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THE IRISH APPROACH TOWARDS TREATMENT OF MERCHANTING AND RELATED TRANSACTIONS

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1. This paper focuses on the CSO's treatment of transactions of multinational companies, which are 'booked' through an Irish affiliate. These transactions can be considered to be within the broad concept of *merchanting*, a topic that was briefly referred to in a related paper prepared for this Seminar[2].

BACKGROUND COMMENT

2. The earlier paper described the significance of foreign-owned multinational companies (FDIEs) in the Irish economy. It also examined some statistical compilation issues encountered by the CSO concerning their changing structures, activities, trading and accounting practices as well as their BoP/FDI reporting arrangements. The CSO's treatment of merchanting and related transactions is another facet of general practical compilation issues.

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MERCHANTING AND RELATED PHENOMENA IN IRELAND

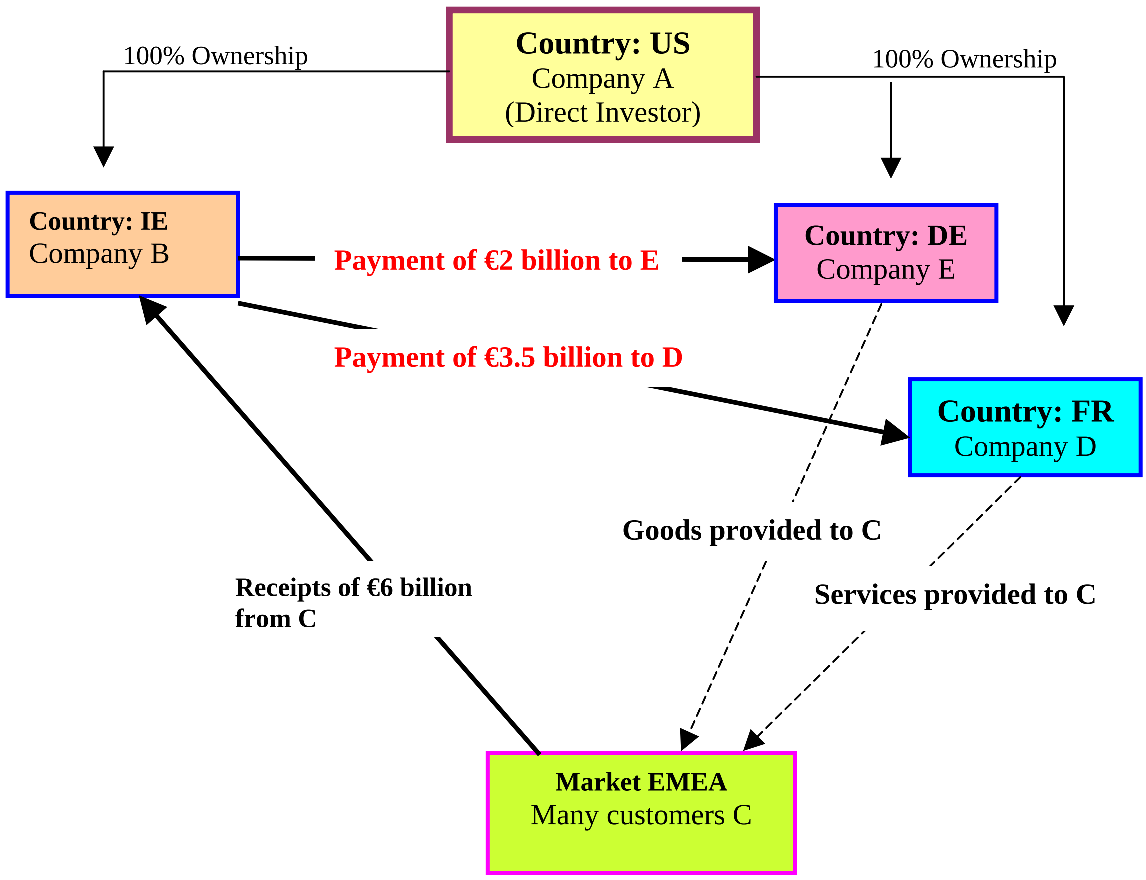
3. Merchanting is defined in the IMF's BPM5 as the purchase of a good by a resident trader from a non-resident and the subsequent resale of the good to another non-resident, without the good entering or leaving the economy of the merchanting trader. The difference between the value of the good when acquired and its value when sold is recorded as the value of the (merchanting) service provided by the merchant trader.

4. The focus in this paper is on the approach adopted by the CSO in the treatment of merchanting and related trading matters i.e. on the recording of sales turnover and expenditure of the entity located in Ireland. In the situation being described, the goods and services supplied are not produced by the Irish entity but are sourced abroad and delivered to a foreign third party customer by non-resident affiliates of the Irish operation. The particular type of trading practice outlined is simply one of a number of scenarios that are encountered. Multinational company group structures facilitate the types of arrangements encountered but membership of a group structure is not a strict requirement for the existence of these trading practices. Unrelated third parties may be involved in the supply/delivery of the goods/services.

5. The CSO approach is fundamentally based on the recommendations of the BPM5 in relation to merchanted goods. However, certain significant modifications are made where considered necessary in the interest of the clarity and understandability of the results. These modifications initially related to the treatment of services outsourced and delivered in association with the supply of goods. They have recently been extended to the treatment of services where goods are not involved.

6. Consider the following fictitious situation (which is a simplified version of more complicated activities and practices). A foreign direct investment enterprise located in Ireland (B) is owned by a US investor (A). B in Ireland arranges for the supply, installation and maintenance of goods/equipment to a number of unrelated customers (C) in the Europe, Middle East and Africa (EMEA) market, as well as the provision of staff training programmes, etc. concerning the operation of the goods/equipment. The goods and services supplied are not sourced in Ireland by B. The goods/equipment are purchased for €2 billion by B from its affiliate (E) located in Germany while the various services are purchased for €3.5 billion from another affiliate D in France. The two affiliates deliver the goods and services to the customers (C). These customers pay B a total of €6 billion for the goods (€2.2 billion) and services (€3.8 billion) they receive. The Irish trader, B, records in its accounts all payments and receipts arising from the order. Figure 1 describes the situation.

Figure 1. Merchanting and related transactions



7. Under the BPM5 and other international recommendations, the above transactions would (normally) be recorded in the BoP statement under service imports and exports, with, in the case of the goods element, only the net margin (€0.2 billion) being recorded as a merchanting service credit. The related service transactions would appear under services: a credit of €3.8 billion and a debit of €3.5 billion (see Table 1 below).

Table 1. Recommended recording treatment

BoP Item	Credit	Debit	Net
	€ million		
Merchanting service	**200**		**200**
Other services	**3,800**	**3,500**	**300**
Total	4,000	3,500	500

8. As both the goods and services delivered to the EMEA customers (C) have been sourced from and delivered by a non-resident of Ireland (i.e. a French D and a German E foreign affiliate of the Irish entity B), the CSO treats the combined transactions for goods and services described above on a net basis. It records the overall net margin of €0.5 billion as a credit (service export)

under merchanting services in the ‘Services’ part of the BoP Current Account (see Table 2).

Table 2. CSO, Ireland recording treatment

BoP Item	Credit	Debit	Net
	€ million		
Merchanting services	**500**		**500**
Other services	**-**		**-**
Total	500		500

9. This is an important extension by the CSO of the BPM5 definition of merchanting (as it applies to goods supplied which do not enter or leave the compiling economy). Under the CSO’s approach for the type of scenario shown in the example, services which are

- sourced abroad by an Irish resident trader and associated with the supply of merchanted goods to a customer resident abroad, and
- then delivered to the customer by a non-Irish-resident entity are included on a net basis under *merchanting*.

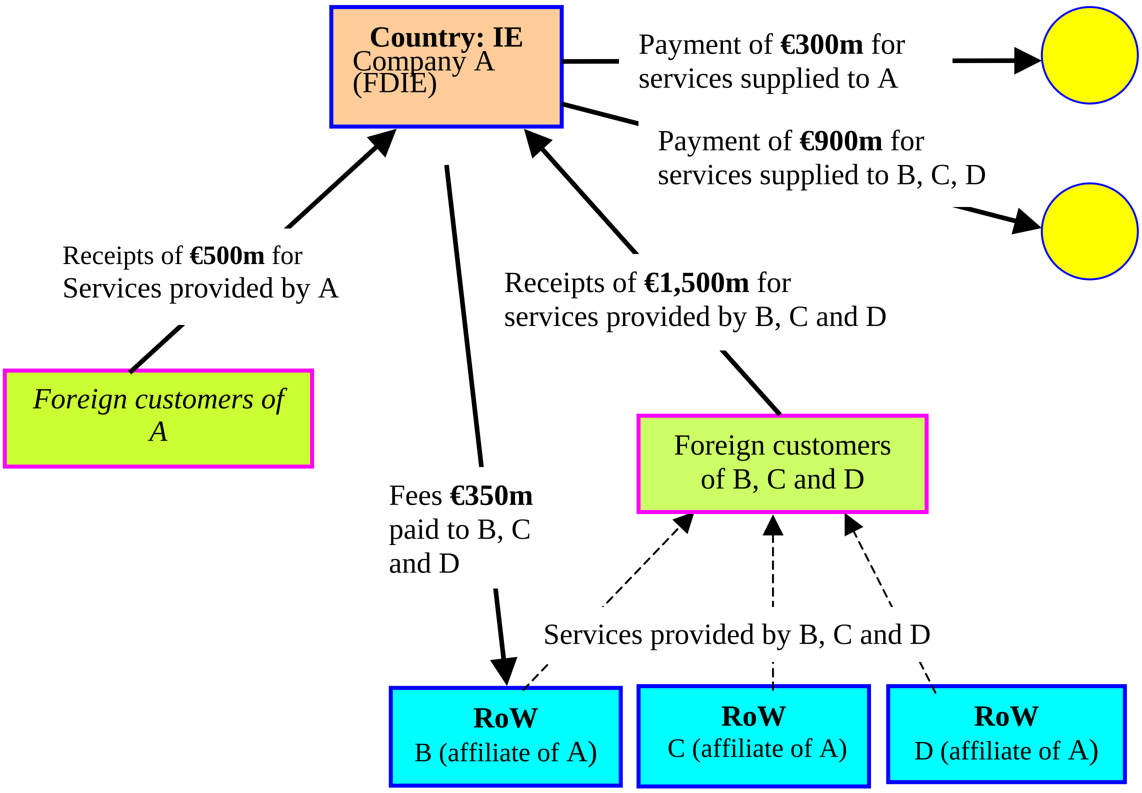
10. The main reason for CSO’s adoption of this approach is to reduce the potential for statistical distortion arising from these very large transactions in both goods and services sourced and delivered abroad. It does not seem appropriate or meaningful to inflate the services exports and imports data for such transactions, particularly when such large aggregate flows in the statistics presented are referenced against employment levels in a particular industrial activity in Ireland. In saying this, it is acknowledged that net recording by one compiler can lead to distortions or asymmetries where counterpart compilers may have no option but to record the transactions on a gross basis in their BoP statistics.

11. While the scenario and treatment just described deal with goods and associated services outsourced abroad by an Irish resident trader and delivered abroad by affiliates of the trader, they could also apply where foreign third party enterprises rather than affiliates are involved.

12. Recently, the CSO decided to extend this treatment to the situation involving transactions in services which are not associated with the supply of goods. Where services are provided to foreign customers by affiliates of an Irish resident enterprise and all receipts and expenditure are recorded in the books of the Irish operation, then the CSO applies a net treatment for recording the relevant transactions involved.

13. For example, an Irish resident FDIE, A, directly supplies services to non-resident customers valued at €500m. It has three affiliates, B, C and D, located abroad which supply similar services valued at €1,500m to such customers. Invoices are issued from B, C and D on behalf of A i.e. A essentially invoices all of the customers (covering services provided by all 4 companies: A, B, C and D). A pays B, C and D commission fees of €350m covering their costs plus a margin. A also incurs direct expenses of €300m with other non-residents while the expenses of B, C and D combined amount to €900m. A records all turnover and expenditure as well as the profits generated. Figure 2 describes the situation.

Figure 2. Treatment of receipts and expenditure of Irish FDIE for services partly provided by foreign affiliates



14. The CSO records the above transactions in its BoP statement as shown in Table 3.

Table 3. CSO, Ireland recording treatment for services partly outsourced

BoP Item	Credit	Debit	Net
	€ million		
Merchanting services	**250**	**-**	**250**
Other services	**500**	**300**	**200**
Total	750	300	450

15. The €250m recorded under merchanting services results from the netting of A's commission fees of €350m paid to affiliates B, C and D along with the combined service expenditure of B, C and D of €900m against the value of the services they provide to customers i.e. €1,500m. The value of A's direct service exports (of €500m) to its foreign customers is recorded gross under other services (credit); its related expenditure of €300m is recorded gross as a debit. The internationally recommended treatment would be as follows in Table 4.

Table 4. Recommended recording treatment for services partly outsourced

BoP Item	Credit	Debit	Net
	€ million		
Specific services	**1,500**	**900**	**600**
Trade-related services	**-**	**350**	**- 350**
Other services	**500**	**300**	**200**
Total	2,000	1,550	450

16. An important point was mentioned earlier (Section 2 – trading practices). If the Irish entity is the ‘principal’ enterprise within a multi-national group through which the receipts and expenditure of the various affiliates are routed, then a change in this arrangement can have a significant impact on the data before and after the change. If, for example, the ultimate parent company decides to no longer have the Irish entity as the ‘principal’ but to transfer this role to an affiliate in another country then significant discontinuities can result in the service data and the profit/loss when the change occurred.

CONCLUDING REMARKS

17. The treatments adopted by CSO and described above are a departure from the recommendations of the international statistical standards. While a gross treatment of outsourced services delivered to a non-resident customer may be implicit in BPM5, there appears to be no explicit discussion of such delivery of services in the Manual documentation or any explicit reference as to how the relevant transactions should be treated. The Manual on Statistics of International Trade in Services, however, does refer to the requirement for gross recording of services purchased by the merchant connected to the delivery of the merchanted goods (e.g. transport, insurance, etc.). Similarly, there appears to be very little guidance on the treatment of goods and services provided by affiliates abroad but invoiced by a resident enterprise.

18. The treatment of merchanting in BoP statistics is being addressed in the BPM revision work currently underway at the IMF. The focus is again on merchanted goods and a net treatment is apparently being proposed but with, additionally, the gross flows also shown as positive and negative quantities on the exports side. The supply of outsourced services delivered to non-resident customers whether or not associated with the supply of the goods does not appear to be addressed however. It is likely that both compilers and users would benefit from a discussion of the proposed treatment of merchanting and the underlying rationale for it in the new BPM6. Also, it is hoped that some clear guidance will be forthcoming on the treatment of the booking of receipts and expenditure by an enterprise in a compiling economy in respect of transactions of its affiliates in other economies.

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