**BOPCOM-05/22**

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**Eighteenth Meeting of the**
**IMF Committee on Balance of Payments Statistics**
**Washington, D.C., June 27–July 1, 2005**

# Merchanting

# BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP (BOPTEG)

## OUTCOME PAPER (BOPTEG) # 16A

## JANUARY 2005

(1) Topic: **Merchanting**

(2) Issues – see BOPTEG Issues Paper # 16A

(3) Recommendations:

(i) A significant majority of BOPTEG members supported the recording of goods under merchanting as transactions in goods and favored introducing a new subcategory "goods under merchanting" under goods. Application of the concept of the change of ownership, cross-border symmetry of data, consistency with SNA (as balance of payments record transactions rather than production) were noted as major conceptual arguments for recording merchanting as transactions in goods. Some members pointed to practical problems in separately identifying goods under merchanting while other members saw no practical problems. It was noted that the service margins are not identified in other cases where they are included in the price of the good.

(ii) A few members preferred the continuation of the existing treatment emphasizing that the nature of the activity, as intermediation, is essentially a service.

(iii) The group noted that the issue should also go to the Task Force on Statistics on International Trade in Services for consultation.

(4) Rejected Alternatives:

None.

(5) Questions for the Committee:

*(i)* *Does the Committee agree that goods under merchanting be recorded as transactions in goods?*

*(ii)* *If yes, does the Committee agree that a new subcategory "goods under merchanting" be introduced under goods?*

*See 3(i) above for all questions.*

**IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS**

**BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP (BOPTEG)**

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# ISSUES PAPER (BOPTEG) # 16A

## MERCHANTING

**Prepared by Hidetoshi Takeda, IMF Statistics Department**

**October 2004**

# BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP

# ISSUES PAPER (BOPTEG) #16A

# MERCHANTING

At the first meeting of the BOPTEG in June 2004, the issue of the treatment of merchanting was discussed based on the issues paper BOPTEG # 16. No clear view emerged on the treatment of merchanting. Therefore, the group decided to put this issue at the agenda for the next BOPTEG meeting and IMF volunteered to prepare an issues paper.

This issues paper was prepared to facilitate further discussion.

## I. Current international standards for the treatment of the issue

### Balance of Payments Manual, 5th Edition (BPM5)[1]

Merchanting is defined as the purchase of a good by a resident (of the compiling economy) from a nonresident and the subsequent resale of the good to another nonresident; during the process, the good does not enter or leave the compiling economy. The difference between the value of goods when acquired and the value when sold is recorded as the value of merchanting services provided (para 262).

If the commodities are not resold by the merchant in the same accounting period, an import of goods is recorded in the first period, and a negative import entry is recorded in the later period. In the case that a merchanting transaction straddles different recording periods, changes from one recording period to another in the stocks of goods located abroad and valued at acquisition cost constitute part of goods of the economy of the owner (para 213, 262).

In either situation, any difference between the value of the goods when acquired and relinquished is entered as merchanting under other business services (para 213).

***Balance of payments compilation guide*** (para 138-139) and ***Balance of Payments Textbook*** (para 189-194, 361-362) provide specific treatments of merchanting in BOP.

### Manual on Statistics of International Trade in Services (MSITS)

The MSITS's definition of and recommendation on treatments for merchanting are consistent with those of *BPM5* (3.123).

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[1] The *BPM5* seems to reflect treatments of wholesalers/retailers services in the *1993 SNA*. The *BPM4* treated merchanting the same as the *BPM5* (the *BPM4* references are para 219, 228, 237).

Box 6 of the MSITS provides detailed explanations on merchanting. The box also shows that; (1) the recording of merchanting transactions is asymmetrical, i.e., merchanting services are recorded only in the economy in which the merchant is resident[2], and (2) if the goods are resold for less than the original cost of purchase, then a negative export of merchanting services would be recorded.

## II. Concerns/Shortcomings of the current treatment

### (1) How to measure merchanting services[3]

- The *MSITS* explicitly accepts a negative export of merchanting services. It is apparent that the *BPM5* accepts the negative exports of merchanting services[4].

### (2) Holding gains and losses for the relevant goods may distort the measurement of merchanting services[5].

- Holding gains/losses are valuation changes of merchants' assets (inventories). So, they should not be included in services.

### (3) The current guidance on merchanting results in structural asymmetry.

- Merchanting services are recorded only by the exporting countries. This causes asymmetry for merchanting services (*Balance of Payments Textbook*, para 192; *MSITS*, Box6).

### (4) The recommendation on merchanting trading that straddles different accounting periods may provide misleading data on goods. The recommendation is also very difficult to implement in practice.

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[2] Merchanting services are included in trade in goods in the economy of the original seller and the ultimate purchaser of goods.

[3] Practical difficulties in compiling regional breakdowns for merchanting service can also arise. This, however, does not seem to have influenced the discussion of the concept of merchanting.

[4] The *1993 SNA* also states that output of wholesalers/retailers is measured by the total value of the trade margins realized on the goods they purchase for resale and that " the margins realized on some goods may be negative if their prices have to be marked down"(6.110).

[5] *Balance of Payments Textbook* states, "Speculative gains or losses realized from transactions in commodity arbitrage are also recorded under this item" (merchanting, para 361). This is implied from the *BPM5* definition and explicitly presented in the *MSITS*. This, however, does not fit the *1993 SNA* concept of services.

- Conceptually, the recommendations in the *BPM5* are appropriate when purchases and resale of the relevant goods straddle different accounting periods, and so merchanting services are not completed in the accounting period of purchase. As the ownership of the relevant goods changes from foreign providers to the merchants (residents), it is appropriate to record imports of the goods. Then, when the relevant goods are resold to nonresidents, merchanting services are to be recorded in the accounting period of resale because the services are completed in the period. Negative imports of the relevant goods are to be recorded for the accounting period of purchase in order to reverse the entry in the previous period.

- Data on trade in goods could be distorted under current treatments when large amount of merchanting transactions straddle different accounting periods.

- There is a danger of mismeasurements under this *BPM5* procedure, and more generally problems in implementation.

## III. Possible Alternative treatments[6]

### (1) Recording merchanting as trade in goods

The alternative is to record transactions in goods alone.

To support analysis, a new subcategory 'goods under merchanting' could be introduced under the goods. The goods related to merchanting should be recorded separately from other goods under this subcategory.

This alternative has the following merits[7] [8];

- It avoids exceptional treatments in relation to 'change of ownership' principle.

- The recording of goods under merchanting becomes symmetrical.

- No negative exports of merchanting services are recorded.

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[6] The alternatives coincide with whether the BOP goods and services account is trying to cover transactions in goods and services (as in the SNA's Goods and Services Account) or production (as in the SNA's production account).

[7] This would be consistent with how we treat the activities of merchants when the goods pass through their territory. In these cases, the wholesale margin is included with the price of the good, and we would not try to separate it, even though the wholesaler and the customer are in different countries.

[8] Under this option, providing regional breakdowns of goods under merchanting also become easier.

- Distortions in the measurement of services caused by holding gains and losses on the relevant goods are eliminated.

- Practical difficulties or misleading volatilities are also eliminated when merchanting transactions straddle different recording periods

On the other hand, statistical continuity would not be kept between the *BPM5* and the revised manual[9].

### (2) Recording merchanting as trade in services

The *BPM5* approach could be maintained, but for merchanting that straddle different accounting periods, a new subcategory 'goods under merchanting' under the trade in goods category could be introduced.

## IV. Question/Points for discussion

***(1) Which alternative does the group recommend? Does the group have other views?***

**Reference**

Annotated Outline (Chapter 9)

Merchanting BOPTEG Issues Paper # 16

Balance of Payments Manual, Fourth Edition (1977)

Balance of Payments Manual, Fifth Edition (1993)

Balance of Payments Compilation Guide (1995)

Balance of Payments Textbook (1996)

Manual on Statistics of International Trade in Services (2002)

1993 System of National Accounts

[9] If data on trade on goods is compiled from customs record without sufficient supplementary source for transactions that do not cross customs, new distortions would arise.

IMF COMMITTEE ON BALANCE OF PAYMENTS STATISTICS

BALANCE OF PAYMENTS TECHNICAL EXPERT GROUP (BOPTEG)

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# ISSUES PAPER (BOPTEG) # 16B

## MERCHANTING:

## SOME NUMERICAL EXAMPLES OF THE PRESENT AND PROPOSED TREATMENTS

Prepared by Hidetoshi Takeda, IMF Statistics Department

May 2005

# Some Numerical Examples of the Present and Proposed treatments of Merchanting

## Introduction

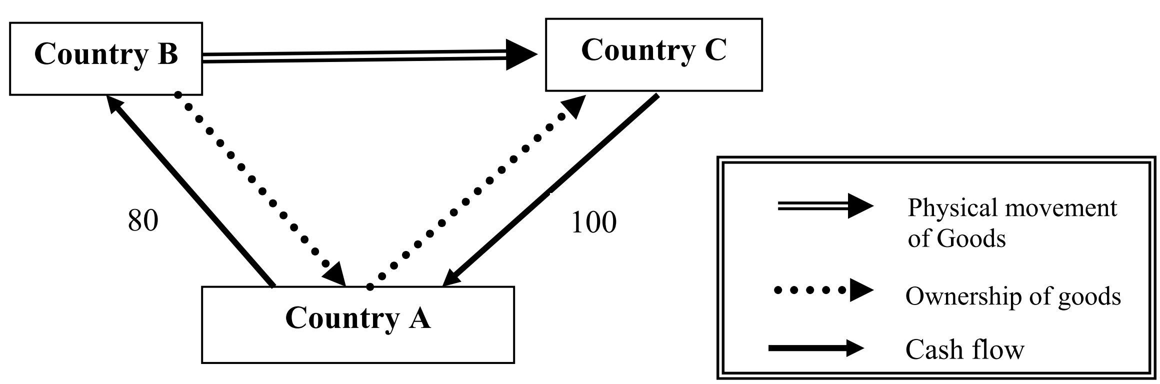
*Balance of Payments Manual, fifth edition (BPM5)* defines merchanting as the purchase of a good by a resident (of the compiling economy) from a nonresident and the subsequent resale of the good to another nonresident; during the process, the good does not enter or leave the compiling economy. The difference between the value of goods when acquired and the value when sold is recorded as the value of merchanting services provided (paragraph 262).

BOTEG issues paper # 16A proposes to record merchanting transactions as trade in goods, and indicates the shortcomings of the current treatment. This paper complements the issues paper by providing numerical examples below to show the difference between the present and proposed treatment.

## Case 1: Basic case

The following example illustrates the basic principles of the present and proposed treatments. All transactions occur within a recording period, with the goods physically moving from Country B to Country C directly, and not entering into Country A. It is assumed that all transactions are settled by currency and deposits.

| | |
|---|---|
| Value of goods purchased by a resident of country A' from a resident of B' | 80 |
| Value of goods A' resells to a resident of C' | 100 |



| Present treatment | Credit | Debit |
|---|---|---|
| **Country A** | | |
| Services: Merchanting | 20 | |
| Currency & deposits | | 20 |
| **Country B** | | |
| Goods | 80 | |
| Currency & deposits | | 80 |
| **Country C** | | |
| Goods | | 100 |
| Currency & deposits | 100 | |
| **Global balance**[1] | | |
| Goods | 80 | 100 |
| Merchanting | 20 | |
| Currency & deposits | 100 | 100 |

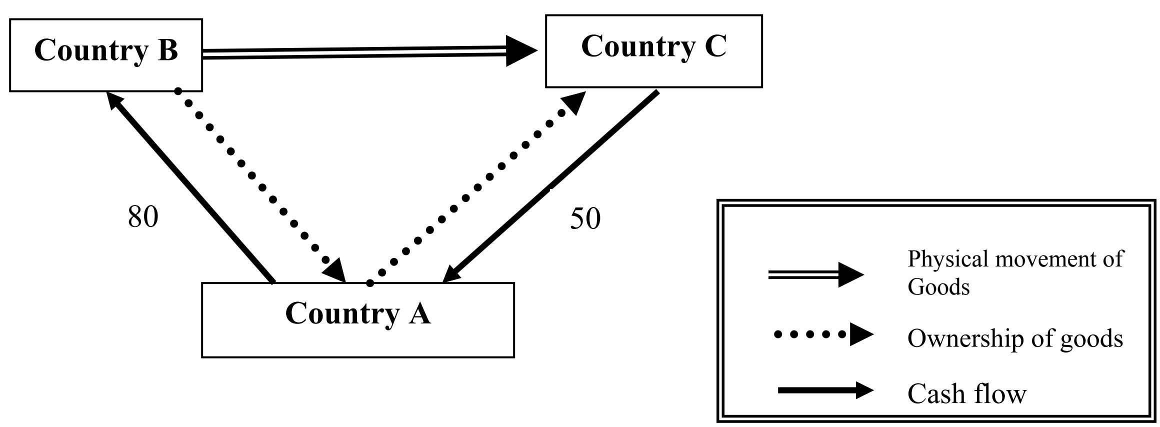
| Proposed treatment | Credit | Debit |
|---|---|---|
| **Country A** | | |
| Goods under merchanting | 100 | 80 |
| Currency & deposits | | 20 |
| **Country B** | | |
| Goods | 80 | |
| Currency & deposits | | 80 |
| **Country C** | | |
| Goods | | 100 |
| Currency & deposits | 100 | |
| **Global balance** | | |
| Goods | 180 | 180 |
| Goods under merchanting | 100 | 80 |
| Currency & deposits | 100 | 100 |

[1] Merchanting is recorded only in the country A (the exporter of merchanting services). This causes global imbalances in goods and services as no debit entry in merchanting is recorded.

**Case 2: Holding gains/losses occur**[2]

The following example illustrates the principles of the present and proposed treatments if holding gains and losses occur. Before A' resells the goods to B', the price decreases by up to 30. All transactions occur within a recording period, with the goods physically moving from Country B to Country C directly, and not entering into Country A. It is assumed that all transactions are settled by currency and deposits.

| | |
|---|---|
| Value of goods purchased by a resident of country A' from a resident of B' | 80 |
| Value of goods A' resells to a resident of C' | 50 |

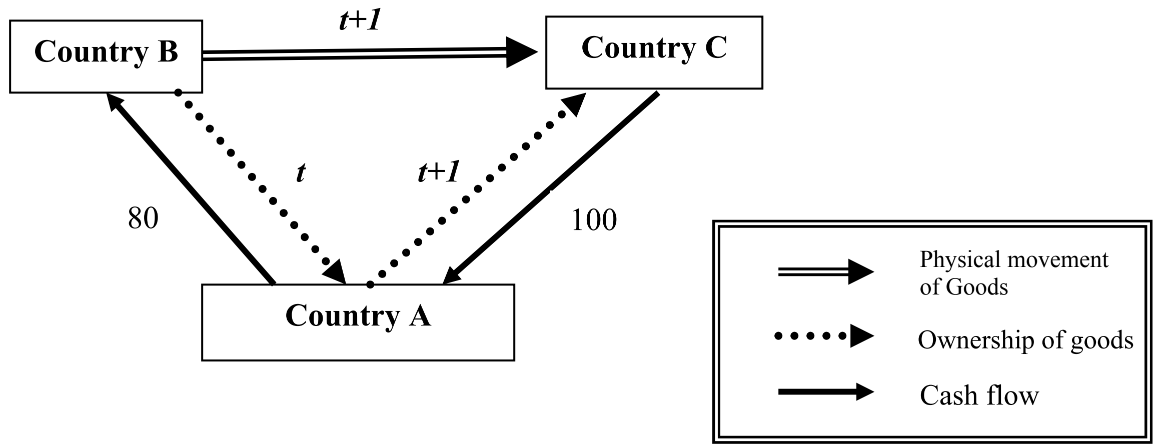



[2] The above case treats holding losses; the recording principles are the same for a holding gain.

| Present treatment | Credit | Debit | Proposed treatment | Credit | Debit |
|---|---|---|---|---|---|
| **Country A** | | | **Country A** | | |
| Services: Merchanting | -30 | | Goods under merchanting | 50 | 80 |
| Currency & deposits | 30 | | Currency & deposits | 30 | |
| **Country B** | | | **Country B** | | |
| Goods | 80 | | Goods | 80 | |
| Currency & deposits | | 80 | Currency & deposits | | 80 |
| **Country C** | | | **Country C** | | |
| Goods | | 50 | Goods | | 50 |
| Currency & deposits | 50 | | Currency & deposits | 50 | |
| **Global balance** | | | **Global balance** | | |
| Goods | 80 | 50 | Goods | 130 | 130 |
| | | | Goods under merchanting | 50 | 80 |
| Services: Merchanting | -30 | | | | |
| Currency & deposits | 80 | 80 | Currency & deposits | 80 | 80 |

**Case 3: Transactions that straddle recording periods**

The following example illustrates the principles of the present and proposed treatments if transactions straddle the recording period. The value of the transactions is the same as in the basic case. However, resident of A purchases from the resident of B in time **t** and resells the goods to a resident of C in time ***(t+1)***. Goods physically move from Country B to Country C directly, and not entering into Country A. It is assumed that all transactions are settled by currency and deposits.




**Present treatment**

| **a) period t** | **Credit** | **Debit** |
|---|---|---|
| **Country A** | | |
| Goods | | 80 |
| Currency & deposits | 80 | |
| **Country B** | | |
| Goods* | 80 | |
| Currency & deposits | | 80 |
| **Global balance** | | |
| Goods | 80 | 80 |
| Currency & deposits | 80 | 80 |

| **b) period (t +1)** | **Credit** | **Debit** |
|---|---|---|
| **Country A** | | |
| Goods | | -80 |
| Services: Merchanting | 20 | |
| Currency & deposits | | 100 |
| **Country B** | | |
| **Country C** | | |
| Goods | | 100 |
| Currency & deposits | 100 | |
| **Global balance** | | |
| Goods | | 20 |
| Services: Merchanting | 20 | |
| Currency & deposits | 100 | 100 |

**Proposed treatment**

| **a) period t** | **Credit** | **Debit** |
|---|---|---|
| **Country A** | | |
| Goods under merchanting | | 80 |
| Currency & deposits | 80 | |
| **Country B** | | |
| Goods* | 80 | |
| Currency & deposits | | 80 |
| **Country C** | | |
| **Global balance** | | |
| Goods | 80 | 80 |
| Goods under merchanting | | 80 |
| Currency & deposits | 80 | 80 |

| **b) period (t +1)** | **Credit** | **Debit** |
|---|---|---|
| **Country A** | | |
| Goods under merchanting | 100 | |
| Currency & deposits | | 100 |
| **Country B** | | |
| **Country C** | | |
| Goods, debit | | 100 |
| Currency & deposits | 100 | |
| **Global balance** | | |
| Goods | 100 | 100 |
| Goods under merchanting | 100 | |
| Currency & deposits | 100 | 100 |

* It is assumed that country B records the transactions of the relevant goods based on "change of ownership", rather than physical movement of the goods. In practice, many countries record trade in goods based on trade statistics, under which data are compiled based on goods physically cross the customs. If the country B records exports based solely on customs data, the country might record the export of the related goods in period (t+1), when the goods actually cross the customs. In such a case, errors and omissions would be recorded under country B's balance of payments in both period for balancing currency & deposits (t) and goods credit (t+1). Alternatively, the timing problem could show up in trade credit, if the countries derive trade credit from the difference between goods transactions from customs and those from banking system data