



**Economic and Social
Council**

Distr.
GENERAL

ECE/CES/2008/32
2 June 2008

ENGLISH ONLY

ECONOMIC COMMISSION FOR EUROPE

STATISTICAL COMMISSION

CONFERENCE OF EUROPEAN STATISTICIANS

Fifty-sixth plenary session
Paris, 10-12 June 2008
Item 6(b) of the provisional agenda

**UNECE STATISTICAL PROGRAMME AND WORK
OF THE CES TEAMS OF SPECIALISTS**

**PROGRESS REPORT ON THE IMPACT OF GLOBALISATION
ON NATIONAL ACCOUNTS**

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Globalisation on National Accounts)¹

1. The Joint UNECE/Eurostat/OECD Working Group on the Impact of Globalisation on National Accounts (WGGNA) was established in 2007. According to the terms of reference, approved by the CES Bureau in April 2007, the objective of the WGGNA is “to review the main distortions in the compilation of national accounts and related source statistics, as caused by globalisation”.
2. The final outcome, to be presented to the Conference of European Statisticians (CES) in June 2010, is a report with recommendations and best practices on the following points:
 - (a) To identify the areas most affected by globalisation;

¹ This paper has been prepared at the invitation of the secretariat.

- (b) Proposals to improve surveying, processing and integration of data;
- (c) Proposals to arrive at international consistency;
- (d) Proposals to improve international guidelines;
- (e) Proposals to create medium for exchange of best practices.

3. The CES Bureau also decided to set up a leadership group to steer the work of the WGGNA and report on the progress of work to the Conference. The 2007 CES took note of the terms of reference and the planned work of the group.

4. Since the last progress report in June 2007, the complete WGGNA met for the first time on 23-24 April 2008, back-to-back with the Joint UNECE/OECD/Eurostat Meeting on National Accounts. The leadership group of the WGGNA met twice: on 8-9 October 2007, and, back-to-back with the meeting of the WGGNA, on 25 April 2008.

5. During the first meeting of the WGGNA, three issues were discussed in detail: (i) treatment of goods for processing, (ii) treatment of merchanting, and (iii) multinational enterprises and the allocation of income in the balance of payments and national accounts. The conclusions related to each of these three topics are attached in Annex 1. The issue papers, which were the basis for discussing these topics, are intended to serve as a starting point for drafting the chapters in the final report to be presented to the CES in June 2010. The papers will be further developed to reflect comments made at the meeting. A follow-up discussion will take place at the second meeting of the WGGNA.

6. During the first meeting, the WGGNA also reviewed a provisional list of problem areas to be included in the research agenda. Delegates had the opportunity to further reflect on the topics listed in the research agenda and propose changes via written consultation. The research agenda is attached in Annex 2. It is a living document that could be updated as the work progresses.

7. The WGGNA will meet again in late April/early May 2009 in Geneva. The following substantive topics were agreed for inclusion in the agenda of the 2009 meeting: (i) follow-up to the first WGGNA meeting, (ii) remittances, (iii) foreign direct investment, and (iv) special purpose entities. Besides, the leadership group at its meeting on 25 April decided to seek inputs from existing specialised groups with the view of including additional topics on the agenda of the 2009 WGGNA meeting. This will ensure that issues are reviewed as much as possible before the first draft report is presented to the WGGNA in spring 2010.

8. Furthermore, the secretariat of the UNECE has created a dedicated website for the work of the WGGNA, and for the exchange of knowledge, experience and best practices in relation to (the solving of) the main distortions in the compilation of national accounts and related source statistics, as caused by globalisation. The address of the website is as follows:

<http://www.unece.org/stats/groups/wggna.e.htm>

9. Finally, the leadership group has completed an inventory of international working groups that are involved, either directly or indirectly, in international discussions on issues related to globalisation. It is the clear intention of the WGGNA and the leadership group to closely collaborate with existing task forces and working groups on topics that coincide with those from

the WGGNA's research agenda. The relevant list of international working group can be found on the above-mentioned website.

ANNEX 1

MAIN CONCLUSIONS OF THE FIRST WGGNA MEETING

On the basis of the presentations and discussions in each of the three topic sessions, the following conclusions were summarised by the chairman during the closing session:

I. GOODS SENT ABROAD FOR PROCESSING

- Under the new treatment of the SNA Rev. 1 and the Balance of Payments Manual, 6th edition (BPM6), no change of ownership will be imputed to goods being processed abroad. In line with this proposal, the Balance of Payments (BoP) and the National accounts (NA) will no longer show the flow of goods but instead will show flows of processing services. On the basis of the discussions, there is a general agreement that goods for processing should be recorded on a “change of ownership” basis, in line with the new treatment;
- The new proposal, which relates to the recording of the goods sent abroad for processing in the BoP and the NA, should be done in a consistent manner;
- Under the new treatment, data information that can be extracted from the supply and use tables will be affected. This especially relates to structural measures (e.g. productivity, environmental indicators) that are widely used for analytical purposes;
- In line with what was proposed in the issue paper, it would be useful for analysts (users) that statistical agencies preserve additional supply-use tables that record the gross flows of the processing industries.

II. MERCHANTING

- There is a general agreement on the SNA Rev. 1 and the BPM6 proposals for recording merchanting transactions;
- The new SNA-proposals relate to merchanting of goods only. As a consequence, the issue of reporting “merchanting of services” should be further addressed. Important questions are what merchanting of services exactly entails; and how we can deal with it in line with the proposed treatment;
- There is a need for more narrow definitions for “global manufacturing” and “merchanting” activities. There is an agreement that these should be treated as two separate activities;
- Measuring merchanting activities is challenging: what and how do we collect data of such activities? These measurement issues need to be addressed in more detail.

III. MULTINATIONAL ENTERPRISES AND ALLOCATION OF INCOME IN NATIONAL ACCOUNTS

- Large multinational enterprises often take advantage of transferring goods, services and assets to foreign affiliates residing in countries with lower tax rates, and therefore, the issue of (incorrect) transfer prices is important;
- There is reluctance to adjust for transfer prices, unless the prices recorded in the company’s books are clearly wrong, and additional information on true market prices is available;

- Gross National Income (GNI) may become more important in future, because GNI is invariant to the use of misleading transfer prices while GDP will be affected by (adjustments of) transfer price;
- Data availability on transfer prices through surveys and interviews with multinational enterprises may give new insights.

ANNEX 2

LIST OF PROBLEM AREAS IN THE RESEARCH AGENDA

1. According to the ToR, the WGGNA has to develop a list of issues linked to globalisation that should be addressed in the course of its work. The leadership group agreed on a preliminary list of issues that was presented for discussion at the first meeting of the WGGNA on 23-24 April 2008 in Geneva. Countries were also invited to comment via written consultation after the meeting. The research agenda deals with four broad groups of topics linked to the effects of globalisation on compilation of national accounts:

- (a) Problems linked to allocation of value added and income to national economies;
- (b) Specialisation of supply chains;
- (c) Issues in relation to households, persons and employment; and
- (d) Other issues linked to globalisation.

I. ALLOCATION OF OUTPUT AND VALUE ADDED TO NATIONAL ECONOMIES

The impact of the activities of Multinational Enterprises

2. The national boundaries are of limited importance to Multinational Enterprises (MNEs). Information on the transactions and other flows between the branches located in different countries cannot be easily obtained in an individual country. Often it is only the headquarters of a MNE that has the necessary detailed information. In this context, the following questions should be considered:

- (a) Can we draw national boundaries any more and can we produce national statistics at all? Should we compile accounts at global level, European and North-American level and then regionalise the data, or compile only some regional data?
- (b) Do we need to involve tax experts to provide guidance on rules for the calculation of transfer prices of international transactions? It is feared that measurability of the national economy in general and GDP in particular might be biased by the use of transfer pricing within MNEs (among others for reasons of minimisation of the tax burden) that differ from market prices (the latter are consistent with international statistical guidelines). The resulting allocation of operating surplus and profits to countries directly affects the allocation of value added as reported by the companies, particularly in the cases of patents, virtual manufacturing, foot-loose production, and other situations where there is little or no physical dimension associated with the production.
- (c) How to arrive at a consistent recording of transactions, between different national statistics and between different countries?
- (d) Frequent changes in the structure of MNEs.
- (e) The sensitivity of MNEs with regard to confidentiality of their data and the attempts to reconcile their reporting to different statistical agencies.
- (f) Revisions of data can come at a late stage as enterprises reassess the valuations attributed to different parts of their operations; changes in accounting practices can have similar effects.

II. SPECIALISATION OF SUPPLY CHAINS

3. The process of increased specialisation is occurring both within vertically integrated MNEs (i.e. foreign direct investment) and across companies without ownership links. The international statistical communities are aware of the measurement problems resulting from forcing national frameworks into companies that organise their production globally, or that adjust their financial reporting to minimise their overall tax liability. International specialisation challenges some working assumptions on structural ratios of businesses such as turnover to gross value added that are used to produce key economic statistics.

Transactions in intellectual property (e.g. R&D)

4. Little is known about the flows of intellectual property and related income. Companies exchange intangible assets such as business and technological knowledge with their foreign suppliers and subsidiaries as they set up global supply chains across national borders. The following issues can be identified:

- (a) Intra-company flows of R&D services. It is not straightforward to determine within MNEs the exact location of use of R&D capital services in production. There are problems to measuring R&D import and export flows.
- (b) Ghost services from intellectual property, such as computer software used globally.
- (c) Return to capital for intellectual property, as a means of determining economic profit centers.
- (d) Measurement of (multifactor) productivity.

Special Purpose Entities (SPEs)

5. Three types of Special Purpose Entities (SPEs) can be distinguished. The first (and perhaps most important) category consists of financing and holding companies that act as a financing chain on behalf of the non-resident parent company. This type of SPE is characterized by large cross-border financial transactions.

6. The second category of SPEs consists of royalty and licence companies. These companies have been given ownership of intellectual property rights by their parent companies and collect income in the form royalties or as fees on (sub) licences. These flows are recorded as exports of services. The revenues are transmitted to the parent company in the form of exports of royalty and licence fees or in the form of dividends.

7. The third group of SPEs are factoring corporations that conduct the invoice of sales of the worldwide company on behalf of the parent company. These SPEs do not relate to the domestic economy, but only conduct the settlement of international payments for the sales of the worldwide company. Most SPEs are financing vehicles for non-resident mother-companies. They own foreign daughter companies and facilitate financial flows for the worldwide company. They do not normally have any real substantial economic relations with the domestic economy and almost entirely engage in cross-border transactions.

8. With regard to the treatment of SPEs the following questions arise:

- (a) What criteria can be used to determine the residency of the relevant unit?

- (b) How can SPEs be defined and how to deal with complex groups of units owned by non-residents?
- (c) How the relevant monetary flows should be recorded: as service, capital formation, income or financial transaction?
- (d) How to group the SPEs: financial and holding companies, royalty and license companies, factoring companies, etc.?
- (e) How to deal with SPEs created by government?

9. Most of these issues have been addressed in the context of the methodological guidelines of *BPM 6* and *Benchmark Definition of Foreign Direct Investment*, 4th edition (*BD 4*) to which national accounts compilers may want to refer.

Goods for processing

10. Goods sent abroad for processing are defined as materials or semi-processed goods belonging to a unit in country A which are shipped to a unit in country B for significant transformation and then returned to the original unit in country A. The goods do not change ownership from A to B and B receives from the unit in country A just a fee for processing the goods, plus perhaps additional payments for related services such as transportation, insurance and handling of goods. Minor transformations of goods, such as repair and packaging are not regarded as processing. The recording of processing has been extensively discussed during the update of the *1993 SNA* and the *BPM*. The Inter Secretariat Working Group on National Accounts (ISWGNA) has requested the WGGNA to look into the main issues in relation to the implementation of the new recommendations on the recording of processing and to propose operational guidelines.

Toll Manufacturing

11. Toll manufacturing is similar to processing. An enterprise in country A sends goods to country B for further processing without changing ownership. The goods are then either cleared from B for home use or delivered directly to a third country C as a consequence of a transaction between the enterprise in A and the consumer in country C; the former includes the final value in its turnover. However, the exports from A are valued initially in customs source data only at standard cost price (as the final selling price may not be known at the time of export from A to B) leading to a difference between turnover and export values. The trade statistics export value must be replaced in BOP with the final sales value when the change of ownership is known.

Merchanting (including triangular trade)

12. Merchanting can be defined as the purchase of a good by a resident of country A from a non-resident in country B and the subsequent resale of the good to another non-resident; during the process, the good does not enter or leave the territory of country A. Three basic cases can be distinguished:

- (a) Global manufacturing: such activities aim to make profits from production of goods and the international transactions of goods take place as a process of such production activities;

- (b) Global wholesaling/retailing: such activities aim to provide their customers (original sellers and purchasers of the relevant goods) with wholesale/retail services and, as a result, obtain margin (or fee, commission);
- (c) Commodity dealing: such activities aim to obtain profits from the difference between purchased price and resale price of the relevant goods.

13. As in the case of processing, the recording of merchanting has been extensively discussed during the update of the 1993 SNA and the BPM. Here too, the ISWGNA has requested the WGGNA to look into the main issues in relation to the implementation of the new recommendations on the recording of merchanting and propose operational guidelines.

Consignment Goods

14. Consignment is a specialised way of marketing certain types of goods. The consignor delivers goods to the consignee, who acts as the consignor's agent in selling the merchandise to a third party. The consignee accepts the goods without any liability except to protect them from damage and receives a commission, when the merchandise is sold. The consignor does not give up ownership of the goods until their sale.

15. In the case of international trade consignment goods are exported to be stored and resold. In practice, these goods are recorded as merchandise exports when they cross the border, but should only be recorded in the Balance of Payments when ownership changes.

Commissionaire Trading

16. Enterprises can sell to a foreign distribution affiliate that then sells to a final customer. Alternatively, enterprises may sell directly to the final customer who has been identified by the local distribution company; the latter receives a sales commission fee. A change from the former to the latter type of arrangement causes overnight increases in exports that should be balanced by service imports (the service fees). This is an example of a change in operating structure that affects national statistics even though there may not appear to have been substantive change in the national operation.

Re-exports and centralisation of logistics

17. A good is imported to a country and, after some minor processing (like packaging and minor assembling), it is exported to a third country. It is not quite clear from customs documents, which are generally the data source, whether or not ownership actually changes, and consequently whether imports and exports of the relevant goods should be recorded or only a purchase of service. An example is the import of cars when some accessories are installed before the same cars move on as export to a third country. Another example relates to computers where the processing only consists of packaging, inclusion of a manual and the like. Often, the relevant activities are done within companies operating globally and distributing their products from one or more central places (e.g. the Netherlands or Belgium in the case of Western Europe).

Other centralised services

18. Several other ancillary activities within MNEs, such as financial administration, marketing and sales, call centres and the like may be centralised in a particular country. It may be problematic to arrive at an adequate recording of the relevant international service flows. This problem is very similar to the measurement of services from intellectual property (see item 1). It is also very much related to the more general problem of allocation of value added to output and value added to national economies (transfer pricing).

III. ISSUES IN RELATION TO HOUSEHOLDS, PERSONS AND EMPLOYMENT

E-commerce

19. The widespread use of the internet has enabled consumers to purchase products such as books, music and films through e-commerce. Increasingly these products are not shipped across borders on physical media, but are transmitted electronically (digitized products). As a consequence substantial statistical, taxation and trade policy issues arise. These trades may fail to be picked up by statistics for two reasons: (i) digitized products are difficult to register, and (ii) goods shipped as a consequence of an e-commerce activity such as physical books, etc. often correspond to transaction values below customs authority thresholds. In addition, many small e-commerce companies are poorly reflected in business registers and thus escape survey frames and most surveys miss final consumers' e-commerce purchases from abroad, partly because these consumers may not be fully aware of the products' overseas origin.

Labour mobility and trade in services through the movement of persons

20. International labour mobility has increased. For example, within the European Union there is a clear trend of increased labour mobility from the "new" EU members to the "old" members. Not all types of labour mobility are easy to catch in statistics. As a consequence, the measurement of labour input and productivity will become more problematic. Two specific problems can be identified:

- (a) How to get data on international contracting of services involving the movement of workers (workers sent by their foreign employers to the compiling economy in the context of services contracts including hired labour force via employment agencies), foreign self-employed persons as well as intra-corporate transfers? An important related issue can concern the measurement of labour productivity of industries, etc.
- (b) How to arrive at a proper recording and measurement of both the above categories and of non-resident employees employed in the resident economy for short period of time or recruited illegally?

Remittances

21. Economic liberalisation, migrant movements and rising number of cross-border workers has triggered a sharp rise in remittance flows in the last two decades. Remittances are important source of income for many countries and some studies even estimate that their volume is higher than overseas development assistance.

22. BPM6 identifies the standard components to allow compilation of remittances aggregates. Remittances are mainly derived from two items in the balance of payments framework: incomes earned by workers in economies where they are not resident (or from non-resident employers) and transfers from resident persons/households of one economy to resident persons/households of another. In spite of the definitions and concepts set out in the manual, there are many measurement issues linked to recording of these flows:

- (a) Total remittances may be difficult to estimate because of the absence of adequate source information. This is even more true when part of the remittances do not pass through the banking system.
- (b) Furthermore, migrants often invest in their economy of origin, e.g. financial investments and investment in real estate. These transactions are considered cross border investment and they should not be recorded as part of remittances in the balance of payments framework. However, it could be difficult to distinguish both transactions and, in some cases, investment transactions may be vehicles for the provision of remittances.
- (c) Acquisitions of goods and services by border and seasonal workers in the economy of their employment are not part of remittances and should be included under travel in the balance of payments. In practice it could be difficult to separate them.
- (d) Balance of payments and national accounts frameworks rest on the identification of residency, which may be difficult to follow in cases of migrant movements. It could be especially difficult when workers are hired illegally.

Tourism and second homes

23. In recent years the size of second home sector has been increasing constantly. In Europe, second homes have been gaining more and more attention. Relaxed border controls, and the rise of the low-cost airlines has made it easier for people to travel and consequently to invest in holiday and second homes abroad.

24. In parallel, there have been a growing number of studies on the implications of the second homes - economic, social and environmental. One of the main issues identified is the lack of statistical data to measure the scale of second homes, their characteristics and trends. The valuation of second home usage has been developed in the tourism satellite accounts. However, it has been recognised that this valuation is difficult and complex. Imputations have to be made. The imputations apply to the production of services by the second homes and to the consumption of these services.

IV. OTHER ISSUES

Foreign Direct Investment and related income

25. A number of issues may arise in the national accounts from cross-border activities of MNEs, which are captured in direct investment in the balance of payments. Modifying the transfer pricing used on goods and services by multinationals will affect the earnings, retained earnings, dividends and shareholders' equity of multinationals. As well, though the national accounts and balance of payments are harmonized conceptually, these two systems are generally

compiled from different data sources and techniques and by different data producing institutions (e.g., national statistical offices and the central bank). Given that the rest of the world sector in the national accounts is largely derived from balance of payments data, differences in coverage and in statistical techniques between the two systems are largely to become more material as economies become more globalised. For instance, direct investment earnings are generally compiled from surveys whereas profits of the corporate sector can be derived from tax records that are adjusted for national accounts purposes. National accounts compilers should also be mindful of data compiled from counterpart economies, such as the upcoming Coordinated Direct Investment Survey, that may provide a measure of financial claims different from that produced with domestic data sources.

26. Another issue pertains to the increasing analytical and policy needs of identifying the transactions and positions of the foreign controlled corporate sector in the national accounts, referred to as Activities of Multinationals (AMNEs) for Foreign Affiliates Statistics (FATS). For instance, as economies increasingly globalise, policy interests may rise on delineating wages and salaries and research and development that arise from domestic versus foreign controlled firms. This may entail a tighter working relationship between national accounts and balance of payments compilers, such as the need to share survey frame and business register and to deal with confidentiality issues to the extent that these two datasets are compiled by different data producing institutions.

Transit trade

27. In the case of transit trade, goods go through a country without being declared for import in the relevant transit country. In principle, transit trade should not be a problem as there is no import and export, but only transport through the country. In practice, however, there may be measurement problems and the terminology may be used confusingly (transit trade vs. quasi-transit, re-export).

Common trading and currency block issues

28. Regional arrangements for economic and monetary cooperation are increasingly prevalent, with perhaps the most notable development being the creation of the euro area in the broader framework of the European Union. These arrangements both respond to, and help foster, regional economic integration, supporting an expansion in the growth in trade in goods and services across borders, and in the case of currency unions, reducing the impact of exchange rate volatility on such activity. The main statistical challenge for customs union is to identify new data sources for merchandise trade as customs data, the traditional data source, may become unreliable.

29. In monetary and currency unions, the rest of the world account/balance of payments data of national economies are still required for the compilation of national statistics, the conduct of economic and fiscal policies, as well as for representational purposes at international level (e.g. trade agreements). Some of the statistical challenges consist in the implementation of the resident concept in compiling data, respectively, for the individual countries and the union as a whole. This entails separately identifying non-residents between those belonging to the currency union and those that are outside the union. As well, cash holdings no longer have a national

identification though they need to be allocated among the countries of the union. Furthermore, the foreign currencies assets of national central banks that represent claims on other member of the currency union are classified as reserve assets in national external accounts whereas they are excluded from the reserve assets for the union as a whole.

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