

# Differentiating merchanting and manufacturing services transactions

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14.88. As noted above, delineating between manufacturing services and merchanting transactions is not always trivial. The key issue here concerns the degree of transformation provided by the processing firm.

14.89. In practice countries adopt a variety of methods to determine this delineation. One approach looks to identify whether the imported good and corresponding exported good significantly change their product classification (Harmonised Code (HS), for example a change at the six digit level). This criterion has the advantage of being consistent with the definition used for re-exports in the BPM6 (10.37) and the IMTS 2010<sup>[1]</sup>. Although BPM5 had a different method for recording goods for processing, it did state that following the 1993 SNA methodology, goods reclassified, in a different three-digit group of the Central Product Classification (CPC), were considered to have undergone a substantial transformation.

14.90. However, it worth noting that a change in a classification might not occur even when processing and transformation have taken place. In other words this proposed approach does not always hold since there is a need to take into account the production process and the different commodity chains that exist. A good example being when a good is sent to another country for processing that involves changing its colour (e.g. jeans sent for dyeing), the classification will remain the same (i.e. jeans) even though the good has undergone (not minor) processing. More analysis is therefore required when accessing such situations, to dig deeper, and this can be undertaken for example using trade surveys, administrative data, statistical business registers and linkages with other relevant databases.

14.91. The *Eurostat Manual on Goods Sent Abroad for Processing* (2014 edition) takes, as a general rule, that goods that have been processed in any way are assumed to have been transformed, while goods that have been simply repacked or labelled are not. BPM5 assumed that all processing resulted in a substantial physical change; a convention adopted in recognition of the delineation challenges.

14.92. It's important to note that delineation issues have implications for the flows recorded on the accounts for the principal too, as if the transaction is identified as transformative then the principal (contracting out the manufacturing service) is de facto recorded in the SNA as a manufacturer, with imports and intermediate consumption of the material inputs used by the processor and the processors' fees. This question becomes more complex when the relationship is between related parties (e.g. direct investor and an affiliate) and the owner of the material inputs is blurry.

14.93. The UNECE *Guide to Measuring Global Production* (para 2.82) recommends that the dividing line between manufacturing services and merchanting (which in this case is aligned with FGPs) is whether or not the principal has obtained at least some of the material (physical) inputs prior to processing. This is seen as being consistent with recommendations outlined in ISIC, the 2008 SNA and BPM6.

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[1] The IMTS 2010 additionally uses the criteria of where the last manufacturing is "deemed sufficient to give the commodity its essential character".