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Merchanting and similar transactions.

1 Introduction

Some Swedish enterprises let foreign enterprises produce their products and buy the products from the foreign enterprises. They then invoice the customers abroad without the products entering Swedish territory.
These transactions are similar to the trading of so called merchants (merchanting according to the BOP – manual). This is the reason why we include them in merchanting. Since the amounts involved are considerable and also change over time our results become difficult to interpret. We think that we need more guidelines on these issues in SNA and ESA.

2 The problem

In SNA 14.60 merchanting is described

” The following 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.”

Why are these transactions treated as margins and not as imports and exports of goods? According to SNA and ESA the most important criteria for exports/imports of a product is change of ownership. Since foreign trade often is recorded when a border is crossed, merchanting is a problem. No border is crossed. This seems to be the reason why merchanting is recorded net as a margin and not as a product.

We have noticed several cases of transactions similar to merchanting made by multinational enterprises. In most of these cases they do R&D in Sweden and buy their own product from a manufacturing enterprise abroad. This enterprise is in some cases a daughter company, but in other cases is not related to the Swedish MNE. The Swedish company does not provide any part of the input, only the design of the product. The manufactured product is transported directly from the manufacturing country to a customer in a third country. The Swedish MNE buys the product from the enterprise which manufactures it and invoices a higher price to the customer in the third country. The margin is often seen as pay for R&D made in Sweden, but this

is not entered in the enterprise accounts. In most cases there is also a time lag between the R&D and the manufacturing and invoicing of the product.
After consultations with the Swedish Central bank and Eurostat we decided to treat these cases of transactions as merchanting. If we had made imputations our accounts would have become difficult to compare with other countries.
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2 Example 1

Transactions between Swedish MNE:s and independent manufacturing enterprises abroad

The following transactions are taken from a Swedish MNE (the amounts shown here are simulated to show the structure) :

Income from sales abroad	25 000
Expenditure on products manufactured abroad	18 750
Margin on sales abroad (= production of merchanting)	6250
Input	5000
Value added	1250
Compensation of employees	1000
Gross operating surplus	250

The invoiced gross amount is high, but leads to a small operating surplus. The input is mainly used for the production of R&D. In the real figures the value added was even negative for one year.
According to the accounts this enterprise produces a margin, but their employees work with R&D. The margin of sales abroad pays for the development of new products. According to SNA we could impute production of R&D with production costs but in that case we would have to impute a corresponding export. This export of a service has no recorded counterpart import to another country.

3 Example 2

Transactions with a daughter enterprise

The enterprise of example 2 produces some of its products in Sweden and some through a daughter company abroad. The Swedish mother company buys the produced product from the daughter abroad. The product is not imported to Sweden but the mother enterprise invoices the customer in the third country to which the product is sold. A margin is recorded in the enterprise accounts. The mother enterprise considers this margin to be payment for R&D. But some of it might be profits which are brought to Sweden through too low prices paid to the daughter. This part of the margin

should be excluded from the margin. This can only be done through imputing a market price.
According to SNA 14.43
" a substitution of an imputed or notional market value for an actual transfer value in the case of goods transactions between affiliated enterprises should be the exception rather than the rule because of both conceptual and practical difficulties involved. In any event, if it is determined that certain transfer prices are so divorced from those of similar transactions that they significantly distort measurement, they should, if possible, be replaced by market equivalents or, if not, be separately identified for analytical porpose."

This is described in more detail in the Balance of Payments manual. According to our information we think that market prices are recorded for this enterprise. This can change over time but it would be difficult to impute market prices that differ from what is recorded in the country of the daughter company. We also have a problem with separately identifying this company since it would mean revealing secrete information.
A solution where the Swedish enterprise produces R&D is also possible.

4 Conclusions

There are several possible alternatives of how to record the transactions of the two enterprises.

1) as merchanting the way we do it now
2) as imports and exports of goods according to the principle of change of ownership
3) as a trade margin on the export of the concerned product
4) if necessary impute market price and use one of the methods 1,2 or 3
5) impute R&D for some of the margin and show the rest according to 1,2 or 3

We think that we have an approximation of a market price in the two examples. But if a calculation of operating surplus leads to an unbelievable operating surplus you would have to impute a market price. But you would still be creating a result which is not internationally comparable.

We think that 1) and 2) are the best solutions if market prices are recorded. Method 2) is the best one since you then can follow more clearly what happens. But then the producing country would have to have a similar treatment, which could create new problems.