

STATISTICS DIRECTORATE

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National Accounts and Economic Statistics - International Trade Statistics

11 (b) Goods for Processing: Draft chapter of the forthcoming IMTS Compiler Manual

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This document is made available to the delegates of the Joint 8th International Trade Statistics (ITS) and Trade in Services (TIS) Session for information and comment.

This paper has been prepared by :

UNSD: Ronald Jansen jansen1@un.org and Vladimir Markhonko markhonko@un.org

WTO: Andreas Maurer andreas.maurer@wto.org

OECD: William Cave william.cave@oecd.org and Andreas Lindner andreas.lindner@oecd.org provided input and comments

For further information, please contact William Cave at e-mail: william.cave@oecd.org and/or Andreas Lindner at e-mail: andreas.lindner@oecd.org

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INTRODUCTION

1. During the past years, the issue of measurement of “*goods for processing abroad (GPA)*” has received increasing attention from trade statisticians. Basically, there are two main reasons for this: first, GPA is part of the globalisation process where enterprises outsource parts of their production internationally or multinationals share productive activities across affiliates and locations. Second, international merchandise trade statistics, generally collected from customs declarations and in line with the UN Concepts and Definitions framework IMTS, feed as input into the data compiled by accountants and BoP compilers (SNA and BPM6 frameworks).

2. There are, thus, three statistical frameworks (IMTS, SNA and BPM6) where “international trade in goods” is the element common to all three, but inherently differently measured by IMTS (physical movement of goods across borders) as opposed to the other two where change of ownerships and residence of owners are the criteria for measurement.

3. In addition to these already very substantive differences, the new BPM6 and SNA 1993 Rev1 introduce new measurement principles which would not only pose considerable practical problems for merchandise trade statisticians, but potentially lead to a further drifting apart of IMTS and SNA. Also the proposal to consider goods processed abroad without change of ownership as trade in services and not as trade of goods would lead to - sometimes very considerable – necessary adjustments altering the respective weight of goods and services of a country’s trade.

4. At a time where national and international statisticians are aiming at linking together hitherto separate databases, at making progress realising a data warehouse capable of better answering cross-cutting issues and improving general coherence and consistency, there is a very real threat here that trade in goods figures according to IMTS and to BoP/SNA will show greater discrepancies and incoherencies in future.

5. In response to concern expressed, OECD wrote in November 2005 to the members of ISWGNA and BOPCOM flagging possible consequences of the proposed changes as well as practical measurement implications. The note included

- An illustrative example of changes to country trade data in BOP for selected countries compiled by OECD
- A note from UNSD, Trade Statistics Branch, on Goods for/after processing (and some related concepts) in the IMTS context
- A communication on Goods for Processing from the Task Force on International Merchandise Trade Statistics

6. The above communication constitutes **Part I** of this document.

7. UNSD is currently preparing, with input from other international organisations, the new UN Compilers Manual and Supplements on International Merchandise Trade Statistics. A particularly important feature of the forthcoming version is the broadening of scope to better reflect new production processes and links. The preliminary draft constitutes **Part II** of this document.

8. OECD considers that this joint session of OECDs 8th ITS/TIS meeting provides an excellent opportunity to compare views and visions from both merchandise trade statistics compilers and BoP compilers.

9. Delegates are invited to express their opinion on the key issues identified, notably:

1. What could be done to better ensure conceptual consistency?
2. Comment on the different scenarios given.
3. Practical issues stemming from basic data sources (see GM examples given).
4. Scope of collecting additional information needed.
5. Borderline case (China example)

PART I:

**OFFICIAL REACTION FROM OECD TO ISWGNA AND BOPCOM FOLLOWING THE
DISCUSSION WITH DELEGATES ATTENDING THE 6TH OECD ITS AND TIS MEETING 12-14
SEPTEMBER 2005**

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

Paris, 18 November 2005

Reference: STD/TASS(2005)1811

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
Structural Business Statistics Section (TASS)

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**

By Vladimir Markhonko
Chief of Trade Statistics Branch
United Nations Statistics Division

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 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.

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)).

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 re-imports

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 – STATEMENT OF THE INTER-SECRETARIAT TASK FORCE ON INTERNATIONAL MERCHANDISE TRADE STATISTICS IMTS

1. 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.

2. 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

3. 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".

4. 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.

5. 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

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).

will no longer be included in the balance of payments and instead a fee for the processing service will be recorded.³

Merchandise trade statistics and IMTS Rev.2

6. 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.

7. 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."

8. 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.

9. 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

10. 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)

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 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).

Classifications

11. 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 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).

12. 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.

13. 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

14. 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

15. 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.

16. 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.

17. 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

18. 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.).

PART II:

Goods for Processing Abroad

Introduction

19. International trade has been at the centre of many recent discussions on globalization, be it from the point of view of off-shoring of the production process, operations of multi-nationals, foreign direct investments or trade negotiations. The production process of garments, motor vehicles, televisions or computers is now often spread over a number of countries not only to reduce labor and capital costs but also, for instance, to benefit from investment incentives offered by the host countries.

20. Even though treatment of goods for processing in the statistical sense is by no means a new discussion, it gained a lot of new attention because of the changes to the 1993 System of National Accounts (SNA93, Rev1) and because of its increasing economic importance, especially for economies like China and Mexico. At the centre of the measurement discussion stands the issue of the economic ownership of the goods being processed, in particular if these goods add to the economic wealth or the stock of resources of the country receiving them. The SNA93, Rev1 and the sixth edition of the Balance of Payment Manual (BPM6) now specifically recommend that if goods are being processed abroad but ownership of the goods have not been passed on to the processing company, that in such case the transaction would be described as an international service transaction.⁴ This terminates an exception to the principle of change in ownership which had been in place in the previous editions of these manuals.⁵

Basic Goods for Processing scenario

21. The basic scenario of transactions categorized as “goods for processing abroad” would be a mother company sending goods to its affiliate abroad which processes these goods and returns an enhanced product back to the mother company. Many more complicated (but more realistic) scenarios will be illustrated in subsequent sections. The crucial point in these transactions concerns the economic ownership of the goods. If the mother company remains owner of the goods, then BPM6⁶ define this transaction as a **trade in services** transaction, in which the mother company imports services of its affiliate abroad. If the affiliate acquires economic ownership, the transaction would be a regular **trade in goods** transaction, in which the country of the mother company exports the goods going into the production process and the country of the affiliate afterwards exports a finished product in return. In a nutshell, this is the issue at stake.

⁴ In the latest draft of BPM6 IMF introduces the wording “Manufacturing services on physical inputs owned by others” instead of goods for processing, to stress the fact that the goods have not changed ownership to the manufacturer.

⁵ A change in ownership was imputed in case of "substantial processing" in SNA 1993, and systematically in BPM5 for goods processed abroad and returned to the country from which they were consigned.

⁶ From here onwards SNA93, Rev1 is implied as well when making reference to the concepts of BPM6, since both have been harmonized as much as possible in their latest versions.

22. The issue of goods for processing emphasizes a fundamental difference between the conceptual frameworks of the second revision of *International Merchandise Trade Statistics, Concepts and Definitions* (IMTS, Rev2) and of BPM6. In IMTS, Rev2 change of ownership is (in almost all cases) not considered. Trade is in this framework mainly defined as transactions in which goods cross the border.

23. The basic source of trade in goods statistics are the customs declarations, which are usually compiled into IMTS data by the national statistical offices (which may use other data sources to complete the full set of IMTS data). BOP statisticians, thereupon, use IMTS data to derive the goods components of the Current Account. Given the stricter application of the change of ownership principle in BPM6, statistics in addition to current IMTS data will be necessary to identify change in ownership in the goods transactions.

The conceptual issues

24. The basic principles of the framework of IMTS, Rev2 are that (1) trade is the physical movement of goods across the borders, (2) the statistical value is the transaction value of the goods at their market rate (including insurance and freight charges for imports), and (3) the trading partner country is determined by the origin of the goods and the final destination of the transaction. The principle of substantial transformation – which is directly related to goods for processing – will determine if there is a change of origin of the produced goods and, consequently, if there will be a recording of an export or a re-export when the (compensation) goods leave the country after processing.

25. The basic principle of the framework of BPM6 (in relation to this topic) is that trade in goods is a transaction between a resident and a non-resident where the economic ownership of the goods changes from one to the other. If residency is identical there is no international transaction, thus no trade. If there is a resident/non-resident transaction but no change of economic ownership, then the BPM6 framework defines the processing of the goods only as an international service transaction and not as a goods transaction, specifically it categorizes this international service transaction as a transaction in manufacturing services on physical inputs owned by others. BPM6 recommends not only to record the services fee, but also to record separately the value of the goods exported and the value of the processed goods imported.

The measurement issues

26. Already a number of years ago the inter-agency Task Force on IMTS warned of data collection problems arising from the wish by BOP statisticians to separately identify, revalue and reclassify goods for processing without change of ownership. It indicated the elements that could be recorded and those elements that would be very difficult to measure.

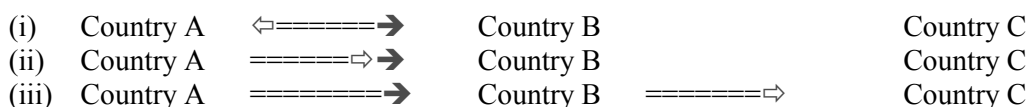
1. Goods for processing and the resulting products can enter or exit a country under the specially designed customs procedure called “inward processing” or “outward processing” or under the regular customs procedures of “clearance for home use” or “outright exportation” depending on practical considerations of the parties involved.
2. 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.

3. 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.
4. IMTS recommends application of the general trade system that is to record goods which enter or 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.
5. 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.

Different scenarios of processing goods abroad

27. The illustration below shows goods sent abroad for processing (closed red arrow) where the processed goods (open green arrow) subsequently (i) return to the originally exporting country, (ii) enter the domestic economy of the country of processing, or (iii) are exported to a third country. Scenarios (ii) and (iii) assume that during processing the goods were still owned by country A, and the change of ownership took only place with respect to the processed goods.



28. Table 1 illustrates recording of the trade flows in IMTS, Rev2 and BPM6. For IMTS, Rev2 it depends if processing is "substantial" or not for recording a flow as exports or re-exports. Substantial transformation determines the country of origin of the goods. Goods before processing are indicated as X and goods after processing as Y. Whereas IMTS makes a distinction between marginal and substantial processing, such distinction is not made in BPM6. In this table flows are allocated by origin and last known destination, assuming these are known to all transactors.

29. As mentioned, in each of the cases (i) to (iii) a processing *service* is recorded as an import of country A (export of B) in BPM6 and only the finished goods (Y) are part of a trade in goods transaction in cases (ii) and (iii).

30. In IMTS, Rev.2 records imports and exports in relation to the physical movement of the goods across borders, recording re-exports/ re-imports only in cases where there has not been any substantial transformation of the goods.

Table 1: Classification of transactions relating to the processing of goods abroad in IMTS, Rev. 2 and BPM6⁷

Case	IMTS, Rev. 2		BPM/SNA	
	no substantial processing	substantial processing	Goods	Processing services ⁸
i	A: exports of X to, then re-import of X from B B: import of X from A, then re-export of X to A	A: export of X to B, then import of Y from B B: import of X from A, then export of Y to A	A and B: no flow as goods remain the property of sending country (A)	A: import from B
ii	A: export of X to B B: import of X from A	A: export of X to B B: import of X (or Y?) from A	A: export of Y to B B: import of Y from A (including processing fee)	B: export to A
iii	A: export of X to C B: import of X from A, re-export of X to C C: import of X from A	A: export of X to B B: import of X from A export of Y to C C: import of Y from B	A: export of Y to C (including processing fee) C: import of Y from A (including processing fee)	

31. In case (i), goods move out of the country of economic ownership A and return to it again. While these flows will no longer be recorded in the goods account of BPM6, they are still recorded in IMTS. Actually, these "gross flows" will be recorded in the BPM6 services part as additional information.

From concepts to basic data sources

32. Given that a customs declaration is still the basic instrument for recording of trade transactions, customs procedures should be further analyzed for their suitability of identifying those involving goods for processing. The relevant customs procedures are:

- Free zones (see paragraph 1.C.2.3), both industrial and commercial free zones
- Inward processing and outward processing (see paragraphs 1.C.2.4 and 1.C.4.2)
- Processing for home use (see paragraph 1.C.2.5)

⁷ The BPM/SNA revision refers to case (i) only. Under previous guidelines, gross flows of goods moving from the sender's country (the client for the processing service) and returning to it needed to be identified separately for recording in a dedicated item, and recording a service transaction was not required.

⁸ Gross values of goods sent abroad for processing without change of ownership may be identified as supplementary items in economies where they are significant

33. However, depending on practical considerations, goods for processing can also enter a country under the general procedures of clearance for home use and exit under the outright exportation procedure. The “Drawback” procedure (see 1.C.4.3) could be useful in cases where goods were temporarily imported (for processing) and full duties were paid at entry (clearance for home use). Under the “Drawback” procedure the importer reclaims the duties paid because the (processed) goods were exported again (certain conditions apply).

34. Most countries already apply the customs procedures described in the Revised Kyoto Convention (see Chapter 1), even if they not fully commit to them; some have laid them down in national customs legislation. This harmonization of customs procedures makes it very predictable for traders on what they can expect regarding their transactions.

35. Especially, the inward and outward processing procedures are important for identification and measurement of “goods for processing”, since (a) these procedures are designed for the processing of goods, and (b) customs procedures are internationally highly regulated, which implies fully comparable among countries. To do justice to the thoroughness of the descriptions of these customs procedures, they have been reproduced in large part in the annex to this paper.

Identification of transactions of goods for processing

36. Ideally, goods sent abroad with intention of re-importing them after processing should be identified in direct relation to goods (the “compensating products”) returning after processing. Corrections to exports are necessary to adjust for goods that eventually do not return (recorded as goods exports – cases (ii) and (iii)). In collection systems where only goods returning after processing are identified, correction of export flows could be problematic in terms of assessing their initial export value.

37. The various scenarios described in table 1 need further consideration with respect to data collection from customs declarations or collection via enterprise surveys. Detailed information on the activities of inward processing companies could be surveyed. The following text boxes attempt to describe recording processes at the customs office for case (i) both from the sending country as well as from the country where processing occurs.

Questions: First of all, how likely is it that a company files the outward processing procedure over the outright export procedure? Is there still any duty/tax benefit to obtain by recording the declaration as outward processing to Mexico? Secondly, do US Customs forms allow for linking of outgoing with incoming declarations?

Case i. General Motors exports automotive parts for assembly by an affiliate in Mexico. Finished vehicles are shipped back from Mexico to USA. Ownership of goods remains with GM-USA for the entire process.

Data Source (A) – Customs declaration at the Mexican border

Part A.3 (Before processing) Mexican Customs registers imports of automotive parts under the inward processing customs procedure. Again GM-USA would be recorded as the liable party.

Part A.4 (After processing) Mexican Customs registers exports of vehicles after inward processing. Officially, GM-USA should be the company on record.

Questions: Is there a link between the incoming goods declaration and the subsequent export declaration of the processed goods? Can a foreign and non-resident company export goods out of Mexico? Would this foreign and non-resident company be part of the business register of Mexico?

38. The text boxes above show customs declarations as data source at the US and the Mexican side. How can those declarations be supplemented with enterprise surveys?

39. The questions here are: (1) for the purpose of enterprise surveys, can companies sending goods for processing be separately identified and (2) can these companies provide information about the processing service they purchase from abroad? These would be the questions on the US side. On the Mexican side, you would need to survey the processing companies and get insights into the imported and exported products and the processing fees.

Case i. General Motors exports automotive parts for assembly by an affiliate in Mexico. Finished vehicles are shipped back from Mexico to USA. Ownership of goods remains with GM-USA for the entire process.

Data Source (B) – Enterprise Surveys by Mexican Statistical Authority

Enterprises involved in inward processing need to be identified. If companies can be identified on customs declarations, companies requesting inward processing procedure could be selected for survey.

40. In conclusion, four pieces of one puzzle could be envisioned for this case. It will be even more challenging how to put these pieces of information together. Is bilateral cooperation a pre-requisite to obtain sufficient information for BOP purposes?

41. For cases (ii) and (iii), the separation of trade flows according to goods processed and subsequently cleared for home use or for exports to third countries seems even more difficult. Some indications for this are given in the following text boxes.

Case ii. General Motors exports automotive parts for assembly by an affiliate in Mexico. Finished vehicles enter the Mexican economy. Ownership of goods only changes after the finished goods are sold.

Data Source (A) – Customs declaration at the US border.

Part A.1 (Before processing) Similar to Case 1, US Customs records exports of automotive parts under the outward processing customs procedure with indication for the approximate date of return. The declaration form should also have GM-USA as the company liable for customs obligations.

Part A.2 (After processing) At best, GM-USA will be requested to file a customs form to terminate the outward processing..

Questions: If some vehicles return to the USA and some are sold in Mexico, how would you be able to trace this via customs declarations?

Case ii. General Motors exports automotive parts for assembly by an affiliate in Mexico. Finished vehicles enter the Mexican economy. Ownership of goods only changes after the finished goods are sold..

Data Source (A) – Customs declaration at the Mexican border

Part A.3 (Before processing) Mexican Customs records imports of automotive parts under the inward processing customs procedure. GM-USA would be recorded as the responsible company.

Part A.4 (After processing) Mexican Customs records entry record for goods coming into the domestic economy. This declaration terminates the inward processing procedure and the buyer would need to pay import duty, if applicable. GM-USA would still be the exporting company and a domestic company or individual would be the importer.

Questions: Will there be a direct link between the inward processing declaration and the subsequent declaration of imports of the finished good into Mexico?

42. In which way can the customs information be supplemented with enterprise surveys? As in the first case, it will be mostly the Mexican Statistical Authority that would be able to get some detailed information on the activities of the inward processing companies.

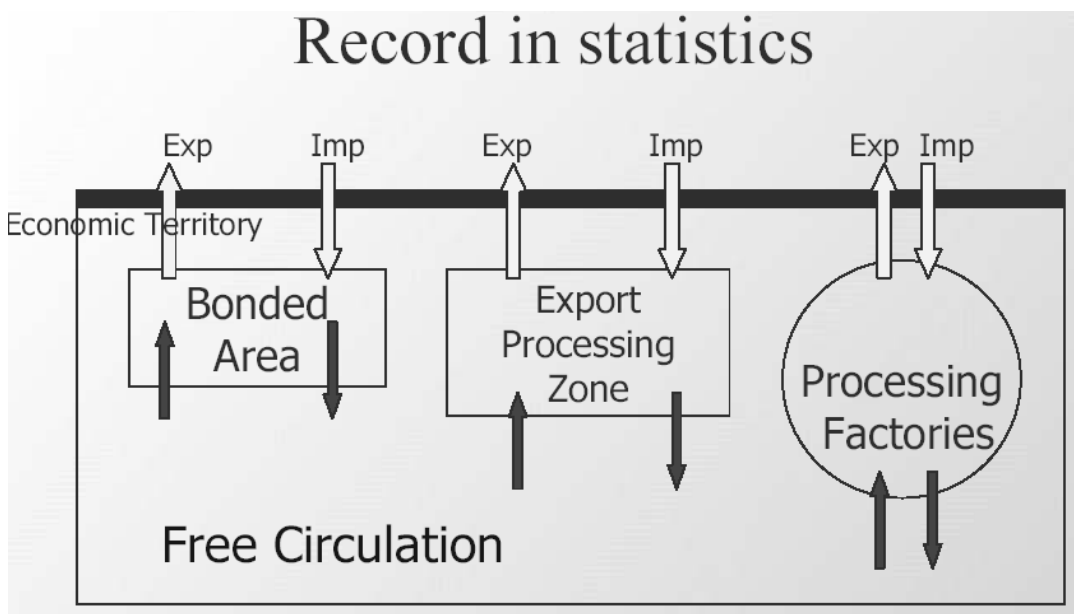
43. For the US Statistical Authority it is virtually impossible to retrieve any survey information, besides some scarce information via multi-nationals in the USA of their foreign affiliates in Mexico.

44. In Case 3, the goods are not shipped back to the mother company but are instead shipped to a third country. The problems for collecting information via customs declarations or enterprise surveys are almost identical to those of case 2. Mexican Customs will have export declarations which may be linked to the inward processing declaration. Further, the Mexican Statistical Authority could obtain some information via the manufacturing and trading companies on its economic territory. On the US side no extra information would be available at Customs and only scarce information from enterprise surveys of the multi-nationals.

The China example

45. The previous cases show the problems associated with gathering additional information. The Revised Kyoto Convention, ratified in 2006, and additional enterprise surveys can be of help in collecting the respective trade flow information. The picture hereafter shows an example of China where recording goods for processing involves a number of related goods transactions.

46. China distinguishes three differently regulated processing zones or factories, namely (1) Export processing zones, (2) Processing factories, and (3) Bonded areas. Each of those factories has a special permit to process goods, which are exempted from import duties. There are imports and exports of goods from abroad into those zones and then there are imports and exports of goods in and out of those zones from China itself. The latter are indicated with blue arrows in the illustration. All of those flows need to be accounted for to get a clear picture of “goods for processing”. While giving these companies certain privileges, China Customs asks in return to have a full view into their accounting books.



47. Given the importance to know if a change of economic ownership took place, the obligations of the processing company towards Customs need to be fully understood. China Customs explained at a recent meeting⁹ that it keeps so-called accounting books for all factories in the export processing zones and (to a lesser extent) for each of the processing factories. More than 70% of all factories doing processing are located in these processing zones. Such accounting books enable them to identify ownership of the goods entering the production process, where the goods originated from and where the processed goods are departing to.

⁹ At an IMTS workshop organized by UNSD and ESCAP in Bangkok in December 2006 (see <http://unstats.un.org/unsd/trade>)

Complicating trade practices

48. The China example shows that in cases of processing under contract not all inputs have to originate from the client's country. The client may provide only a part of the necessary input, while the processing enterprise would need to procure the rest by its own means. Even if the client provides all the necessary input, they do not necessarily originate from its own economy. The client might order these goods from various countries abroad and have them shipped directly to the country of processing. While between the client and the processing enterprise the only transaction is the supply of a service, the actual movement of goods can be more complicated.

Valuation of the processing service

49. Calculation of service fees in cases where goods are returned after processing [case (i)] is the same in BPM6 as was already recommended in cases where goods are eventually sold to residents of the processing country (case (ii)) or sold a third country (case (iii)). However, deriving the service charge as the net of gross *goods for processing* flows does not seem a satisfactory option, because:

- matching of goods for processing and their resulting products when they enter and exit the processing country is problematic; and
- between the time of its import and the time of its export, goods might undergo significant value changes independent from the processing fee (mostly due to mark-up value of the finished product).

Preliminary Conclusion

50. The above examples show issues related to measurement of transactions of “Goods for processing”. The inward and outward processing procedures described in the Revised Kyoto Convention seem helpful. In addition, the compiling economy may conduct enterprise surveys. Finally, country practices – such as the example of China – may show additional possibilities for obtaining information.

ANNEX 1: INWARD PROCESSING

“**inward processing**” means the Customs procedure under which certain goods can be brought into a Customs territory conditionally relieved from payment of import duties and taxes, on the basis that such goods are intended for manufacturing, processing or repair and subsequent exportation.

Field of application

1. Goods admitted for inward processing shall be afforded total conditional relief from import duties and taxes. However, import duties and taxes may be collected on any products, including waste, deriving from the processing or manufacturing of goods admitted for inward processing that are not exported or treated in such a way as to render them commercially valueless.
2. Inward processing shall not be limited to goods imported directly from abroad, but shall also be granted for goods already placed under another Customs procedure.
3. The right to import goods for inward processing shall not be limited to the owner of the imported goods.
4. (Recommended practice) The possibility of determining the presence of the imported goods in the compensating products should not be imposed as a necessary condition of inward processing when:
 - a) the identity of the goods can be established :
 - i. by submitting the details of the inputs and the process of manufacture of the compensating products; or
 - ii. during the processing operations by Customs control; or
 - b) the procedure is terminated by the exportation of products obtained from the treatment of goods identical in description, quality and technical characteristics to those admitted for inward processing.

Placing goods under inward processing

(a) Authorization for inward processing

5. National legislation shall specify the circumstances in which prior authorization is required for inward processing and the authorities empowered to grant such authorization.
6. The inward processing authorization shall specify the manner in which operations permitted under inward processing shall be carried out.

7. Where goods admitted for inward processing are to undergo manufacturing or processing, the competent authorities shall fix or agree to the rate of yield of the operation by reference to the actual conditions under which it is effected. The description, quality and quantity of the various compensating products shall be specified upon fixing or agreeing to that rate.

(b) Identification measures

8. The requirements relating to the identification of goods for inward processing shall be laid down by the Customs. In carrying this out, due account shall be taken of the nature of the goods, of the operation to be carried out and of the importance of the interests involved.

Stay of the goods in the Customs territory

9. The Customs shall fix the time limit for inward processing in each case.
10. Provision shall be made to permit compensating products to be exported through a Customs office other than that through which the goods placed under inward processing were imported.
11. (Recommended practice) The competent authorities should permit processing operations to be carried out by a person other than the person accorded the facilities for inward processing. Transfer of ownership of the goods admitted for inward processing should not be necessary, provided that the person accorded the inward processing facilities remains responsible to the Customs for compliance with the conditions set out in the authorization for the entire duration of the operations.

Termination of inward processing

(a) Exportation

12. Provision shall be made to permit inward processing procedures to be terminated by exportation of the compensating products in one or more consignments.
13. Upon request by the person concerned, the competent authorities shall authorize the re-exportation of the goods in the same state as imported, with termination of inward processing.

(b) Other methods of disposal

14. (Recommended practice) Provision should be made for suspending or terminating inward processing by placing the imported goods or the compensating products under another Customs procedure, subject to compliance with the conditions and formalities applicable in each case.
15. (Recommended practice) National legislation should provide that the amount of import duties and taxes applicable in the case where the compensating products are not exported shall not exceed the amount of import duties and taxes applicable to the imported goods admitted for inward processing.

ANNEX 2: OUTWARD PROCESSING

“**outward processing**” means the Customs procedure under which goods which are in free circulation in a Customs territory may be temporarily exported for manufacturing, processing or repair abroad and then re-imported with total or partial exemption from import duties and taxes.

Field of application

1. Temporary exportation of goods for outward processing shall not be restricted to the owner of the goods.

Placing goods under outward processing

(a) Formalities prior to temporary exportation of the goods

2. National legislation shall enumerate the cases in which prior authorization is required for outward processing and specify the authorities empowered to grant such authorization.
3. (Recommended practice) The competent authorities should fix a rate of yield for an outward processing operation when they deem it necessary or when it will facilitate the operation. The description, quality and quantity of the various compensating products shall be specified upon fixing that rate.

(b) Identification measures

4. The requirements relating to the identification of goods for outward processing shall be laid down by the Customs. In carrying this out, due account shall be taken of the nature of the goods, of the operation to be carried out and of the importance of the interests involved.
5. The Customs shall fix the time limit for outward processing in each case.

Importation of compensating products

6. Provision shall be made to permit compensating products to be imported through a Customs office other than that through which the goods were temporarily exported for outward processing.
7. Provision shall be made to permit compensating products to be imported in one or more consignments.
8. Upon request by the person concerned, the competent authorities shall allow goods temporarily exported for outward processing to be re-imported with exemption from import duties and taxes if they are returned in the same state.
9. Unless national legislation requires the re-importation of goods temporarily exported for outward processing, provision shall be made for terminating the outward processing by declaring the goods for outright exportation subject to compliance with the conditions and formalities applicable in such case.