INTERNATIONAL MONETARY FUND

Statistics Department

The Treatment of Freight and Insurance Associated to Merchanting and the Geographical Allocation of Net Merchanting

The Treatment of Freight and Insurance Associated to Merchanting and the Geographical Allocation of Net Merchanting[1]

Merchanting transactions, according to the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6), *should be recorded in the balance of payments as transactions in goods. However, as the goods involved, by definition, do not cross the customs boundary of the merchant's country, data compilation issues have arisen. Although* BPM6 *provides guidance on the valuation of goods under merchanting, the treatment of freight costs for these goods is considered ambiguous. This note clarifies that, according to the recommendations of* BPM6, *freight transport and insurance costs associated to merchanting are to be recorded at transaction prices as agreed between the parties, and dependent on the agreed delivery terms, that is not "free on board" (fob). In addition, the note also clarifies that the country allocation of "net exports of goods under merchanting" should be done by adding up all credit and debit entries of goods under merchanting* <u>*for each partner country*</u>.

I. Introduction

1. Merchanting is defined as the purchase of goods by a resident (of the compiling economy) from a nonresident combined with the subsequent resale of the same goods to another nonresident without the goods being present in the compiling economy.[2] *BPM6* retains the overall concept of merchanting from *BPM5* but prescribes a change in its methodological treatment, namely reclassifying merchanting from trade in services to trade in goods. This change in the recommended treatment is in line with the change of economic ownership principle that underpins the balance of payments conceptual framework.

2. In international accounts, goods acquired or sold under merchanting are distinguished separately within the goods account in the economy of the merchant on the premise that they are not registered in the customs statistics of the merchant's economy and are of interest of their own. In that regard, merchanting raises two issues: (i) the treatment of freight and insurance in connection with the transportation of goods acquired and sold under merchanting, and (ii) the country allocation of "net exports of goods under merchanting", which according to compilers require a clarification to the current methodological guidance provided in *BPM6*.

3. This note clarifies the guidance provided to compilers and users on the recording of freight and insurance for goods under merchanting and the geographical allocation of net merchanting.

[1] A previous version of this note was prepared by the Balance of Payments Division of the Deutsche Bundesbank and presented at the thirty-first meeting of the IMF Committee on Balance of Payments Statistics in October 2018 (see BOPCOM 18/13a at https://www.imf.org/external/pubs/ft/bop/2018/pdf/18-13a.pdf)

[2] See Paragraph 10.41 of *BPM6*

II. TREATMENT OF FREIGHT AND INSURANCE FOR GOODS UNDER MERCHANTING

4. According to *BPM6*, paragraph 10.44, acquisition of goods under merchanting is recorded, on a gross basis, in the economy of the merchant as '*negative exports – goods under merchanting*', while the sale of the goods is shown as '*positive exports – goods under merchanting*'.

5. The principle for valuation of general merchandise as stipulated in *BPM6*, paragraph 10.30, is at the *point of uniform valuation*, which is *at the customs frontier of the economy from which the goods are first exported, that is, free on board (fob)*. Hence *fob* valuation is as at the customs frontier of the exporting economy such that all freight (transportation and insurance) costs up to the customs frontier are shown as incurred by the exporter and all freight costs beyond the customs frontier are shown as incurred by the importer.

6. Merchanting does not necessitate any local physical storage of the goods by the merchant for the process to occur implying that the goods transactions are not covered in the customs statistics of the merchant's economy (*BPM6*, paragraph 10.43). Consequently, freight (transportation and insurance) costs associated with merchanting are expected to be excluded or included in the value of the transaction prices as agreed by the merchant with its counterparties, depending on the agreed delivery terms.

7. In sum, *BPM6* paragraph 10.44(d) states that **merchanting entries are valued at transaction prices as agreed by the parties, and not *fob***. Thus, if the merchant concurs with the trading partners that the transaction value shall exclude any of the freight transport and insurance costs, the net merchanting recorded in the economy of the merchant will exclude those charges. Otherwise, if the merchant agrees with the relevant parties to be responsible for the freight transport and insurance costs, then the value of the purchase, *negative exports under merchanting*, shall exclude these costs while the value of the sale, *positive exports under merchanting*, will include them. In other words, the values of freight transport and insurance costs are embedded in the value of the sale, rather than separately recorded as credits in trade in services. Another scenario is when the merchant contracts a non-resident to transport the goods from the two different economies or to provide freight insurance, then these costs will be accounted as imports of services in the balance of payments of the economy where the merchant resides.

III. GEOGRAPHICAL ALLOCATION OF NET MERCHANTING

8. With the increased pace of globalization and the emergence of global production arrangements driving demand for more geographical granularity of cross-border statistics, and against the background of compiling international input/output tables, some countries are compiling balance of payments with country breakdowns. In these circumstances, the need to address the issue of geographical allocation of net merchanting arises.

9. While *BPM6* does not specifically elaborate on the geographical allocation of net merchanting, *BPM6 Compilation Guide* (*BPM6CG*) discusses the compilation of partner economy statistics, basing the recording on the change of economic ownership principle. Hence, imports (i.e., negative exports) by merchants would be classified by the economy of the counterpart seller—the economy where the exporter's contractor is domiciled or has its business—and exports by merchants would be classified by the economy of the counterpart buyer—the economy where the importer's contractor is domiciled or has its business. In addition, Table A5.3 of the *BPM6CG* (reproduced as Table 1 below), when comparing movement of goods based on international merchandise trade statistics (IMTS) to the change in ownership, provides an indication on the geographical allocation with respect to merchanting.

Table 1. Comparison of Merchandise Trade and Trade in Goods for Merchanting

	IMTS (movement of goods)			Balance of payments – trade in goods (change of ownership)		
	Partner economy			Partner economy		
	A	B	C	A	B	C
Economy A (merchant's) records	….	….	….	….	Negative export	Export
Economy B records	….	….	Export	Export	….	….
Economy C records	….	Import	….	Import	….	….

Source: Balance of Payments Compilation Guide, Appendix 5, Table A5.3

10. Table 1 above illustrates an example of merchanting where a merchant resident in economy A buys goods produced in economy B and sells the goods to a resident in economy C, shipping the goods directly from economy B to economy C. By geographic breakdown in economy A, goods under merchanting – positive exports (sales) will be registered vis-à-vis economy C and negative exports (purchases) will be recorded against economy B[3]. "Net merchanting" will, therefore, be allocated geographically *de facto* by adding up all credit and debit entries of goods under merchanting for each partner country.

IV. Concluding Remarks

11. This note clarifies that freight transport and insurance costs associated to merchanting are to be recorded at transaction prices agreed between the parties and not fob, as stipulated

[3] Economies B and C will value the transaction on a free-on-board basis (general merchandise) while economy A will value it at its transaction price (merchanting), potentially allowing for bilateral asymmetries to occur if the transaction and f.o.b. valuations are diverging.

in *BPM6*, paragraph 10.44. Dependent on the agreed delivery terms, the freight and insurance costs shall be embedded in the sale value of the good or accounted for separately.

12. Pursuant to the guidance provided in *BPM6CG* on compiling partner economy statistics for trade in goods, the country allocation of “net exports of goods under merchanting” should be done by adding up all credit and debit entries of goods under merchanting for each partner country.