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Letter on Goods for Processing from Andreas Lindner,
Chair of the OECD International Trade Statistics Expert Meeting

Paris September 2005

With Annexes



ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT

To: ISWGNA and BOPCOM members
c.c.: Task Force IMTS,
Task Force SITS.
Participants of the 6th OECD ITS and TIS meeting

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Subject: Goods for processing

Dear colleagues,

I am writing to you as chair of the OECD International Trade Statistics (ITS) Expert Meeting. At the 6th ITS OECD (ITS) Expert Meeting and the OECD-Eurostat Expert Meeting on Trade-in-Services Statistics (TIS) this September, some considerable concern was expressed as to the implications of the SNA AEG decision on goods for processing (GFP). It was proposed that the OECD as convenor of the 6th ITS meeting should issue a note to the ISWGNA and BOPCOM setting out these concerns.

Let me state at the outset that this note is neither a critique nor an attempt to re-open the debate on a decision made by the AEG, but rather aims at encouraging a stronger cooperation across statistical expert groups as to coordination and implementation needs, including future data needs.

It is acknowledged that the SNA decision has been taken and that it offers a conceptually more consistent treatment throughout the accounts for this aspect of trade in processing of goods. It is to be hoped that it may lead in due course of time to a better understanding of the increasing economic contribution of this activity to global production. On the other hand its implementation is likely to pose a severe and immediate challenge to trade, balance of payments, business statisticians, and national accountants in terms of data collection and presentation that can be internationally comparable, understandable and of reasonable quality.

The increasing divergence between customs-based merchandise trade and trade in goods in the balance of payments/external accounts implies a new approach to collection and presentation of trade statistics. For users and producers of trade statistics the decision will need to be explained and sold. Feasibility issues have to be addressed as well. The impacts on a small but important group of countries' trade statistics in the balance of payments, based on what information exists, could be dramatic – reducing trade in goods by up to 50%, and if processing of goods were treated as services doubling services trade in some countries (see Annex 1). Such countries would need to be closely involved in the implementation consultations and discussions.

Also the international compilation guidelines for merchandise trade statistics of the UN and the position of the Task Force on Merchandise Trade Statistics throw a clear light on the scope for implementation and the possible needs for more detailed data (e.g. a separate identification of goods for processing and processed products, the identification of re-imports and re-exports, the value of processing fees) while acknowledging the limits with regard to any additional response burden for enterprises (see Annex 2 and Annex 3).

As information on trade flows are of high political importance everywhere and vital for world trade negotiations, and where much effort over the years has gone into building a stable and comparable system centred on customs data, we would ask ISWGNA to urgently consider with stakeholders in trade policy, trade, balance of payments and other statisticians how the SNA AEG decision can be implemented and presented in the most acceptable, useful and effective way. This cross-disciplinary consultation process seems indispensable to help in the practical implementation process.

It goes without saying that we would be willing to assist in this process if you agree.

With kind regards,



Head, International Trade and
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Attachments:

Annex 1: Illustrative examples of changes to country trade data in BOP for selected countries – table compiled by OECD

Annex 2: Note from UNSD, Trade Statistics Branch, on Goods for/after processing (and some related concepts) in the IMTS context

Annex 3: Communication on Goods for Processing from the Task Force on International Merchandise Trade Statistics

Annex 1: Illustrative impacts of recording GFP net in BOP for selective countries

		GFP shown gross		SNA 1993/BPM5	SNA 1993 rev 1/BPM6		SNA 1993 rev 1/BPM6	
Australia			Millions of US \$	2004	GFP net services	% change	GFP net goods	%change
<i>(assumes Australia only imports processing services)</i>	Trade in Goods	729	Exports	87,063	86,334	-1	87,063	0
		2280	Imports	105,278	102,998	-2	106,829	1
	Trade in services		Exports	25,418	25,418	0	25,418	0
			Imports	26,179	27,730	6	26,179	0
China P.R.			Millions of US \$	2003	GFP net services	% change	GFP net goods	%change
<i>(assumes China only exports processing services)</i>	Trade in Goods	241869	Exports	438270	196401	-55	353074	-19
		156673	Imports	393618	236945	-40	236945	-40
	Trade in services		Exports	46734	131930	182	46734	0
			Imports	55306	55306	0	55306	0
Germany			Millions of US \$	2004	GFP net services	% change	GFP net goods	%change
<i>Germany appears to be a net exporter of processing services but with significant imports</i>	Trade in Goods	48440	Exports	909700	861260	-5	n/a	n/a

		40810	Imports	717920	677110	-6	n/a	n/a	
	Trade in services		Exports	141230	n/a	n/a	141230	0	
			Imports	194650	n/a	n/a	194650	0	
Japan			Millions of US \$	2004	GFP net services	% change	GFP net goods	%change	
<i>(assumes Japan only imports processing services)</i>	Trade in Goods	5270	Exports	539000	533730	-1	533730	-1	
		9730	Imports	406870	397140	-2	401600	-1	
	Trade in services		Exports	97610	97610	0	97610	0	
			Imports	135510	139970	3	135510	0	
Mexico			Millions of US \$	2004	GFP net services	% change	GFP net goods	%change	
<i>(assumes Mexico only exports processing services)</i>	Trade in Goods	86952	Exports	187998	101046	-46	120256	-36	
		67742	Imports	196810	129068	-34	129068	-34	
	Trade in services		Exports	14004	33514	137	14004	0	
			Imports	19779	19779	0	19779	0	
Morocco			Millions of US \$	2004	GFP net services	% change	GFP net goods	%change	
<i>(assumes Morocco only exports processing services)</i>	Trade in Goods	3438	Exports	9744	6306	-35	7641	-22	
		2104	Imports	16238	14135	-13	14135	-13	
	Trade in services		Exports	6830	8164	20	6830	0	
			Imports	3446	3446	0	3446	0	
Philippines			Millions of US \$	2004	GFP net services	% change	GFP net goods	%change	

<i>(assumes Philippines only exports processing services)</i>	Trade in Goods	13670	Exports	38728	25058	-35	31007	-20	
		7721	Imports	45109	37388	-17	37388	-17	
	Trade in services		Exports	4101	10050	145	4101	0	
			Imports	5383	5383	0	5383	0	
UK			Millions of US \$	2004	GFP net services	% change	GFP net goods	%change	
	Trade in Goods		Exports		n/a	n/a	n/a	n/a	
			Imports		n/a	n/a	n/a	n/a	
	Trade in services		Exports		n/a	n/a	n/a	n/a	
			Imports		n/a	n/a	n/a	n/a	
US			Millions of US \$	2004	GFP net services	% change	GFP net goods	%change	
	Trade in Goods		Exports		n/a	n/a	n/a	n/a	
			Imports		n/a	n/a	n/a	n/a	
	Trade in services		Exports		n/a	n/a	n/a	n/a	
			Imports		n/a	n/a	n/a	n/a	

Annex 2: Goods for/after processing (and some related concepts) in the IMTS context

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IMTS coverage

1. *International Merchandise Trade Statistics, Revision 2* (IMTS) recommends that international merchandise trade statistics record all goods which add to or subtract from the stock of material resources of a country by entering (imports) or leaving (exports) its economic territory. Goods simply being transported through a country (goods in transit) or temporarily admitted or withdrawn do not add to or subtract from the stock of material resources of a country and are not included in the international merchandise trade statistics [IMTS/para-14]. In general, goods are considered as adding to the material resources of a country when they are placed in its economic territory for future use within this territory (e.g., for consumption or as input into the production process), and subtracting from the material resources of a country when they are removed from its economic territory without expectation of their return [*International Merchandise Trade Statistics, Compilers Manual* [IMTSCM], para-102]. Such placement/removal can be accompanied by various legal/commercial arrangements (sale, consignment, humanitarian aid, reparation, grant, financial lease etc.) which do not effect inclusion of the goods in international merchandise trade statistics. In another words, the IMTS series are supposed to reflect linkages between production and consumption of various economies independent of the mediating legal/commercial arrangements.
2. National merchandise trade data compilers attempt (with different degree of success) to structure IMTS data by several forms of legal/commercial arrangements to provide a possibility for further analysis and to assist data users who need to focus on those aspects.

Wholesale trade and international merchandise trade

3. Wholesalers may sell goods to (or buy from) any customer – both operating domestically and/or abroad. Therefore, these trades (and statistics) overlap.

Goods simply being transported through a country (goods in transit)

4. Goods in transit are defined as goods entering and leaving a country with the exclusive purpose of reaching a third country. They are excluded, since they do not add to or subtract from the stock of material resources of the country through which they pass [IMTS/para-45].

5. Conceptually, goods being simply transported comprise but are not limited to goods placed under "in transit", or "in trans-shipment" customs procedures.¹ If the goods destination, at the time of crossing the compiling country's border, is another country, these goods are to be treated as being simply transported through the country and are to be excluded. Sometimes it is administratively easier for traders to declare goods, not as being in transit, but as regular imports on arrival and exports on departure. Usually these movements become part of the trade statistics. However, compilers are encouraged to identify movements of this kind and reclassify them as transit goods. Compilers are advised to work out arrangements to collect additional information, if necessary (e.g., country of last known destination at the time when goods enter the compiling country's border, and country of origin when goods leave the country). Such arrangements may involve cooperation with customs in developing suitable forms of recording and/or use of sample surveys.

Goods temporarily admitted or dispatched

6. Goods temporarily admitted or dispatched are defined as goods brought into a country or dispatched from it with a reasonable expectation of subsequent withdrawal or return within a limited time without any change (except normal depreciation due to the use made of the goods) [IMTS/para-44]. Some of these goods are listed in the Kyoto Convention; others may be separately covered in national customs legislation. Examples from the Kyoto Convention are: display equipment for trade fairs and exhibitions; art exhibits, commercial samples and pedagogic material; animals for breeding, show or racing; packaging, means of transport, containers and equipment connected with transport; and equipment for the working of lands adjacent to the border by persons resident abroad. In cases where movements of goods are not covered by a specific customs procedure, the statistical authorities should establish criteria for determining whether the goods movement should be considered temporary (such as temporary storage, which may include minor processing that does not change the nature of the goods; goods under operational lease) [IMTS/para-44].

Goods for processing

7. Goods for processing (in the IMTS context) are goods sent abroad or brought into a country for processing (processing is treated as a process of physical transformation of one kind of goods into another), including processing under contract. Examples are oil refining, metal processing, vehicle assembly and clothing manufacture. These goods and goods resulting from such processing (called "compensating products" by customs) are to

¹ *Ibid.* Goods in transit are goods "transported under customs control from one customs office to another" (Kyoto Convention, annex E.1, definition (a)). Goods under trans-shipment are goods being "transferred under customs control from the importing means of transport to the exporting means of transport within the area of one customs office which is the office of both importation and exportation" (Kyoto Convention, annex E.2, definition (a)).

be recorded as imports and exports of the respective countries [IMTS/para-28]. The implied reason for such treatment is contained in the definition of coverage which has no reference to the nature of the arrangements between the traders - as soon as the foreign goods are used in production of other goods within the economic territory of the compiling country they are included in its imports irrespective whether or not they are still owned by the exporter. Consequently, exports of the goods after processing are included in total export goods of the country where the processing was done, whether or not they are owned by its residents or residents of the country which sent goods for processing. Countries, which import goods after processing, will treat them as imports from the original country or from the country of processing depending on their rules of origin. The valuation of goods for processing and after processing is on a gross basis as any other goods.

Consider an example. Country A sends goods (X) for processing to country B. Country B does processing. The resulting goods (Y) are split into three parts and are sent back to country A (Y1), sold in country B (Y2) and sent to a third country C (Y3). The record of the involved movements of goods in IMTS will be like this:

Country A	Country B	Country C
Imports * Exports	Imports * Exports	Imports
* X to B	X from A * Y1 to A	Y3 from B or A
Y1 from B *	* Y3 to B	depending on rules of origin
or reimports of X depending on rules of origin	(Y2 is not an IMTS flow)	

Goods in the same state

8. For the IMTS purposes, these goods are goods which didn't change any of its physical characteristics and goods undergone normal depreciation due to their use or were subjected to usual forms of handling to improve their packaging or marketable quality or to prepare them for shipment, such as breaking bulk, grouping of packages, sorting and grading and repacking and not intended to authorize any change in the essential character of the goods themselves.

Re-exports and reimports

9. Re-exports are exports of foreign goods, in the same state as previously imported (entered country without being declared for temporary admittance or transit; goods identified as for temporary admittance or transit are excluded from imports and exports). Re-exports are to be included in the country exports. They are also recommended to be recorded separately for analytical purposes, which may require the use of supplementary sources of information in order to determine the origin of re-exports, i.e., to determine that the goods

in question are indeed re-exports rather than the export of goods that have acquired domestic origin through processing.

10. Reimports are imports of domestic goods in the same state as previously exported (withdrawn from the country without being declared for temporary withdrawal; goods identified as for temporary withdrawal are excluded from exports and imports). Reimports are to be included in the country imports. They are also recommended to be recorded separately for analytical purposes, which may require the use of supplementary sources of information in order to determine the origin of reimports, i.e., to determine that the goods in question are indeed reimports rather than the import of goods that have acquired foreign origin through processing.
11. Re-exports and reimports are to be recorded in the same way as any other exports/imports – value, quantity, classification, destination/origin.

Recording of goods for/after processing

12. Goods for processing and the resulting products, can enter/exit a country under the specially designed customs procedure called “inward or outward processing” or under “clearance for home use”/“outright exportation” procedures depending on practical considerations of the parties involved.
13. Under inward or outward processing procedure certain goods can be brought into a customs territory conditionally relieved from payment of import duties and taxes; such goods must be intended for re-exportation within a specific period after having undergone the specified processing; processing may involve use of goods of national origin or previously imported. It should be noted that compensating products can be re-declared for exportation to any third country or for home use (Kyoto Convention, annex E.6). Customs records in the case of application of inward or outward processing may/or may not contain all information needed for the purposes of trade statistics depending on national legislation. IMTS Compilers Manual recommends, therefore, that trade statistics compilers cooperate with the customs administrations to ensure full coverage of both import and export flows in trade statistics, as well as better availability and comparability of data. In general, national statistical systems can identify goods under those procedures and pass the relevant information to SNA/BOP compilers.
14. However, if goods are sent for processing but are declared (in the country where processing is performed) for home use and goods after processing are declared for outright exportation, there will be no separate identification and they will be treated as any regular imports and exports. In such cases, compilers of international trade statistics (normally) will not be able to assist SNA/BOP compilers.
15. IMTS recommends application of the general trade system that is to record goods which enter/exit any part of the economic territory of the compiling country. Many countries apply special trade system (that is recording system which excludes some parts of its economic territory from its statistical territory). If a country applies a strict definition of

the special system and excludes industrial free zones then movements of goods for processing and goods after processing will not be captured.

16. In countries, like members of the European Union and other customs unions, which abolished customs controls, identification of imported goods as goods for processing in merchandise trade statistics is even more difficult.

Conclusions

17. Goods for processing and products resulting from such processing are included in international merchandise trade statistics alongside with other imports and exports whenever identified as such. At the moment, a separate identification of such goods in the detailed (by commodity/partner) data sets on international merchandise trade reported to the UN by the national statistical offices is not available. It is not clear how many countries do have such identification in their national databases and of what quality the resulting data might be. The cross-country comparability of such information might be very low due to differences in country customs and commercial practices. On the other hand countries do compile total figures on imports/exports of such goods for BOP purposes. This suggests that further improvements in compilation of the detailed merchandise trade statistics on goods for/after processing might be possible.
18. In mid 2006 Trade Statistics Branch of UNSD intends to undertake a review of country practices in compilation and reporting of international merchandise trade statistics in order to better identify areas where updating/revision of the existing IMTS recommendations might be needed. Recognizing an analytical value of data on movements of goods for/after processing both in merchandise trade statistics and in the SNA/BOP context, this review will include a number of questions on compilation of data on such goods via customs records and traders surveys. The completion of this exercise and publishing the report is expected in Q4/2006.

Annex 3: Goods for processing – comments of the Task Force on International Merchandise Trade Statistics

The Task Force on International Merchandise Trade Statistics met in Bangkok from 15 to 17 March 2005 and discussed the impact of revisions of the System of National Accounts (SNA) and the Balance of Payments Manual (BPM) with respect to international merchandise trade statistics, notably the treatment of goods for processing.

In 2004, the Task Force had forwarded a letter to IMF commenting on Chapter 9 (Goods and Services Account) of the BPM Annotated Outline. The Task Force reinforced the position taken in existing merchandise trade statistics concepts and definitions (International Merchandise Trade Statistics - IMTS, Rev.2), such as the inclusion of goods for processing on a gross basis.² However, the Task Force pointed out that "...showing separately information on goods through the application of the change of ownership principle would be useful additional information for analysts". It also stated that "...it would be useful to review all these categories comprehensively together (re-exports, goods in transit, processing, etc.) to help understanding the underlying rationale for their different statistical treatment and to facilitate greater harmonisation across different conceptual frameworks. "

Current treatment of goods for processing

BOP/SNA

In the 5th edition of the Balance of Payments Manual (BPM5) and the System of National Accounts 1993 (SNA93) processing is defined as any activity performed under contract and both distinguish "...goods sent abroad for processing that involves a substantial physical change...from other processing" [BPM5, para.120]: processed goods re-classified in a different 3-digit CPC group should be recorded as goods and those not falling in a different group, as services. However for practical purposes BPM5 recommends to record all processing as "goods".

In BOP and SNA the current exception to the change of ownership principle is for the recording of goods for processing where the goods are returned to the country of the owner once the processing has been performed: although there is no change of ownership processed goods sent by economy A to a processing country B are recorded as economy A's exports of goods (respectively B's imports) and goods sent back to A after processing are recorded as A's imports (B's exports) valued when re-imported at total estimated value including the value of processing. No processing fee is recorded in the services account.

It is the above exception to the change of ownership principle that SNA and balance of payments statisticians are currently envisaging to terminate. That is, the imports and exports of goods for processing will no longer be included in the balance of payments and instead a fee for the processing service will be recorded.³

² The Task Force's letter also reinforced the position taken in IMTS, Rev.2 for the treatment of re-exports (separate reporting) and merchanting (exclusion from international merchandise trade statistics).

³ There will be no change envisaged for the treatment of goods which are sent abroad for processing and which are not re-imported by the sending country (either sold to a resident of the processing country or exported to a third country): the sending country records goods exports under the general

Merchandise trade statistics and IMTS Rev.2

The most prevalent source for measuring merchandise trade is customs declarations. Guidelines for customs procedures and declarations are provided by the WCO and the Kyoto Convention. Additional information can be drawn from GATT, the WTO Customs Valuation Agreement and WTO Rules of Origin.

The fundamental difference between IMTS and the BPM5/SNA93 concepts is that the former "recommends the use of crossing the border (...) as the basic principle for compilation of trade statistics..." (IMTS, Compilers Manual, Chapter 1, para.9) whereas the latter recommend the change of ownership as the basic principle. IMTS adds in para.10 that "... customs-based data collection systems run by most countries are unable to apply a change of ownership approach."

According to the Kyoto Convention, goods crossing the border for inward processing (into a free circulation area or industrial free zone) or temporary exportation for outward processing need to be included in merchandise trade statistics. This requires a separate registration of the imported goods under the respective customs regime and the registering of the country of origin in accordance with the country's rules of origin. Countries normally use either the value added (a specific percentage of the value of the product need to be added through processing in the country of origin, e.g. 40%) or the result of the processing as a principle to determine the country of origin. If the result of the processing requires a change in the tariff classification for the processed product, that is, if the product's physical properties are changing, the processing country will become the new origin.

As merchandise trade statistics are used as the main source for BOP and due to above considerations, the current treatment requires to separately identify goods sent (or received) for processing either by customs or through using other sources for estimating goods for processing (e.g., enterprise surveys).

Issues raised by proposed changes for the treatment of goods for processing

Proposed change

Both BPM and SNA aim at the change of ownership as dominant principle. The current proposal for both frameworks is to stop the exception and to consider the processing related trade (the exports of goods for processing and the subsequent re-import or vice-versa) as trade in processing services instead of trade in goods. (i.e. "manufacturing services provided under contract or fee basis", CPC Ver.1.1 Division 88 Manufacturing services on physical inputs owned by others)

Classifications

However a question could be raised: should it be the change of ownership principle, the "substantial change of a product" or the industrial origin that should be used as a predominant

merchandise item (value of the processed good including value of processing) and the payment for processing is entered as a debit under services (credit for country providing the service).

criterion for deciding to classify the transactions as a good (total estimated value of the processed good including processing fee) or a service (processing service).

Alternative treatments have various consequences for different statistical frameworks such as IMTS, SNA (production account, input/output tables, etc.) or BPM (which has also consequences for the Manual on Statistics of International Trade in Services). Each treatment has its own pros and cons and depending on where data consistency focuses on, statisticians prefer either of the alternatives. A number of arguments can be found on the respective websites of the BPM and SNA revision and will not be repeated here.

However, a related question could be posted on the negotiation and dispute settlement side, which is relevant whatever recommendation is chosen. Is a considered processing activity an activity falling into one of the ISIC groups of manufacturing or of services? Would the industrial origin be a determining criterion to consider a product stemming from the same assembly line once as a good, once as a service, depending on the change of ownership in raw materials? Sectors concerned are frequently textiles and apparel or also the car industry where large assembly lines are used to manufacture a final product from various components. It may often be benefits drawn from the fiscal or tax system only that forces the manufacturer to identify himself as owner of the raw materials or as a manufacturer on contract basis. In dispute settlements, depending on the classification of goods for processing, either GATT or GATS rules may apply which could lead to quite different results.

Data collection

A number of countries are not in a position to separate goods temporarily imported for processing from other imported goods, which is also true on the exports side. For those able to identify goods for processing, a difficulty may arise for identifying whether products after processing are returned to the country of the owner or are exported to a 3rd country or are cleared for use in the processing country: they may not be able to identify these circumstances in customs documents which could lead to reporting asymmetries

If the practice were to be changed in the new BPM and SNA, additional information would have to be collected, not only on the value of goods for processing but also on the value of the processing fee, which could be obtained either through separate sources such as enterprise surveys or eventually international transactions reporting systems. Depending on the accounting practices, this may lead to an additional response burden for enterprises (and additional burden for national statistical compilers). On the other hand, this information could be very useful for validating customs flow data of processed goods.

Countries face severe resource problems and their enterprise accounting rules may not easily lend themselves to the surveying of the information on processing. A possible solution could therefore be for merchandise trade statistics to continue the current practice of reporting goods for processing. Those countries (with large processing zones?) that can (or already) survey enterprises to identify goods for processing activities and related fees could do so. Against this information, BOP/SNA statisticians would then need to derive estimates for processing fees.

An important issue that requires further consideration is the capture of trade between related parties. The countries' customs documents should normally include the option of registering trade between related parties, however, as countries use different criteria for identifying

related parties this option is not always included. Further guidance on compilation of adequate trade flows between related parties through customs need to be developed as this combines a number of aspects. Enterprises that send goods for processing abroad to related enterprises could accumulate several benefits such as minimising corporate taxes, using cheap labour and transfer pricing.

Possible implications for data users

It should also be highlighted that a change in current practices would limit the availability of information in case of trade dispute settlements when the case is considered a good by the involved parties and also drastically change the character of economies with large processing zones while the underlying economic relations remain the same. For example, Mexico's exports consist of more than 40% of exports from the maquiladoras. A net treatment would result in a considerable change of the trading position of Mexico which, for example, would have a big impact on WTO budget contribution calculations and also on a large number of derived trade indicators (openness, etc.).