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WORKING PARTY OF THE TRADE COMMITTEE

Standardising Member Countries' Balance of Payments
Statistics on Trade in Services

(Note by the Secretariat)

1. This note sets out revised proposals for the definition and classification of service transactions. The revision incorporates recent developments in this area, mainly:
 - a. The conclusions of this Working Party's meeting on 9th-10th March 1987 (cf. document TC/WP(87)34, paras 19-22);
 - b. EUROSTAT's Detailed Presentation of CEI of 25th May 1987;
 - c. The conclusions of the Expert Group Meeting on External Sector Transactions for the Revision of the System of National Accounts convened by the IMF in Washington on March 23-April 2, 1987.
2. These proposals are preliminary and will further be revised in the light of work in OECD Committees and Working Parties and in other fora, mainly in EUROSTAT and in the United Nations; in particular the conclusions of UNSO's ad hoc committee on service statistics relating to a detailed services classification will be taken into account. On the other hand, these proposals

are designed as a contribution to the ongoing work on the world and the regional level.

3. The proposals address three issues:

- a. Elaboration of a general definition of services; this appears necessary because there is no internationally-agreed definition of services, and Member countries interpret this term differently (1).
- b. Delimitation of services as distinct from goods, factor income and capital gains/losses: this is justified by the fact that the frontiers between these three categories are controversial and variable from country to country; it will be necessary to arrive at understandings on borderline cases.
- c. Establishment of a classification of service items: the classification proposed represents a list of main items which will require, at a later stage, detailed definitions and disaggregation into sub-items.

4. These proposals concern balance of payments current accounts. For certain services sectors "satellite accounts" will have to be constructed in order to measure more fully their international trade in services activities. This is the case, for instance, and inter alia, for banking and financial services for which data on services transactions have been complemented by investment income data collected for the same institutions by the OECD Group of Financial Statisticians (2).

1. The general definition of services and of trade in services

5. Services have been defined on the basis of two approaches. The first, which can be characterised as institutional, considers the methods of production and the industrial structure. According to traditional classifications, industries are grouped into primary, secondary and tertiary industries. According to this logic the service industries constitute the tertiary sector which is negatively defined: it comprises all industries other

than agricultural, mining, manufacturing, construction and utilities. In terms of the revised International Standard Industrial Classification of all Economic Activities (ISIC), the service industries commonly correspond to Sections 6, 7, 8 and 9 (see Appendix I).

6. The second approach is functional and emphasises the nature of the product. In contrast to a good -- which may be defined as a physical object which is appropriable and, therefore transferable between economic units -- a service can be defined as an improvement in the condition of one economic unit which is brought about as a result of the productive activity of some other economic unit (3). The improvement may take the form of a physical transformation of some goods owned by the consumer unit, in which case the nature of the production process itself may be no different from processes used to produce goods. Alternatively, the improvement may relate to the physical or mental condition of some individual, or group of individuals. In either case, the distinguishing feature of service activity does not lie in the nature of the production process but rather in the fact that producer adds value, not to his own person or property, but to the person or property of another economic unit. Unlike goods, services cannot be produced in isolation and subsequently sold to the economic units which eventually consume them. Services have usually to be provided directly to consumers at the time they are produced, so that the activities of production and consumption cannot be separated either in time or space. International trade in services occurs whenever a resident economic unit provides a service to a non-resident (or vice versa). The producer and consumer have to come into contact with each other, which usually implies that the producer has to travel the country of the consumer or that the consumer travels to the place of work of the producer. On the other hand, the production and consumption of goods are usually completely separated from each other. For example, goods may be produced in country A in period 1; they may be transported to country B in period 2 and then eventually sold to a consumer in B in period 3. These different stages -- production, transportation, and trading -- are compressed into one in the case of trade in services, which implies that the organisation of trade in services is quite different from that for goods. The fact that services do not have to pass through specific points of exit or entry to a country is just one obvious manifestation of the importance of the distinction between goods and services in international trade.

7. Alternatively, services have sometimes been defined as economic output -- either final or intermediate -- that are intangible and invisible (4); thus they have been contrasted with goods which are both tangible and visible. It is often difficult to identify service outputs if goods and services are sold jointly, or if tangible outputs serve as media for the delivery of intangible outputs.

8. International trade in services in the balance-of-payments sense is confined to transactions between residents and non-residents. These may be grouped into three main types:

- a. Cross-border transactions, including the transmission of voice, video, data or other information and the transportation of goods and passengers from one country to another;
- b. Travel of individual consumers to another country (e.g., services provided to non-resident tourists, students, and medical patients);
- c. Travel of individual producers to another country (e.g., services provided to foreign clients by business consultants, engineers, lawyers, etc.).

9 To these three types, a fourth may be added if the coverage of services is not limited to non-factor services, i.e. contractual arrangements transmitting rights to use intellectual property, technology, or other services (e.g. patents, trademarks, franchises, book, film, broadcast and recording rights).

10. Because the sales of services require close contact between producer and consumer -- and also because of restrictions on the provision of services by non-residents -- delivery of services abroad must often be through foreign affiliates rather than directly from parents in the reporting country. In order to obtain a complete picture of international trade in services, it is essential to have information on sales abroad by affiliates; because these sales are transactions between foreign residents, they are not covered by balance of payments data.

11. The heterogenous and complex nature of services renders any attempt of meaningfully classifying services very difficult. A possible analytical classification in the field of trade in services would distinguish five major categories:

- a. Goods-related services (such as distribution, freight transportation, merchanting, brokerage);
- b. Financial services (such as insurance and banking);
- c. Business services (such as consultancy, communications and computer services);
- d. Personal services (such as passenger transport, health and recreation);
- e. Public services (civil administration and defence).

II. Delimitation of services

12. If services are defined as intangible and invisible economic outputs, they have to be distinguished from goods, factor income, and capital gains (losses).

13. In principle, services differ from goods in that goods represent tangible and visible outputs. In practice there exist a category of transactions which encompass both visible and invisible outputs, because goods and services are sold as a package (e.g. travel which combines goods such as food with services like transportation). The main items of this category have traditionally been classified as services because the service elements are predominant; this is the case of travel, transportation and current government transactions. There does not appear to be any justification for changing this procedure. On the other hand, there are items whose classification has not been as consistent as that of travel, transportation and current government transactions: merchanting, processing, repair and construction.

14. Merchanting is defined in the fourth edition of the Balance of Payments Manual of the International Monetary Fund (cited hereafter as IMF Manual), paragraph 337, as follows: "When goods are acquired and relinquished again without crossing the frontier of the economy in which their temporary owner is a resident, the temporary owner is considered to have been engaging in merchanting transactions...". Merchanting represents an intermediate case between merchandise transactions (which are characterised by a change of ownership between residents and non-residents) and brokerage (which relates to goods that do not enter the reporting country's territory). The IMF treatment of merchanting has not been constant: in the third edition of the Manual, it formed a part of the merchandise account, while the fourth edition included it in "other services". On the assumption, that the merchandise account should be confined to goods that cross the frontier of the reporting country and are integrated into its production process or are consumed there, it is suggested that the treatment in the fourth edition of the IMF Manual, i.e. the inclusion in the service account, should be maintained (see Appendix II, item 2.1.1).

15. Processing and repair are defined in the IMF Manual, paragraph 336, as follows: "When an enterprise in one economy processes goods owned by another economy, the value of the goods that cross the frontier is excluded from the merchandise item and the fees paid for processing are entered in this item. Improvements, repairs except those classified as port services, and other nondistributive services performed for nonresidents on goods should also be entered in this item." This item is included in "other services" in the fourth edition of the Manual, contrary to the third edition where it was a component of merchandise. Goods imported for processing and repair differ from ordinary imports in two respects: (i) there is no change in ownership of the imported goods between residents and non-residents; (ii) such goods are from the outset to be reexported and not to stay in the economy where processing and repairing take place. From an analytical point of view there are fundamental differences between imports of goods for processing and repair and their subsequent reexport, on one hand, and ordinary imports and exports, on the other. The contracts concerning ordinary exports and imports provide for the delivery of goods, whereas processing and repairing contracts relate to changes made to clearly-identified goods. The exporter receives a price for delivering a good, the processor and repairer a fee for changing an existing good. For an ordinary importer, the price of the good concerned is

of great importance, contrary to the processor or repairer, to whom the price of the good to be processed or repaired is not relevant -- he may not even know it. Processing presents a good illustration of the fact that services are not defined by the nature of the production process itself, but by the direct contact between producer and consumer of the service.

16. For the recording of processing and repair three possibilities can be envisaged:

- a. To maintain the treatment of the fourth edition of the Manual, i.e. to record them as a whole as service transactions.
- b. To follow the suggestions of the expert group on external sector transactions which breaks processing and repair into two components each; for processing it suggests to record as merchandise transactions all processing that implies a substantial physical change in the goods processed reflecting a change in their characteristics and to record as services only the remainder; for repairing it suggests to record as merchandise transactions all repairs of investment goods, and as service transactions all other repairs.
- c. To record all processing and repairing as service transactions, but to provide for subdivisions along the lines described under 15b; this solution is embodied in Appendix II (items 2.2 and 2.3).

17. As regards construction and installation a distinction has to be made between construction services (Division 71 of the Central Product Classification (CPC) and constructions (CPC Division 72). For constructions, the OECD Group of Financial Statisticians (5) recommends the following solution: "Construction enterprises in one economy can undertake the construction of plant, buildings, etc. in another economy through subsidiary and associate companies in that economy, a foreign branch set up for the project, or directly undertake the work themselves. However, the IMF Manual, in line with the UN System of National Accounts, recommends that all construction work abroad be regarded as being done by a direct investment enterprise resident in the economy in which the work is being carried out.

Therefore when a construction enterprise directly undertakes work abroad, even if the work takes less than one year, this should be regarded as being done through a national direct investment enterprise. Where an enterprise in one country is installing machinery and equipment in another country, the IMF Manual recommends, in paragraph 73, that the work should be regarded as services provided to the foreign country if the installation is carried out entirely, or primarily, by employees of the enterprise who go abroad to do the work, and they complete the installation in less than one year. All other installation work should be regarded as being done through a direct investment enterprise. The Group recommends that construction and installation work carried out abroad be classified as set out in the IMF Manual". The same treatment is suggested in the balance-of-payments context so as to ensure consistency with the recording of direct investment, i.e. income from construction work and -- to the extent that installation is not carried out entirely, or primarily, by employees of the resident contractor -- of installation should be recorded as direct investment income.

18. Construction services, on the other hand, would be recorded as service transactions. It is suggested that the item 2.5 (construction services) in Appendix II should correspond not only to CPC Division 71, but also cover architectural and engineering services which are included in CPC Group 893 (Technical services).

19. The distinction between services on the one hand, and factor income on the other, is fundamental and rests on the fact that the latter are payments to factors of production (capital and labour) used as inputs into production processes, whilst services constitute the outputs or products of those processes. Factor income is normally linked to a stock of capital (human, financial, intellectual); it tends to be recurrent, while receipts from services mostly are of a once-for-all nature. The distinction between services and factor income is made in the fourth edition of the Manual (differing in this from the third edition), but no definition of the two categories is given. Many Member countries' balance of payments presentations have maintained the practice of the third IMF Manual, i.e. they show all services and factor income under the heading of "services".

20. The items that undoubtedly belong to the factor income category are:

(i) investment income, defined in the IMF Manual as "income derived from the ownership of foreign financial assets..." (paragraph 289);

(ii) labour income covering "wages, salaries and other compensation (in cash or in kind) that persons earn in an economy other than the one in which they reside, by working for a resident of that economy" (paragraph 319).

21. On the other side, there are some items whose nature (whether service or factor income) is not so clear cut; for these borderline cases the solutions suggested below conform with the principles of the IMF Balance of Payments Manual and the UN-OECD System of National Accounts (SNA).

22. The first of these items is income from property other than financial assets (shown as "property income, n.i.e." in the fourth edition of the IMF Manual, paras 321-324) which covers income accruing to the owners of patents, copyrights, and similar nonfinancial intangible assets (income of this sort is often referred to by such terms as royalties and licence fees) and of land. Property can be considered as a special sort of capital the use of which yields an income, similar to that stemming from the use of financial assets. For this reason, it is suggested to treat income from these categories of property as factor income.

23. The second controversial item is revenue of self-employed (such as fees received by lawyers and artists), which is included, in certain Member countries' data, in labour income. Such income represents, however, not only remuneration from work, but also a compensation for overhead costs and other outlays. Moreover, such activities are more akin to the production of services than to working for an employer. In fact, fees are paid for an agreed result and not for the time spent under instruction from an employer who carries the risks inherent in the production process. Hence, it is suggested to treat activities of self-employed as services.

24. The third item is revenue from the use of tangible assets (except land); this item is referred to as rental or leasing. The fourth edition of the IMF Manual differentiates between three kinds:

- (i) financial leasing which is to be included with "merchandise" (paragraph 217);
- (ii) operational leasing of carriers (chartering) which is included with "other transportation" (paragraph 273);
- (iii) other operational leasing, relating to structures, machinery, equipment (other than transportation equipment), films, tapes, records and other tangible assets.

Other operational leasing is treated as a service rather than factor income (paragraph 322). This treatment is suggested, as leasing fees represent not only a remuneration of the capital involved, but also for the management of leasing; they are shown as item 2.4 (Rental services) in Appendix II.

25. In conclusion, it is suggested that the category "Factor income" be confined to the three items whose income nature appears to be well established:

- Labour income (limited to wages and salaries);
- Investment income;
- Property income.

26. There exist borderline cases between services and capital gains or losses. They relate to pairs of transactions that are closely linked, because a transactor intends to dispose of a certain asset at virtually the same moment when ownership of it is nominally acquired. Such cases include, for example, arbitrage and certain other dealings in foreign exchange, such as those under forward contracts. The question for consideration is whether (i) two changes of ownership of the asset have actually occurred, so that any profit or loss could be regarded as the realization of a capital gain or loss,

to be entered like any other realization of a capital gain or loss in the capital account item that refers to the asset concerned, or (ii) no change of ownership has effectively taken place, so that the profit or loss could be seen as a fee for a service. The IMF Manual (para 370) recommends the solution set out in (i). It appears, however, that solution (ii) would be more appropriate for the case of professional dealers.

III. A possible classification of services

27. A possible classification of services is set out in Appendix II. It draws on:

- a. The United Nations Central Product Classification (CPC), whose service sections have been circulated as document TC/WP(87)59; reconciliation with the CPC raises particular problems for the two traditional balance-of-payments items that are not defined by the nature of products, but on the basis of special groups of consumers: travel and government services.
- b. The fourth edition of the IMF Balance-of-Payments Manual.
- c. Member Countries' available data on trade in services as shown in document TC/WP(87)13.
- d. Member countries' studies of trade in services (particularly of the United States Department of Commerce and the United Kingdom Central Statistical Office and the Bank of England) as well as private studies, the most important of which are:
 - E. Parrish Lederer, W. Lederer and R.L. Sammons, International Services Transactions of the United States: Proposals for Improvement in Data Collection, Washington 1982;
 - N.L. McKellar, A Classification of Services for International Trade, Ottawa 1982.

28. The proposed classification endeavours to organise services transactions into the five analytical categories sketched in paragraph 11 of this note. Exceptions are made for Transportation, Travel and Governmental Services which are shown separately because they represent traditional balance of payments categories that are identified in all Member countries' balance of payments data.

29. The classification of Category 1 Transportation closely follows the CPC classification which is structured on the basis of modes of transport, except that (i) the items of CPC Group 857 (Supporting and auxiliary transport services) that are directly related to a given mode of transport are included in that group, e.g. CPC Class 8576 (Supporting services for air transport) is included in item 1.2 Air transport as sub-item 1.2.4 and (ii) inland passenger transport is excluded. In line with CEI, an item "Space transport" (1.7) has been added.

30. Category 2 Goods-Related Services cuts across the CPC system. It includes items that correspond to CPC Divisions: Trade services (CPC Division 82) and Rental services (CPC 88). The three other items correspond to combinations of CPC Groups and Classes. Processing (item 2.2) reflects the two CPC Classes that relate to manufacturing on a fee or contract basis. Item 2.3 Repair services covers all kinds of repairing services, not only those that are identified as services in the CPC (repairing of motorvehicles, computer systems, personal and household goods), but also those that are included in the CPC Divisions of transportable goods (e.g. Division 241 which encompasses building and repairing of ships and boats). Item 2.5 Construction services corresponds to CPC Division 71 (Construction services) but includes also the part of CPC Group 893 (Technical services) that concern construction.

31. Category 3 Insurance follows the CPC classification, but adds merchandise insurance as a separate item.

32. While the total of category 4 Financial Services corresponds to CPC Groups, its breakdown by products differs in some points, reflecting the contributions from the United Kingdom (6). A breakdown on the basis of institutional factors -- as is proposed by EUROSTAT in CEI item 112 -- is inappropriate, because the institutional boundaries are being eroded by

deregulation and innovation, leading to despecialisation of financial institutions.

33. Category 5 Communications corresponds to CPC Groups 858 and 859, with an additional breakdown of item 5.1 into postal and courier services.
34. Category 6 Business Services which draws together services that are essentially provided to businesses broadly corresponds to CPC Division 89.
35. Category 7 Personal Services combines services that are essentially provided to individuals. It fully corresponds to CPC Divisions 93, 94 and 95.
36. Category 8 Travel corresponds to the IMF Manual definition as covering the goods and services acquired from an economy by travellers (business travellers, students and trainees, excursionists and other travellers) during their stay in the economy (paras 278-286); it is identified on the basis of demand (7). This category cuts across CPC categories; it partially corresponds to CPC Division 84, but includes also parts of other Groups (such as inland passenger transportation). The proposed breakdown of total travel by types of travellers reflects the classification of travellers set out of the World Tourism Organisation's Guidelines for Tourism Statistics.
37. Category 9 Government Services is confined (in line with a suggestion by the UK Central Statistical Office) to services that can only be provided by governments. Its definition corresponds to that of the IMF Manual which recommends: "Goods, services, and income to be classified in this category are all the real resources, that have not been classified under merchandise, shipment, other transportation, travel and investment income" (para 307). It is, thus, defined -- like travel -- by the transactors and not by the nature of the products concerned. In this way, it is hardly consistent with the CPC classification.

NOTES AND REFERENCES

1. Cf. document TC/WP(87)13, paragraph 3.
2. OECD Committee on Financial Markets, Tables on international trade in financial services (Report of the Group of Financial Statisticians), doc. CMF(87)8.
3. T.P. Hill, "On goods and services", Review of Income and Wealth 1977, p. 315-338.
4. O.G. Whichard, "US international trade and investment in services: Data needs and availability", Washington 1984.
5. OECD, Detailed benchmark definition of foreign direct investment, Paris 1983, paragraphs 74-76.
6. OECD Group of Financial Statisticians, Treatment of finance and insurance in ISIC and CPC (note by Mr. Alexander of the CSO) and comments by the Financial Statistics Division of the Bank of England.
7. Cf. World Tourism Organisation, Preliminary Report on a Proposal for integrating tourism in the ISIC and CPC, Madrid 1987.

APPENDIX I

International Standard Industrial Classification of all
Economic Activities (ISIC)

- | | |
|-----------|--|
| Section 0 | Agriculture, hunting, forestry and fishing |
| Section 1 | Mining and quarrying |
| Section 2 | Manufacture of metal products, machinery and equipment |
| Section 3 | Manufacturing, except manufacture of metal products, machinery and equipment |
| Section 4 | Electricity, gas and water supplies |
| Section 5 | Construction |
| Section 6 | Wholesale and retail trade; repair of motor vehicles, motorcycles, cycles and personal and household goods; restaurants and hotels |
| Section 7 | Transport, storage and communication |
| Section 8 | Banking, insurance, real estate, renting and business activities |
| Section 9 | Community, social and personal service activities |

Source: United Nations, First complete draft of the revised ISIC, June 1986.

APPENDIX II

Proposed Classification of Services Transactions

OECD Proposal	CPC
1. <u>Transportation</u>	85 - (858 + 859)
1.1 Sea transport	854 + 8575p
1.1.1 Passenger transportation	8541
1.1.2 Freight transportation	8542
1.1.3 Rental of sea-going vessels with crew	8543
1.1.4 Towing and pushing services	8544
1.1.5 Supporting services for sea transport	8575p
1.2 Air transport	856 + 8576
1.2.1 Passenger transportation	8561p
1.2.2 Freight transportation	8562
1.2.3 Rental of aircraft with crew	8563
1.2.4 Supporting services for air transport	8576
1.3 Rail transport	851 + 8573
1.3.1 Passenger transportation	8511p
1.3.2 Freight transportation	8512
1.3.3 Supporting services for railway transport	8573
1.4 Other land transport	852 + 8574
1.4.1 Passenger transportation	8521p + 8522p
1.4.2 Freight transportation	8523
1.4.3 Rental of commercial vehicles with operator	8524
1.4.4 Supporting services for road transport	8574
1.5 Internal waterways transport	855 + 8575p
1.5.1 Passenger transportation	8551p
1.5.2 Freight transportation	8552
1.5.3 Rental of vessels with crew	8553
1.5.4 Towing and pushing services	8554
1.5.5 Supporting services for internal waterway transport	8575p

1.6	Pipeline transport	853
1.7	Space transport	
1.8	Supporting and auxiliary transport services	8571 + 8572 + 8577 + 8578
2	<u>Goods-related services</u> (other than transport)	
2.1	Trade services	82
2.1.1	Merchanting	822
2.1.2	Brokerage and other commission agent's services	821
2.2	Processing	8983 + 8989
2.2.1	Processing implying substantial physical change	-
2.2.2	Other processing	-
2.3	Repair services	8113 + 8122 + 833 + 8915
2.3.1	Repair of investment goods	-
2.3.2	Other repair	-
2.4	Rental services	88
2.4.1	Rental services concerning transport equipment	8811
2.4.1.1	Rental of ships without crew	
2.4.1.2	Rental of aircraft without crew	
2.4.1.3	Rental of other transport equipment	
2.4.2	Rental services concerning other machinery and equipment	881 - 8811
2.4.3	Rental services concerning personal and household goods	882
2.5	Construction services	71 + 893p
2.5.1	General construction work for buildings	711
2.5.2	General construction work for civil engineering	712
2.5.3	Assembly, installation and completion work	713 + 715 + 716
2.5.4	Other	714 + 717 + 718
3	<u>Insurance Services</u>	863
3.1	Life insurance	8631
3.2	Disability insurance	8632

3.3	Medical care insurance	8633
3.4	Property and liability insurance	8634
3.4.1	Merchandise insurance	
3.4.2	Other	
3.5	Pensions and annuities	8636
3.6	Reinsurance	8635
3.7	Other	8639
4	<u>Financial services</u> (Other than insurance)	861 + 862
4.1	Deposit services	8611
4.2	Credit services	8612
4.3	Security services	862p
4.4	Money transmission	
4.5	Financial market services	862p
4.6	Financial management services	8613
4.7	Collection services	
4.8	Contingent services	
5.	<u>Communications</u>	858 + 859
5.1	Postal and courier services	858
5.1.1	Postal services	
5.1.2	Courier services	
5.2	Telecommunication services	859
5.2.1	Telephone services	8591
5.2.2	Telegraph services	8592
5.2.3	Radio and television broadcasting and relay	8593
5.2.4	Satellite transmission	8594
5.2.5	Other	8595

6.	<u>Business services</u>	89 - (8915 + 8983 + 8989)
6.1	Computer services	891 - 8915
6.1.1	Consultancy related to hardware installation	8911
6.1.2	Services related to software	8912
6.1.3	Data processing	8913
6.1.4	Data bank services	8914
6.2	Legal services	8921
6.3	Accounting, auditing and tax consultancy	8922
6.4	Business and management consultancy	8923
6.5	Technical services	893p
6.6	Research and development services	894
6.7	Advertising and promotional services	895
6.8	Agricultural services	8981
6.9	Mining services	8982
6.10	Other business services	896 + 897
7	<u>Personal services</u>	93 + 94 + 96
7.1	Education services	93
7.2	Health and social services	94
7.3	Recreational and cultural services	95
8.	<u>Travel</u>	84 + 8561p + 8511p + 8521p + 8522p + 8551p
8.1	Tourists	
8.1.1	Professional travels	
8.1.2	Pleasure travels	
8.1.3	Other travels	
8.2	Excursionists	
8.3	Other travellers	

9.	<u>Governmental services</u>	91 + 92
9.1	Civil administration	9121 + 9122
9.2	Defence	9123 + 9124 + 9125

BOP Manual: International Monetary Fund, Balance of Payments Manual, Fourth Edition 1977

CPC : United Nations, First Draft of the Central Product Classification 1986