

Manufacturing services on physical inputs owned by others

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Definition

14.71. *Manufacturing services on physical inputs owned by others* is defined as covering the processing, assembly, labelling, packing, and other such processes undertaken by enterprises that do not own the physical inputs concerned. Only the fee (the manufacturing service) charged by the enterprise undertaking the manufacturing service is included under this item.

14.72. The classic example of a manufacturing service transaction involves a principal (in country A) providing material inputs to a foreign enterprise (country B) which then undertakes some form of transformative manufacturing (e.g. processing, assembly) on these inputs (which are at all times owned by the principal). The final output is then sold and the service fee (which may be less than the difference between the cost of the material inputs and the eventual sale prices or indeed the difference between the cost of the material inputs and any imputed value included in the merchandise trade export figures in the processing economy) is recorded in the BPM6 current account, service component under the item 'Manufacturing services on physical inputs owned by others'. Common examples of manufacturing services given in BPM6 include oil refining, liquefaction of natural gas, and assembly of electronics and clothing.

14.73. To avoid any misunderstanding, it is also best to clarify the origin of the inputs in the manufacturing services transaction here. The MSITS 2010, paragraphs 3.69 and 3.70, under the heading "Recording of related purchases and sales of goods and services" outlines the situation well and this is worth repeating here:

- Purchases of materials by the owner (that is, goods to be processed) may be obtained from residents of the same economy as that of the owner, the same economy as that of the processor, or a third economy. The treatment is as follows:
 - When the goods are acquired from residents of the same economy as that of the owner, there is no international transaction
 - When the goods are acquired from residents of the same economy as that of the processor or a third economy, the owner of the goods to be processed records imports of general merchandise
- Sales of finished goods (that is, goods after processing) are treated as follows:
 - When the goods are sold to residents of the same economy as that of the owner, there is no international transaction
 - When the goods are sold to residents of the same economy as that of the processor or a third economy, the owner of the goods under processing records the sale as exports of general merchandise

Recording and compilation

14.74. Manufacturing services are recorded in the services account, and includes two *supplementary items*: the gross flows of the physical inputs and of the final goods. Assuming the classic case where the owner, a resident of the compiling economy, sends goods to a non-resident processor (in another economy) who processes the goods and returns them to the owner in the compiling economy, the balance of payments entries would reflect an import of manufacturing services and be recorded as follows:

- Manufacturing services on physical inputs owned by others [Debit, the processing fee]
 - Supplementary items
 - Goods for processing abroad-Goods sent [Credit, value of the goods sent]
 - Goods returned [Debit, value of the goods returned]

14.75. Likewise, in the country of the processor, an export of manufacturing services is recorded, with two complementary items:

- Manufacturing services on physical inputs owned by others [Credit, the processing fee]
 - Supplementary items
 - Goods for processing in reporting economy-Goods received [Debit, value of the goods received]
 - Goods returned [Credit, value of the goods returned]

Conceptual and compilation challenges

14.76. There are at least three conceptual and compilation challenges that a compiler must address when recording manufacturing services transactions.

- It is important to correctly value the processing service fee, recognising that this will not necessarily equal the value of the difference between the imported material inputs and exported outputs. International merchandise trade data for example will necessarily record the values for these flows and in particular the final flow (e.g. the finished good) may include additional value provided by intellectual property, such as software, design, brand owned by the proprietor of the goods. Further, when the processing occurs over a long period of time price changes in the eventual exported goods may also create a further wedge between the difference in input and output values and the processing fee.
- The gross flows of the goods transactions (export and import) need to be separately identified in order to be able to remove them from the general international merchandise trade figures (where these gross flows should be included as per the recommendation of the IMTS 2010) for balance of payments purposes.
- It is important to distinguish between merchanting and processing transactions: if only minor processing occurs, goods transactions recorded in the accounts of the economy where the principal firm (that has contracted the processor) is resident should be recorded as 'net goods under merchanting' (with the inclusion of manufacturing services imports as their intermediate consumption).

- It is also important to differentiate between processing modes of production (treated as manufacturing services exports) and conventional modes of production (treated as goods exports). Present guidelines indicate that if any material inputs are owned by the principal firm (and not the processor) then the activity should be recorded as manufacturing services, which in theory applies even if the processor itself purchases significant quantities of material inputs on its own account. This is the subject of on-going discussion.

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