

Globalisation: Merchanting and Factoryless Producers; Clarifying Negative Exports in Merchanting; and Merchanting of Services.

Options Paper

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Executive Summary

This paper is the second in series of papers about the globalisation updates within the SNA 2025. This paper focuses on Factoryless Goods Producers and Merchanting. The paper will include background information on the issues, how it relates to the international picture and relation to economic concepts. The paper will also present the options below and will give a recommendation on what the ONS thinks is the best option.

Options for Factoryless Goods Producers

- **Option 1** - To continue to treat activities related to FGPs as merchanting, and therefore output recorded as a negative export. This is UK current practice and was introduced as part of Blue Book 2023 improvements.
- **Option 2** - To align with recommendation of the guidance note, which suggests treating activities related to FGPs as manufacturing, and therefore to record output as gross.

Options for Merchanting of Services

- **Option 1** - To continue to treat subcontracting services and service intermediaries and “service merchanting” as is current practice.
- **Option 2** - To move to align to the recommendation of this guidance note which suggests separating service intermediaries from services subcontracting, and instead bring in line with services provided by agents and recording the intermediation fees (explicitly or implicitly) as a supplementary “of which” item under trade-related services are in.

Option 2 has been recommended in both cases.

Introduction

Issue synopsis

1. This paper is presented to the National Statistician’s Committee for Advice on Standards for Economic Statistics (NSCASE) by the Office for National Statistics (ONS) as the second in a series related to the broader topic of Globalisation. Globalisation increasingly creates challenges for statistical compilers in their efforts to capture economic activities accurately. The international statistical community, led by the International Monetary Fund (IMF) Globalization Task Team (GZTT), recognises that new definitions and guidance need to be considered.
2. This paper introduces the topic of global production arrangements and Factoryless Goods Producers (FGPs), as outlined in the guidance note titled

“Merchanting and Factoryless Goods Producers; Clarifying Negative Exports in Merchanting; and Merchanting of Services” jointly authored by GZTT and the Current Account Task Team (CATT). Guidance Note C.4 ([International Monetary Fund](#), 2021) is provided in the reading pack, henceforth it is referred to simply as the guidance note.

3. Please note, that where this paper discusses options for aligning with recommendations within the guidance note, this is on the assumption that these recommendations will be reflected in the manual update (BPM7). The update to the manual is still in discussion, and it is not yet clear when changes to the manuals will be communicated and the exact content of any changes.
4. On the future treatment of FGPs in the National Accounts and Balance of Payments (BoP), the options presented are:
 - 4.1. To treat activities related to FGPs as merchanting as outlined in ISIC Rev.4 ([United Nations](#), 2022), and therefore record related output as net exports (as outlined in BPM6 ([International Monetary Fund](#), 2009). The UK has been working towards this treatment, and as part of Blue Book 2023 improvements has identified businesses as FGPs, with a view to implement an adjustment to record output as net exports for Blue Book 2025,
 - 4.2. To align with the recommendation made within the guidance note (section II, paragraph 44). This suggests treating activities related to FGPs as manufacturing and therefore to record output as gross. The UK currently records FGP output as gross and therefore is already partly aligned to the recommendation in the guidance note.
5. On Merchanting of Services, the options presented are:
 - 5.1. To continue treating subcontracting services (bilateral relationship between principal and subcontractor) and service intermediaries (trilateral relationship between producer, intermediary and consumer) as “service merchanting”, as is current practice according to BPM6.
 - 5.2. Move to align with the recommendation made within the guidance note (section II, paragraph 51), which suggests separating service intermediaries from services subcontracting. Instead, the treatment would be to bring service intermediaries in line with services provided by agents, and therefore record the intermediation fees (explicitly or implicitly) as a supplementary “of which” item under trade-related services.
6. The guidance note also discusses the topic of negative exports but suggests no changes in the update to BPM7. Therefore, negative exports are not covered in this paper as no decision is sought from NSCASE at this time in the absence of alternative options.

Recommendation

7. We ask NSCASE to confirm if they agree with our preferred option on the treatment of FGPs (4.2), to align with the recommendation made within the

guidance note. This partly reflects our current practice (for those FGPs we have identified); that output associated with FGPs is recorded as gross. Continuing this approach would allow future international comparability.

8. We also ask NSCASE to confirm if they agree with our preferred option on the treatment of “Merchandising of Services” (5.2) in alignment with the guidance note. This separates service intermediaries from subcontracting services, and to record intermediation fees (explicitly or implicitly) as a supplementary “of which” item under trade-related services.

Background

Goods traded within a global manufacturing arrangement and factoryless goods producers.

Current issue and current practice

9. A FGP (sometimes referred to as virtual manufacturers or fables manufacturers) is an arrangement where the directing business, or principal, outsources the entire production process to another business that acts as a contract manufacturer. This includes the purchase of raw materials by the contract manufacturer. The input of the principal is the intellectual property, blueprints, or designs of the product. A similar arrangement can exist, whereby the principal supplies the material input to the contractor, this is called toll manufacturing.
10. The UK currently follows ISIC Rev.4 guidance that states a principal acting as an FGP should be classified to the wholesale industry and therefore treated as a merchant. Any related activity should then be recorded as a net export, in which receipt of the finished good from abroad is considered a negative export and the subsequent sale to a foreign party is a positive export, in line with the treatment of merchants in BPM6. BPM6 does not explicitly address FGP.
11. The UK has been working towards introducing an adjustment for net exports as part of Blue Book 2023 improvements. Our current practice, based on historical needs, is that any FGP output is recorded as a gross transaction. This means that at present, for those FGPs we have identified in the UK, we are not fully aligned to BPM6 guidance.
12. Negative exports as opposed to imports can cause conceptual challenges. For merchandising the acquisition of goods is shown under goods as a negative export of the economy of the merchant; the sale of goods is shown under goods sold under merchandising as a positive export of the economy of the merchant and the difference between sales over purchases is shown as the item 'net exports of goods under merchandising'. Although the updated guidance will not change, and activities of merchandising will still be recorded as net exports, this guidance note has suggested that the updated manual should have supplementary information to aid understanding.

13. Merchanting of Services is currently treated in the same way as subcontracting services according to BPM6. This is the UK's current practice; however, it is accepted that conceptually this is not an accurate representation of the activity as a subcontractor is a bilateral relationship between principal and contractor, whereas merchanting of services reflects a trilateral relationship between producer, intermediary and consumer. Therefore, aligning the treatment of these service providers is misleading to users, and current UK practice does not reflect the true nature of the transactions.

International Guidance

14. The guidance note, which has been provided internationally but not yet adopted, suggests that the following should be included in the next update of the manual (BPM7):

14.1. activities related to FGPs are classified as manufacturing (section II, paragraph 44),

14.2. the output of the contractor in a global manufacturing arrangement should be recorded as a good when the contractor takes ownership of the material inputs (where Intellectual Property Products (IPP) and the management of the production process are provided by the principal FGP type arrangement), and as a service when the material inputs are owned by the principal (typical processing arrangement) (section II, paragraph 45),

14.3. the definition of FGP activity should not be dependent on whether the contractor responsible for the transformation is an affiliated enterprise (section II, paragraph 46),

14.4. additional standard (or supplementary) component(s) should be added to the balance of payments goods account to explicitly cover transactions related to goods traded as part of a global manufacturing arrangement (with a further breakdown proposed on a supplementary basis) (section II, paragraph 47).

14.5. transactions in which an intermediary arranges the supply of a service between a producer and a consumer should be distinguished from services subcontracting, where the principal maintains control of the production process. The guidance note proposes to assimilate these 'intermediation services' to the services provided by agents, as defined in the Balance of Payments and International Investment Position Manual, sixth edition, paragraph 3.10 ([International Monetary Fund](#), 2009) and suggests recording the intermediation fees (explicitly or implicitly) as a supplementary "of which" item under trade-related services. (section II, paragraph 53)

15. The guidance note suggests updates to the current BPM6 guidance, more aligned with a Task Team on ISIC (TT-ISIC 2021) recommendation ([United Nations](#), recommendation 10, paragraphs 45 – 47, 2022), and 2013 guidance of the Advisory Expert Group (AEG) on National Accounts.

16. This guidance note was discussed and received strong support from members of the IMF Committee on Balance of Payments Statistics and the Advisory Expert Group on National Accounts (AEG). Furthermore, support for this update was also clear in the global consultation.
17. The UK did not contribute to the compilation of this guidance note, however, did respond to the global consultation. In summary, the UK agrees conceptually with the recommendations laid out in the guidance note. However, the UK does have some concerns around the practicality of some of the recommendations, and raises that the data required to achieve these, will need to be of an improved quality e.g., having data that identifies ownership of material inputs is a challenge, along with data to identify FGPs.

Relation to Economic Concepts

18. FGPs are not merchants as they do not buy and resell goods. A principal in an FGP arrangement supplies IPP (regarded as material input) and controls the production process, and therefore should be recorded as a manufacturer (regardless of any affiliation with the contractor responsible for transforming goods). Therefore, this update moves towards a definition that is more widely accepted.
19. It is also widely agreed that “merchandising of services” is different to subcontracting and therefore common treatment (as is currently the case according to paragraph 10.160 BPM6) is not justified. Subcontracting is recognised as a bilateral relationship between the principal and contractor, whereas merchandising is a trilateral relationship between the producer, intermediary, and consumer. Therefore, separating an intermediary from subcontracting services, as is the suggestion here, is preferable.
20. Services, by definition, cannot be “merchandised”. Merchandising can apply to goods due to the condition of change of economic ownership. As a service is generally produced at the same time it is consumed, it cannot be traded in the same way as a good, and therefore “pure” merchandising transactions cannot involve services.
21. Recording fees under trade-related services, as a supplementary “of which” item in the international accounts of the partner countries acknowledges that the arranger neither produces nor consumes the service, and users would be better informed of the real character of these flows compared to the current gross recording.

UK Specific Factors

22. The ability to record the activity of FGPs accurately will be dependent upon good-quality data and the ability to identify the ownership of material inputs. A clear understanding of business practices and the structure of Multinational Enterprises (MNEs) where affiliates work in these arrangements will be key.

23. Being able to separate the intermediary fee from the actual service fee, or any other transactions will be reliant upon good quality data and businesses holding or understanding this information.

Options

24. For all options stakeholders both internally to ONS and externally (Bank of England, Department for Business and Trade, HM Treasury, for example) have been consulted.

Option 1 for FGPs (current treatment)

25. To treat activities related to FGPs as merchanting, and therefore record related output as a negative export.
- 25.1. This option describes the approach the UK is currently working towards achieving, and indicative timelines would suggest that this will be achieved as part of Blue Book 2025 improvements.
- 25.2. The challenge with this approach is how our processing will deal with negative outputs as a result of the net exports treatment. Our current plan is to achieve this by 2025.
- 25.3. Guidance in ISIC Rev.4 is to classify FGPs in Wholesale, therefore this approach has been adopted internationally. However, it is our understanding and belief that if BPM7 is updated in line with the recommendations made in the guidance note, countries will move to align with this approach, given the support for it as detailed in previous sections of this paper.
- 25.4. Understanding the impact globalisation has on Gross Domestic Product (GDP) in the UK is still in the initial stages, as outlined in the article produced by ONS, [Measuring globalisation in the UK National Accounts, Blue Book 2023](#).
- 25.5. ONS also has a team (Large Cases Unit (LCU)) that works with MNEs, some of which will be FGPs, with the aim of understanding and estimating the impacts of globalisation on our National Accounts.
- 25.6. In summary, the main benefit of this option is that work is already in train, fully scoped and understood, therefore ONS would require no further discovery to work towards implementation. The main disbenefit would be that this would impact our international comparability further down the line when countries move to align to BPM7 if this does include the recommendations from the guidance note.

Option 2 for FGPs (aligned to guidance note which informs BPM7 update - recommended)

26. To treat activities related to FGPs as manufacturing, and therefore to record output as gross.

26.1. The UK is in practice already recording FGP output as gross in the absence of the net reporting adjustment to Blue Book 2023. There are some further considerations we would need to take to capture all FGPs, that had been scoped as part of the work related to option 1.

26.2. ONS would need to work towards understanding the impact of the reclassification of FGPs from merchanting to manufacturing, and any adjustments to be made retrospectively, given that only part of this recommendation is current practice. For example, planned work to collect merchanting data from the International Trade in Services survey (ITIS), would not go ahead, and we would need to reconsider how we might capture this FGP activity elsewhere.

26.3. This manual update will be published in the next 2 years; therefore, it is unlikely that countries are already operating on this basis. However, the strong support for the recommendations in the guidance note suggests that countries will move to align to this practice as BPM7 is rolled out (if aligned with the guidance note), dependent on data availability. This means initially, we will not align internationally, however, given other countries will move towards this treatment, a long-term aim of international comparability is preferable.

26.4. This option is leaving systems and treatment as is for FGP outputs in the main, therefore will be considerably less work than option 1. However, what has yet to be scoped is whether the data we currently have supports this option, and whether we can disentangle the principal and contractor to understand where the true change of economic ownership occurs dependent on ownership of initial input raw materials.

26.5. In summary, the main benefits of this option are likely international comparability moving forward, and no changes to our current treatment of transactions on a gross basis. However, the main disbenefit is the work required to understand whether the quality of our data allows us to achieve what is likely to be set out in BPM7.

Option 1 for Merchanting of Services (current BPM6 treatment)

27. Treat subcontracting services and service intermediaries as “service merchanting”, as is current practice according to BPM6.

27.1. This is UK current practice, and therefore no changes would be required to systems or data inputs.

27.2. There is a consensus that conceptually, this approach is incorrect, therefore, countries will likely move to a different approach as is outlined in the guidance note.

27.3. The benefit of this option is that we continue with current practice, and further resource is not required for development. However, the disbenefits include likely future lack of international comparability given that there is agreement that this treatment is conceptually incorrect.

Option 2 for Merchanting of Services (aligned to guidance note which informs BPM7 update - recommended)

28. To separate service intermediaries from services subcontracting. The treatment would include bringing service intermediaries in line with services provided by agents. This would therefore record the intermediation fees (explicitly or implicitly) as a supplementary “of which” item under trade-related services.

28.1. As stated, consensus is that conceptually this is the preferred approach as it outlines to users the true nature of the transaction, whereas current practice, can be misleading.

28.2. As already outlined, given the strong support for this recommendation in international discussions and global consultations it is our opinion that countries are likely to move to align with this guidance over the coming years if this is included in the BPM7 manual update. We would then therefore retain international comparability by doing so as well.

28.3. In terms of whether this is practical, ONS are of the view that the adjustment, that is currently applied for services merchanting, could be modified to achieve what is required under this new treatment. What is not clear and would need to be scoped to be fully understood is whether input data would support this. No discovery work has taken place to understand when this would be achievable.

28.4. In summary, the main benefit of this option is continued international comparability on an agreed conceptually correct definition. However, the disbenefit is the lack of clarity we have currently to understand whether input data would support this, and the work required to achieve it.

Conclusion

29. In conclusion, in line with the likely manual updates, we recommend that the following options be considered for future implementation.

30. For FGPs, to treat activities related to FGPs as manufacturing, and therefore to record output as gross. The future international comparability, and the fact that we are already part way there is a strong justification as to why we believe this is the preferred option.

31. For Merchanting of Services, to bring service intermediaries in line with services provided by agents, and therefore record the intermediation fees (explicitly or implicitly) as a supplementary “of which” item under trade-related services. Again, for future international comparability, on a mutually agreed more appropriate

basis than current practice, there is a strong justification to move toward this treatment, with the caveat that, some work will be required first to understand the data challenges, and how we may approach these.

References¹

International Monetary Fund. (2021)

[C.4 Merchanting and Factoryless Producers; Clarifying Negative Exports in Merchanting; and Merchanting of Services](#) *

International Monetary Fund. (2009) [Balance of Payments and International Investment Position Manual - Sixth Edition \(BPM6\)](#)

United Nations. (2022) [Revised new structure of ISIC, Note on the main changes to ISIC Rev. 4](#)

¹ * Asterisks mark papers available in the supplementary reading pack