express its views on the treatment of freight and insurance in international trade.

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Treatment of Freight and Insurance in International Trade

Introduction

Both the *System of National Accounts 2008* (2008 SNA) and the latest (6th) edition of the *Balance of Payments and International Investment Position Manual* (BPM6) record international transactions in goods crossing borders free on board (FOB) at the customs frontier.

- In the 2008 SNA, change of ownership is used throughout for accrual of transactions in goods between units that are resident in the same economic territory. This means the date and value of recording are determined at the point of change of ownership. Thus, recording of international transactions in goods in the 2008 SNA is an exception from the change of ownership accrual principle used elsewhere in the system.

- In the BPM6, the change of ownership principle has been used to justify a new (compared with BPM5 and the 1993 SNA) treatment of goods for processing as well as of goods merchanting; these new treatments also have been incorporated into the 2008 SNA. Transactions in goods crossing borders are still recorded FOB, but paragraph 10.43(d) of BPM6 further states that "Merchanting entries are valued at transaction prices as agreed by the parties, *not FOB*" (italics added).

When data are acquired from surveys of enterprises, including for international goods transactions, change of ownership accrual is broadly the basis of the source information. This type of source is typical of trade between member states of economic and customs unions, as in, for example, the Intrastat system for tracking trade between member states of the European Union. However, the principal source of data for goods transactions between countries not belonging to economic and customs unions is customs clearances, which set recording and valuation at border crossing.

The 2008 SNA's Chapter 14 discusses the precise accounting for change of ownership of goods in domestic as well as international trade. In the latter case, this section clarifies the distinction between FOB and transaction-based, change of ownership accrual of international transactions in goods. Along these lines, the 2008 SNA notes in paragraph 14.70 that

> … The CIF/FOB valuation principles arise from the common situation where goods are transported by ship from one country to another and it is not unreasonable to assume that transport to and from the ship would be undertaken by carriers resident in the relevant economy. This assumption may still hold in the main for goods transported by sea and air. It is much less satisfactory for goods transported overland where a single vehicle may transport goods from the exporter to importer without a break at national borders.

The above citation from 2008 SNA Chapter 14 cites the presence of overland transportation as an example where border crossing/FOB accrual may differ significantly from the change of ownership principle. More recently, Anne Harrison has cited container transport by sea (which may have a significant overland component) as another case where border crossing and FOB accrual would differ.

The need for clarification

References from Chapters 3 and 26 in the 2008 SNA state that the recording standard for goods in international trade is FOB:

- Paragraph 3.149 states that "Imports and exports of goods are recorded in the SNA at border values. Total imports and exports of goods are valued free on board (FOB, that is, at the exporter's customs frontier)." From this general guidance it appears that the 2008 SNA is suggesting FOB valuation based on point of uniform valuation (similar to BPM6 10.30-34 and 10.78-79).

- Paragraph 26.19 states that "valuation principles are the same in the SNA and the international accounts …..a uniform valuation point is used, namely the value at the customs frontier of the exporting economy, that is FOB type valuation…"

- Paragraph 26.20 "Time of recording and ownership principles are the same in the SNA and the international accounts…(clarifies that)…. "

However, chapter 14 (paragraphs 14.63, 68, 70, 71) could create an ambiguity about 2008 SNA guidance by giving the impression that transactions for goods in international trade are to be valued and recognized at transaction prices when change of ownership occurs.

A proposed clarification

The foregoing suggests there is a need for clarifying the guidance in the 2008 SNA concerning the accrual principle compilers are to follow for international goods transactions in Chapters 2 and 26 on one hand, and Chapter 14 on the other. The AEG could consider following:

In the 2008 SNA, goods transactions between residents of the same economic territory accrue at transaction prices when change of ownership occurs. However, goods transactions between residents of different economic territories accrue at FOB value at the time of border crossing. The implications of the difference between these two accrual principles are explained for international transactions in goods in Chapter 14 of the 2008 SNA. This, however, is not intended to contradict the requirement to use FOB accrual for compiling statistics on international trade in goods.

Compilers of external statistics have argued for FOB accrual of merchandise trade in the interest of establishing a uniform point of valuation:

> Since the balance of payments is a systematic record, transactions in merchandise are recorded on a uniform valuation basis which also leads to a uniform coverage for the transportation and insurance entries. In general, the valuation basis is f.o.b. the customs frontier of the exporting country for both exports and imports …. The f.o.b. basis for both exports and imports makes the export and import data comparable between trading partners. For comparing data for each country over time, valuation as of some common boundary is necessary. If merchandise were valued in accordance with the varying terms of the individual transactions, it might sometimes be recorded f.o.b. some inland point in the exporting country, sometimes f.o.b. its customs frontier, and sometimes c.i.f. the importing country's frontier, or even some inland point in it. It would be impossible to determine to what extent changes from period to period in figures compiled on such varying bases were due to underlying economic factors, as expressed in quantum and price, or were purely nominal, resulting from changes in the contractual place of delivery. … It is therefore necessary to define the border line between merchandise and the related transportation and insurance in accordance with some uniform principle. (*Balance of Payments Manual*, *Third Edition* (BPM3, 1961), pp 8-9)

The argument for a point of uniform valuation thus intends to define a standard package of goods, transportation, and insurance to the border of the exporter's territory in the interest of avoiding variations in current price trade flows arising from variations in the composition of the package of goods, transportation, and insurance over time and from territory to territory. Transaction basis recording thus would not affect total flows so much as the share of total trade assigned to goods and services, and these shares might be more volatile than would be the case with FOB recording. Moreover, temporal variations in the composition of current price flows would broadly translate into variations in goods trade volume flows, because the prices of the goods and services components of the package are likely to be somewhat correlated. Thus the time series evolution of goods trade volumes could become more volatile.

Nevertheless, international trade arrangements have evolved since 1961 and continue to evolve with the advent of customs and economic unions in major economic regions, undermining customs sources of administrative data on FOB recording within those regions, and increasingly extensive global supply chains and their complex logistics, whose transport and insurance arrangements are an important component in the overall picture of international trade. Further, following well established principles in the national accounts, the relevant (flow) event is the transaction, and there is a strong argument that the national accounts and its rest of the world subaccounts should faithfully reflect economic events. Thus, this argument goes, the fundamental change of ownership accrual principle should apply regardless whether the residencies of the transactors match or differ. Finally, the rest of the system has long valued output at basic prices, inclusive of transport and insurance that are not separately invoiced, but with distinct recording and sector attribution of separately invoiced transport and insurance. This view favors the change ownership principle for international trade in goods that is elucidated pedagogically in Chapter 14 of the 2008 SNA.

Conclusion

Given the importance of these data within BOP and that the BPM6 is being implemented, we do not support reopening this issue at this time. This was the view expressed at the IMF Committee on Balance of Payments Statistics meeting in January 2013. Rather it would be helpful if it was clarified that SNA follows BPM6 for cross border trade transactions. However, whether to align the accrual principle for international trade in goods with the change of ownership principle used in the rest of the SNA could be placed on the long term research agenda so that a thorough review of the issue is undertaken when the BPM (BPM7) and the SNA are next updated.