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**INTRODUCTION TO THE WGGNA AND RESEARCH AGENDA**

**CONSOLIDATED LIST OF PROBLEM AREAS (SECOND DRAFT)**

Note by the secretariat<sup>1</sup>

*Summary*

The purpose of the newly established Working Group on the Impact of Globalisation on National Accounts (WGGNA) is to review the distortions in the compilation of National Accounts caused by globalisation and to propose ways to deal with these distortions and to improve the quality of the data. This document presents a list of well-recognized problem areas to be included in the research agenda of the WGGNA.

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<sup>1</sup> Prepared by the UNECE secretariat on the basis of contributions by the members of the Leadership Group of WGGNA.

## I. BACKGROUND

1. At the biennial UNECE/Eurostat/OECD meeting on national accounts in Geneva in April 2006, a day was devoted to the topic of globalisation and national accounts. In view of the high level of interest it was proposed to consider follow up work to explore how national accounts are affected by globalisation and propose operational guidelines to address these effects. In June 2006, the Conference of European Statisticians (CES) reviewed a Rapporteur Report on Globalisation Statistics prepared by Statistics Canada and ONS, United Kingdom and decided to create a body to coordinate the work on globalisation statistics. Following a series of consultations the Working Group on the impact of Globalisation on National accounts (WGGNA) was established.

2. The purpose of the Working Group is to review the main distortions in the compilation of national accounts and related source statistics, as caused by the growing globalisation of economies and to put forward proposals to deal with these distortions and improve the quality of national accounts. In order to develop a more detailed work plan, the WGGNA should agree on a list of issues linked to globalization that should be addressed in the course of its work.

3. It was also decided to set up a Leadership group to steer the work of the Working Group and report on the progress of work to the Conference and its Bureau. The leadership group is composed of Canada, Czech Republic, Finland, Netherlands, United Kingdom, USA, UNECE, OECD, Eurostat and IMF.

4. The first meeting of the leadership group took place on 8 – 9 October in Geneva and discussed a list of issues linked to globalization that should be included in the research agenda of the WGGNA. The group decided that the research should not be limited to the effects of globalisation on non-financial accounts but should deal with the full sequence of accounts, including financial accounts and balance sheets. This paper presents a consolidated list of issues to be reviewed by WGGNA, as agreed by the members of the leadership group. It deals with three 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; and
- (c) Other issues linked to globalisation.

5. These are just an indication of the challenges posed by increasing globalisation to the compilation of national accounts for a country. The list below sets out the well recognised areas where there are measurement problems. Countries are invited to comment on the proposed list, fill identified gaps and set the priority areas.

## II. INTRODUCTION TO GLOBALISATION AND ITS IMPACT ON STATISTICS

6. Globalisation can be described as the increasing “easiness” of economic transactions occurring across national boundaries. They are easy because of the following reasons:

- (a) The lowering of trade barriers;
- (b) The accessibility and cheapness of foreign travel;
- (c) The internet enabling quicker conduct of business abroad;

(d) The increased ability of companies and people to operate abroad.

7. These factors have seen the rise of foreign trade, of increased household spending abroad, of multi-national companies spanning the world in their economic activities, and increasing their share of world trade.

8. The increase of economic transactions across national boundaries has made it more difficult to measure economic transactions from a national viewpoint. The lowering of trade barriers and the activities of multinational corporations has resulted in the production function being spread across national borders, with a significant increase of goods between affiliated companies. Also more and more services are provided across the world, for example computer software services. Other examples relate to outsourcing of activities such as “call centres”, financial services, and marketing and sales.

9. Multinationals can move these goods and services across the borders with no change in economic ownership and/or use transfer pricing to value the inputs and outputs of such goods and services. In some cases, no value at all is attributed to the services provided. The use of transfer pricing affects not only the revenues and expenses of the units involved but also their earnings (direct investment income), retained earnings, dividends as well as equity. As such, it is challenging for statisticians to modify the value of goods and services as they have also to take into consideration the impact on other accounts, such as on direct investment earnings.

### **III. ALLOCATION OF OUTPUT AND VALUE ADDED TO NATIONAL ECONOMIES**

10. 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 have 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) The need of involving tax experts in the work of WGGNA to provide guidance on tax rules and international transactions. Measurability of the national economy in general and GDP in particular are complicated by transfer pricing within MNEs, among others for reasons of minimisation of the tax burden. The resulting allocation of operating surplus and profits to countries directly affects the allocation of value added as reported by the companies.
- (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.

## **IV. SPECIALISATION OF SUPPLY CHAINS**

11. 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 behave as if there were no frontiers, 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.

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

12. 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.

### **B. Special Purpose Entities (SPEs)**

13. 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.

14. The second category of SPEs consists of royalty and licence companies. These companies collect income on royalties and (sub) licences on behalf of their parent company. 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.

15. 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.

16. 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?

### **C. Goods for processing**

17. 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 A just a fee for processing the 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 Balance of Payments Manual (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.

### **D. Toll Manufacturing**

18. 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 often delivered from B to a third country C having been sold by the enterprise in A; the latter includes the final value in its turnover. However, the exports from A are valued initially 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.

### **E. Merchanting (including triangular trade)**

19. 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.

20. As in the case of processing, the recording of merchanting has been extensively discussed during the update of the 1993 SNA and the Balance of Payments Manual (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.

#### **F. Consignment Goods**

21. Consignment is a specialized 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.

22. 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.

#### **G. Commissionaire Trading**

23. 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 has been no real change in the national operation.

#### **H. Re-exports and centralisation of logistics**

24. 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 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).

#### **I. Other centralised services**

25. 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).

## V. OTHER ISSUES

### A. E-commerce

26. The widespread use of the internet has enabled consumers to purchase goods such as books, music and films, without the need for these products to be shipped across borders in the form of DVDs or books. Substantial statistical, taxation and trade policy issues arise because these products are being increasingly transmitted via data files through borderless virtual networks. These trades may fail to be picked up by statistics if transaction values are below customs authority thresholds and because many small e-commerce companies are poorly reflected in business registers. Furthermore, most surveys miss final consumers' e-commerce purchases from abroad, partly because they may not be fully aware of its overseas origin.

### B. 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).

### C. Remittances

28. 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.

29. 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.

#### **D. Second homes**

30. 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.

31. In parallel there has 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.

#### **E. Labour migration**

32. Labour migration has increased (especially from the developing to the developed world). Within the European Union there is a clear trend of increased labour migration from the "new" EU members to the "old" members. Not all types of labour migration 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) Agencies that hire labour force from abroad: how to get data on hired labour force from abroad via employment agencies (which should be recorded as import of services). Important related issues can concern the measurement of labour productivity of industries, etc.
- (b) The treatment of foreign workers directly employed may be problematic when they operate as a sole proprietor, when they have short-term contracts or when they are recruited illegally.

#### **F. Common trading and currency block issues**

33. Regional arrangements for economic and monetary cooperation are increasingly prevalent, with 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, become unreliable.

34. In monetary and currency unions (the most important being the European area), 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. GATS). 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, bank notes 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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