Recording Factoryless Goods Production Arrangements in the National Accounts

Task Force on Global Production

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2008 SNA and BPM6

• Began to tackle the difficulties raised by new forms of global production
  – With new accounting rules for *goods sent abroad for processing* and *merchanting*, reflecting a strict interpretation of the change of ownership principle
  – with further implementation guidelines developed by Globalisation in the National Accounts and more recently the TFGP’s Guide to Measuring Global Production.
Typology of Global Production

• The Guide lays out a typology
  – Goods sent abroad for processing
  – Goods under merchanting
  – Factoryless goods production

• But, it appears that further guidelines are needed on factoryless goods production
A factoryless goods producer arrangement

**Consumer**
(domestic or abroad)

- Purchase final good by the consumer

**Principal**
(domestic economy)

- IPP investment
- Purchase manufactured good by the FGP
- Blueprints of production (not a transaction)

**Contract producer**
(abroad)

- Purchase material inputs By the contract producers
- = information IPP related
- = transactions in goods
The issue - Classification

- ISIC guidelines provide detailed recommendations for units that outsource the entire production process:

  A principal who completely outsources the transformation process should be classified into **manufacturing** if and only if it owns (some of) the input materials to the production process—and therefore owns the final output. .....(*goods sent abroad for processing arrangements*)

  A principal who completely outsources the transformation process but does not own the input materials is in fact buying the completed good from the contractor with the intention to re-sell it. Such an activity is classified in Section G (**wholesale and retail trade**), specifically according to the type of sale and the specific type of good sold......(*merchanting*)....

- **An outdated view of production?**
Factoryless goods producers: why defined narrowly?

- A unit (principal) that is factoryless in nature (i.e., does not maintain a manufacturing plant) may or may not own material inputs.
- However, TF focuses on the narrow view because units that do not maintain a manufacturing plant but own material inputs are already considered as manufacturers by ISIC.
- TF defines factoryless goods producers (narrowly):
  - Units (principals) that control the outcome of production of a good by undertaking the entrepreneurial steps and supplying inputs of intellectual property products (IPPs), concentrating on innovation and marketing decisions. FGPs usually control access and delivery of the final output to consumers and do not purchase nor supply any material inputs into the production process.
The role of intangible capital

• ....often the considerable part of the value of the final product ......with the value added through pure distribution activities only marginal
• The TF took the view that FGPs should not be classified as distributors but instead took a ‘contemporary’ view of production.
  
  ....the value of a good increasingly reflects the underlying IP
  
  ....the business of the FGP is fundamentally about producing the good
  
  ...ergo the FGP is a manufacturer
However, the TF view implies changes to the framework and so, for now, the guidance remains as is...with FGPs classified to distribution sectors...

But.....recognising that FGPs differ from conventional distributors, the TFGP recommends that FGPs are shown as a separate ‘of-which’ item.
Defining FGPs

• ...substantive IPP investors...

• more than 50% of value added originates on IPP activities such as R&D and design, innovation, supply chain management, including activities related to non-produced assets, such as market research and marketing.

• Because a company must be a substantive IPP investor most companies that are only involved in branding would be excluded.
Identifying FGPs in practice

• A significant investor in IP (either via production or acquisition)
• A higher than average ‘trade’ margin
• A staff profile that is far from the norm
  – Researchers, higher average salaries etc.
FGPs as manufacturers…issues and consequences

• Output of the FGP; good or trade margins?

• Output of the contract producer under a factoryless arrangement; a good or a service?

• Recording of international trade flows?
Output of the FGP; good or trade margins?

- Special case of manufacturing;
- Which implies the FGP’s main activity is connected to physical transformation (providing the blueprints);
- BPM6 (par.10.42): merchant as organiser of a global manufacturing process.....
- IPP services dominate substantially the value added of FGPs which exceeds the notion of a trade margin

→ The FGP’s output is a good

Purchases from the contract producer are intermediate consumption
Output of the contract producer under a factoryless arrangement; a good or a service?

- The contractor
  - The contract producer faces additional risks with regard to input prices and holding inventories.
  - But doesn’t ‘control’ the process
  - In economic terms the contract producer’s output differs from the final consumer good (however, not in physical terms)

- A thorny issue….with a majority of the TF opting for the contractor is **not a processor**....

→ *The output of the contractor is a good (and not a service)*
Recording of international trade flows

2 options:
1. Goods under general merchandise?
2. ...or net exports of goods under merchanting?

- Net recording does not align very well to a gross recording of output and intermediate consumption
- BPM6, par.10.42 (referring to merchanting) does not really apply to FGPs

→ The international flows are to be recorded under general merchandise
A summary of recommended decision points if FGPs are to be considered manufacturers (in future international standards):

→ Output of the FGP reflects full value of the manufactured good;

→ Contractor owns the good prior to being transacted;

→ The international flows are to be recorded under general merchandise;

→ Delineating FGPs from traders: FGPs are substantive IPP investors and >50% of value added is connected to IPP, innovation, supply chain management and marketing;
Conclusions

• The Guide presents FGPs as a (special case) of distributors, following the current international standards

Future work:
• Flag for FGP activity is needed to help better track these activities
  – Need support from classification and business register experts in developing more precise criteria
• Collect more practical experience
• A need for more elaborate guidelines for FGPs
• and potentially, future changes to international standards...