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APPENDIX

FURTHER ANALYSIS OF THE TREATMENT OF MIDDLEMAN TRANSACTIONS IN COUNTRY TRADE STATISTICS

The variation in the recording of middleman trade resulting from differences in systems of reporting partner countries and differences in country trade classification systems can be shown with the aid of a simple model of major trade flows suggested by the United Nations Statistical Commission.¹ In this model there are five patterns of trade. Each pattern describes the movement of a commodity from the country of production (A) to the country that imports the commodity for final consumption (D).

<i>Patterns of trade flow</i>	<i>Country of production</i>	<i>Country of consignment from A and to D</i>	<i>Country of sale to D</i>	<i>Country of import for consumption</i>
1	A	A	A	D
2	A	B	B	D
3	A	A	C	D
4	A	B	C	D
5	A	B	A	D

Pattern 1 describes direct trade, in which records of trade are not affected by different systems of reporting partner countries and differences in trade classification systems. That is to say, country A (country D) will report the same amount exported to a particular destination (imported from a particular source) in a given period whether it uses the general or special trade system and whether it reports partner countries on a production-consumption, consignment-consignment, or purchase-sale principle. Pattern 2 illustrates simple middleman trade involving a resale and a reconsignment from the same middleman country. Pattern 3 illustrates offshore merchanting or, as the IMF describes it, merchandise transactions abroad. Pattern 4 illustrates the

¹*Principles for Statistics of External Trade*, United Nations Document E/CN.3/173, Annex, January 14, 1954, p. 1. The U.N. experts use this model to demonstrate that the consignment basis will generally serve to provide information both by country of purchase and country of origin.

case where the country of reconsignment to D is not the same as the country of sale to D. And the last pattern shows a consignment to order or to an agent.

From the model it is clear that if country A and country D report their partner country on a production-consumption basis they will not record any trade with countries B and C. If they report trade on a consignment basis, A will report exports to country B, and D will report imports from country B in all cases where B appears in a pattern. And if A reports country of sale and D country of purchase, A and D will report trade with C where it appears in the model and report trade with B only if it is also country of sale.

Records of A and D are complicated, however, by conceptual difficulties or lack of knowledge in the interpretation of the terms consignment-consignment, purchase-sale, and production-consumption.

The *consignment-consignment system* is beset by difficulties because some countries in denoting partners under this system use *first consignment* and some use *last consignment*. An exporter can easily report first consignment since he need only enter in the customs record the country of the consignee, whether the consignee be an agent or purchaser. In practice, however, the goods may be rerouted before reaching the consignee with consequent errors in the record. Moreover, this is the vaguest of the systems conceptually in that it tells only to whom the goods were sent, not the nature of the transaction. And, as a result, many countries request that their exporters indicate country of last consignment and that their importers indicate first consignment. But the system then becomes synonymous with country of consumption for export and country of production for import. This is more useful for the analysis but raises problems that are discussed below under this category.

The *purchase-sale system* is complicated by possible variations in treatment of purchase from agents who are not residents of the same country as their principal. The reporting country has the choice in such cases of recording as the partner country the country of agent or principal. Moreover, in the case of trade with multinational producers the reporting country has the choice of considering the partner country to be either the country of residence of the ultimate owner or the country in which the branch or subsidiary is located.

The *production-consumption system* raises the question of when goods have been transformed sufficiently to call the country of transformation the country of production for imports or consumption for exports. In practice this is complicated by lack of knowledge by exporters as to country of consumption.

One other source of discrepancy affecting all three systems is par-

ticularly serious in the case of petroleum. Countries have a choice in considering their concessionary enterprises to be located in their own territory, in the country of the parent concern, or to be extra-territorial.²

In current practice there is wide diversity among systems of reporting partner countries according to the *Direction of International Trade* (DIT) for 1953, but many apparently different designations probably amount to almost the same thing. The predominant method is to report imports by country of production and exports by country of consumption, so far as known.

Of the 82 major countries giving usable trade records included in DIT³ for 1953, 58 report their trade on imports by country of origin, first consignment, or production (which are probably identical), and report their exports by country of consumption, destination, or last consignment.⁴ Twelve of the remainder use the provenance-destination system, which is ambiguous; 8 report on a consignment basis, and 4 on purchase-sale basis. In addition, a few countries report trade on both purchase-sale and origin-destination basis.

Next to be considered is how the middleman countries (B and C of the model) report their indirect trade. The problem arises in part from differences in recording systems used. Imports that would enter the trade record of countries on the general system will be excluded by those on the special system if they are entered in entrepôt for eventual re-export. To illustrate, in pattern 2 if a commodity exported by A to B enters entrepôt in B and then leaves it for re-export to D, country B will exclude it entirely from its "regular" trade record if it is on the special system, and include it in general imports and re-exports if it is on general system. This leads to discrepancies in recording the same type of trade between the sterling area, Japan, and dollar Latin America, mainly on the general system, and most of the rest of the world, mainly on the special system.⁵

But more serious than differences between these two systems is the possibility that middleman trade will be excluded or concealed under either. Systems of trade classification, as noted earlier, are based either

²Herbert B. Woolley, "On the Elaboration of a System of International Transaction Accounts," *Problems in the International Comparison of Economic Accounts*, Studies in Income and Wealth, Volume Twenty, Princeton University Press for National Bureau of Economic Research, 1957.

³*Direction of International Trade*, United Nations, Statistical Paper, Series T, Vol. V, No. 8.

⁴Inasmuch as exporters rarely know the final destination of their goods, the trade is probably generally recorded on an origin (for imports) and first consignment (for exports) basis. (See *International Trade Statistics*, R. G. D. Allen and J. Edward Ely, eds., Wiley, 1953, p. 124; and H. B. Woolley, *op. cit.*.)

⁵The United States provides both special and general trade records.

on a "statistical frontier" (general trade) or clearance through customs (special trade).⁶ Thus, under either trade classification system goods sold or consigned to residents of a country where they are to be re-exported may be entered by the country of residence of the buyer or consignee in "regular" trade, entered in transit statistics, or excluded from all trade records; and goods which pass through the country without being sold or consigned to residents may be entered in any of these records. To illustrate: in pattern 2, if goods go through B in direct transit they will be excluded from B's "regular" trade under any system; and in pattern 3, country C will always exclude indirect trade from its customs records.

In summary, an appreciable part of the records of trade, including all middleman trade, shows variations attributable to the systems of reporting partner countries or systems of classifying trade. Trading partners using different systems may include in the ordinary trade records, or omit entirely, identical items. Even if the same systems are used, discrepancies between records of partner countries may occur because of different treatment of domestic exports and imports for reconsignment in trade classification systems. The complexity of variations naturally leads to all shades of discrepancies between records of partner countries for any given transaction.

Data on Middleman Trade Provided by Middleman Countries

For middleman countries, the fact that trade classification systems are related to problems of customs control not only leads to discrepancies between trade records of countries for the same transaction, but also to concealment of some and omission of other middleman trade. For a few middleman countries, however, there are useful partial records.

Countries using the general trade system sometimes give a fairly clear-cut category — re-exports. This includes goods that enter storage warehouses under customs bond and goods that pass through customs but are re-exported without processing other than repacking, resorting, or blending (where such distinction can be made). It is probably not too severe an assumption that re-export trade is largely middleman trade, with some consignment to agents. The general trade system provides no information, however, on the middleman trade passing through in transit or on offshore middleman trade by residents. Moreover, of the countries on the general trade system few provide adequate details of re-exports on a partner-country basis. Countries on special trade (e.g. the Netherlands and Switzerland) sometimes provide information, in quantity only, on entrepôt trade; unlike re-exports, entrepôt excludes items passing through customs.

Two other trade records of middleman countries, the transit records

⁶*International Trade Statistics* (cited in note 4, above), pp. 45-46.

and records of imports in processing warehouses, can be mined for information on middleman activity, though expert knowledge of the trade is required. Many countries with heavy transit trade, including most of the major industrial nations, provide certain data on transit trade, sometimes classified according to whether or not the goods are transhipped. These data, like the entrepôt records, are generally given in quantity only and incompletely. For some countries, however, such as the Netherlands, it is known that much of the transit trade reflects middleman activities by Dutch and sometimes British merchants.

Separate data on improvement or transformation trade are given by some countries such as Belgium and Switzerland, normally engaged in minor processing activities. This trade poses a conceptual problem, of course, of where to draw the line between merchanting and production of new commodities. It is clearly useful for some purposes, as in input-output analysis, to determine the import content, however indirect, of all exports. In the present analysis of middleman trade, concerned with strict middleman activity, I have arbitrarily delimited merchanting where possible on the basis of the three-digit level of the increasingly employed Standard International Trade Classification. It seems practical to distinguish merchanting activity according to whether the improvement of a commodity is sufficient to shift it from one of the 150 commodity groups to another.

Balance of Payments Data on Middleman Activity

Two of the important economic effects of middleman activities, for which we might hope to find data in the balance of payments, are the profits on middleman activity and the change in distribution of holdings of foreign balances resulting from middleman activity. Although the IMF, in the *Balance of Payments Manual*, takes note of these particulars, it either fails to request that a distinction be made between them and other transactions, or its request, when made, is apparently ignored. Therefore, we are given no more than a hint of the magnitude of middleman trade profits for a few countries, and the effect of middleman activity on foreign exchange holdings cannot be determined at all.

As to profits from merchanting activities, four balance of payments adjustments are significant. In Table II of the *Manual*,⁷ item 1.2 requests countries on the special system to make the necessary additions to approximate the general system; item 7 calls for a gross credit entry of proceeds from offshore transactions, adjusted for freight and insurance charges, and a gross debit entry for the total cost of the goods sold, including any foreign services involved; item 8 adjusts for changes in foreign-owned goods in the reporting country and domestically owned goods abroad; in

⁷This table is reproduced in *International Trade Statistics*, *op. cit.*, p. 171.

item 1.1, the special or general exports are to be adjusted to a purchase-sale basis. By these four adjustments the IMF apparently hopes to include all middleman activities⁸ (except those involving foreign branches and subsidies) on a gross basis in the adjusted current balance, but it attempts to reveal the profits only on merchandise transactions abroad. For countries on the general system no separate information is requested on the middleman trade which enters the ordinary records, while for countries on the special system a gross adjustment is requested.

Despite the limitations of the IMF recommendations, countries could supply much useful information by following them. However, at best, they conceal the individual adjustments under broad net categories; for example, no country provides separate information on credits and debits for offshore transactions.⁹ The best data on this, provided by the Netherlands, gives a combined category of net transactions abroad and changes in stock (items 7 and 8 of Table II), as follows (in millions of dollars):¹⁰

1948	1950	1951	1952	1953
26.0	40.3	37.9	62.1	86.8

Other merchanting activities of the Netherlands can be discovered in the difference between the special trade record and the balance of payments record for merchandise, which includes refining operations, coverage and valuation adjustments, as well as all merchanting activities. Other countries give even less information. The United Kingdom conceals the profits from overseas merchanting transactions in a miscellaneous category that includes some part of its earnings from freight, insurance, and foreign investment, as well as other adjustment items.

As to the change in distribution of international currency holdings resulting from middleman activity, there are no available data. The suggestion by the IMF (at the time of writing) of a method of adjustment of the interregional accounts for offshore merchanting is simply that countries adjust their exports and imports to the country of sale or purchase. But few countries make such an adjustment.

⁸No specific provision is made for entering those merchanting activities which pass through the country in the transit trade records. These are only partly included in the general trade record, but countries may include them in the offshore transactions.

⁹Walther P. Michael of the National Bureau, who has been working with the files of the IMF to construct regional balance of payments estimates, has informed me that he has never come across Table II(c) of the *Manual* (which gives the breakdown for merchandise transactions abroad) in the country files.

¹⁰*Balance of Payments Yearbook*, International Monetary Fund, Vols. V and VI, 1954, 1955. It is of more than passing interest that the *London Financial Times* estimated the foreign exchange capital invested in Dutch transit trade, and created entirely out of postwar profits, to have been between \$131 and \$168 million by May 1952 (*London Financial Times*, May 13, 1952).