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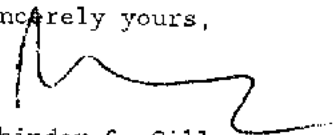
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July 19, 1991

Dear Mr. Albert:

Please find attached the paper entitled "Draft Classification of International Transactions in Services" that is to be considered in session 8 of the forthcoming Vourburg Group meeting in Helsinki. An abstract of the paper is also attached.

Sincerely yours,


Mahinder S. Gill
Chief

Balance of Payments and
External Debt Division
Statistics Department

Attachment

Mr. Jean Albert
EUROSTAT
Batiment Jean Monnet
L-2920 Luxembourg
LUXEMBOURG

001071

INTERNATIONAL MONETARY FUND

Statistics Department

Draft Classification of International Transactions in Services

July 18, 1991

Abstract

The paper deals mainly with objectives, nature, and scope of the draft classification system for international transactions in services (the Draft Classification) that has been prepared in the context of the forthcoming fifth edition of the Balance of Payments Manual (BPM). The Draft Classification is intended primarily to fill a widely recognized gap in the existing classification of international trade in services in the framework of the balance of payments, and has evolved in the course of the revision process of the BPM. The final version of the Draft Classification will reflect the views of national compilers, interested regional and international organizations, the present meeting of the Voorburg Group, and a proposed meeting of balance of payments experts in early 1992.

The Draft Classification, details of which are presented as appendix I to the paper, is compatible with the Central Product Classification mostly at the three-digit level and with the Joint OECD/EC proposal broadly at the one-digit level, and in some cases, at the three- or four-digit level. It can be expanded or contracted according to the needs and the circumstances of national compilers.

July 18, 1991

Draft Classification of International
Transactions in Services

Statistics Department
International Monetary Fund

	<u>Contents</u>	<u>Page</u>
I.	Introduction	1
II.	Objectives, Nature, and Scope	2
	1. Objectives	2
	2. Nature and scope	2
III.	Difference Between Goods and Services	3
IV.	A Rationale for the Draft Classification	5
	1. Principles used in constructing the Draft Classification	5
	2. Structure and coding system of the Draft Classification	6
	3. Deviations from the CPG	6
	4. Proposal for a Joint OECD-EUROSTAT Trade-in- Services classification	7
V.	Summary	8
Appendices		
I.	Balance of Payments: Classification of International Transactions in Goods and Services	9
II.	Notes to the Draft Classification of International Transactions in Services	11

I. Introduction

The Draft Classification of International Transactions in Services, hereinafter referred to as the Draft Classification, was initially prepared by the Fund's Statistics Department in early 1988 as part of the preparatory work in connection with the revision of the fourth edition of the Fund's Balance of Payments Manual (BPM). The Draft Classification reflected, inter alia, recommendations of the Expert Group on External Sector Transactions for the revision of the United Nations' A System of National Accounts (SNA) (March/April 1987), the recommendations of the Group of Balance of Payments Compilers (November 1987), as well as work undertaken by statistical offices of regional and international agencies such as statistical offices of the European Communities (Eurostat), the Organization for Economic Cooperation and Development (OECD), and the United Nations Statistical Office (UNSO) in this field. It was subsequently submitted for consideration by the Expert Group Meeting on Harmonization of Economic Classifications (April 1988), as well as circulated to Eurostat, the OECD, the UNSO, and national balance of payments compilers for comment. The present draft has been prepared in light of the foregoing developments and the ongoing work on the revision of the SNA.

The Draft Classification is intended primarily to fill a widely recognized gap in the existing classification of international trade in services in the framework of the balance of payments. Although the share of services in total international trade has increased in the 1980s, all international trade classifications have dealt exclusively with the classification of goods. The classification systems that include services such as the International Classification of Goods and Services (ICGS) and the Central Product Classification (CPC) are not specifically designed for classification of international transactions in services.

It is expected that a draft of the revised BPM (fifth edition) will be completed in August 1991 and subsequently circulated for comment to national balance of payments compilers, as well as interested regional and international agencies. It is proposed to convene an IMF-sponsored meeting of balance of payments experts in early 1992 with a view to eliciting a broad international consensus on outstanding issues in the context of the finalization of the revised BPM. The Draft Classification presents a proposal for the classification of services as an integral part of the balance of payments and has evolved in the course of the revision process of the BPM. Consequently, the final version of the Draft Classification will take into account that meeting's views as well as those of the participants in the present meeting of the Voorburg Group, in addition to comments of national compilers and interested international and regional organizations. Following decisions taken in the Expert Group on External Transactions as to the borderline between goods and services, and further work undertaken in the SNA review process, Appendix I provides details on the coverage of these flows in the balance of payments.

The plan of the remainder of this paper is as follows. Section II outlines the objectives and the scope of the Draft Classification; section

III deals briefly with issues surrounding a workable definition of services; section IV attempts to provide a rationale for the analytical categories chosen for the Draft Classification, particularly in relation to its conformity with the CPC and other classifications; and section V gives a short summary of the paper. Appendix I shows the Draft Classification and Appendix II provides an explanatory note on the items in the Draft Classification.

II. Objectives, Nature, and Scope

1. Objectives

A general objective of any data classification system is to provide a coherent framework for the compilation of data with due regard to both the analytical needs of users and the statistical feasibility of generating the data. In addition, the Draft Classification aims at facilitating international comparisons of data on international trade in services. Finally, the Draft Classification seeks to serve as an international standard that would have the flexibility to accommodate the diverse statistical needs and capabilities of countries at different stages of statistical development. In this connection, it needs to be stressed that the development of a classification of international transactions in services for purposes of international reporting of balance of payments data does not preclude countries from developing more elaborate and detailed breakdowns of component items; indeed, for statistically advanced countries, the IMF would request and store data in the degree of detail that such data are available and published by these countries.

2. Nature and scope

The classification makes provision for all international trade in services, although it is not as detailed as the CPC mainly because the CPC applies to the structure of total production encompassing domestic as well as international transactions. Meaningful analytical categories are formed by combining appropriate items that may be comparatively insignificant in international trade although they may be important in domestic transactions. The varying and diverse needs of multilateral trade negotiations are also taken into account to the extent practicable.

The scope of the Draft Classification is restricted to nonfactor services, i.e., the services components of the flows relating to exports and imports of goods and services that feature in the measurement of GDP. Consequently, the scope of the classification excludes factor income flows such as labor and property income as well as transfers (e.g., airport taxes, lottery prizes, membership fee paid to nonprofit associations, etc.). The

classification is hierarchical and can be expanded or contracted according to the needs and circumstances of the compiling country.

III. Difference Between Goods and Services

Although a precise distinction between goods and services is largely of theoretical interest, it is necessary to have at least a workable definition of services for purposes of developing a classification system and compiling statistics on trade in services in accordance with that classification. Also, differences in international trade between goods and services may have different implications for economic analysis and policy making, an issue highlighted by current multilateral trade negotiations. Moreover, because of the growing importance of international trade in services, it is necessary to distinguish between exports and imports of goods, on the one hand, and exports and imports of services, on the other.

From available writings and discussions on this subject, ^{1/} it appears that a number of criteria have been suggested to distinguish between goods and services in different circumstances. For example, direct and immediate contact between the producer and the user has been emphasized as a hallmark of services as distinct from goods, which could be produced and sold to an intermediary or stored without knowing who would use them. However, the possibility of temporal and geographical separation of production and consumption of services is increasing with technological progress. Similarly, tangible versus intangible, storable versus nonstorable, or transportable versus nontransportable have been used as distinguishing features between goods and services.

A succinct statement of the distinguishing characteristics of goods and services is provided in the draft Production Accounts chapter of the SNA under revision, ^{2/} which notes three economically significant characteristics of goods as follows:

"(1) The ownership of goods may be exchanged in transactions between different institutional units and markets may be organized for this purpose.

^{1/} See "Final Expenditures and Uses" a chapter of SNA (under revision), May 1989 (mimeo); UN Secretariat, Final Draft of the Central Product Classification (CPC), September 1988; and T. P. Hill, "On Goods and Services," Review of Income and Wealth December, 1987.

^{2/} "The Production Accounts," a chapter of the SNA (under revision), May 1991. pp 1-2.

- 4 -

(2) The ownership of the same good may be exchanged any number of times. Goods may be subsequently retraded by their owners after they have been acquired from their original producers.

(3) The production of a good i.e., the physical process by which it is created, is a completely different activity from the subsequent exchange of that good. At the time a good is produced, its producer may not know the terms on which it may be possible to exchange it, or even whether he will eventually decide to exchange it."

In contrast, services do not have any of the above characteristics, but are endowed with three different features, which again are noted as follows: 1/

"(1) Services are produced on demand at the request of a specific unit or group of units.

(2) The activity of a service producer impinges directly on the consuming unit either by adding value to goods owned by the consumer or by improving the physical or mental condition of some person. This usually imposes a restriction on the location at which the service can be produced as some form of direct contact is required between the producer and consumer.

(3) The production and delivery of a service are one, and the same process. In sharp contrast to goods, the marketing of services cannot be separated from their production."

Although most of these criteria may be applicable in the majority of cases, there are numerous borderline cases that require judgmental decisions as to their classification. Borderline cases are exemplified by items such as photographs, computer tapes, and meals or drinks in restaurants. Other examples are goods in which some services become embodied when the goods are insured and transported, or are subject to repairs. These borderline classifications arise from analytical needs as well as statistical convenience. For example, transportation and other distributive services are embodied in goods when these are shipped from the point of production to the country's customs border for export. While in the context of input-output analysis, a separation is made between the valuation of goods output ex-establishment and the associated transport and distributive services if performed by different establishments, other analytical requirements and considerations of statistical convenience argue in favor of using the f.o.b.

1/ "The Production Accounts," a chapter of the SNA (under revision) May 1991. pp 1-2.

valuation at the customs border for the exporting country as the basis for distinguishing between goods and services flows, both in the balance of payments and the external sector accounts of the SNA. Similarly, some goods are classified as services because their response to economic factors is different from that of most merchandise. For example, goods acquired for their own use by travelers are classified as "Travel" and those acquired by diplomatic and military missions, or by official personnel are treated as "Government services, n.i.e."

IV. A Rationale for the Draft Classification

1. Principles used in constructing the Draft Classification

As noted previously, the principles underpinning this classification system are derived from the recommendations of the Expert Group on External Sector Transactions to the effect that a standard list of service items be used as the basis for the harmonization of the classification of services in the BPM and the SNA. Such a list should include the traditional items shown under services such as transport, travel, etc., as well as items that are becoming increasingly important in international trade (e.g., financial services and communications). The Draft Classification should be compatible with the CPC, preferably at a high level of that hierarchy. The Group further recommended that the CPC provide for the needs of both the balance of payments and external sector accounts of the SNA, so that harmonization between these accounts and other accounts, including input-output, be attainable.

The Group of Balance of Payments Compilers agreed with these guidelines and went further in emphasizing the need for the retention of separate items for travel and government transactions. In addition, this Group suggested separate identification and coverage of a number of items such as telecommunications, data bank services, etc.

As can be seen in Appendix I, the Draft Classification embodies the basic principles underlying the above recommendations. In classifying different services, particular attention is given to their nature and production process. Also, as mentioned earlier, it attains harmonization with the SNA (under revision) and close correspondence to the CPC (the exceptions being noted shortly). It is also broadly compatible with the proposed Joint OECD-Eurostat Trade-in-Services Classification (see OECD TD/TC/WP (90) 43, Paris, 11th July 1990). However, the Draft Classification is more aggregated than the CPC and the OECD/Eurostat proposal, in light of comments received from a large number of compilers who emphasized the need for a compromise between details needed by users and the capacity constraint of compilers.

2. Structure and coding system of the Draft Classification

The structure of the Draft Classification is hierarchical and its coding system is decimal, as in the CPC. Its categories have been built up from the sub-classes (five-digit codes), classes (four-digit codes), groups (three-digit codes), and divisions (two-digit codes) of the CPC, although the Draft Classification seeks correspondence with the CPC mostly at the three-digit level.

The Draft Classification is flexible insofar as each three-digit category can be expanded by appending a decimal place to the three-digit code which represents the most detailed category in this classification. However, if some countries do not want as much detail, the three-digit categories could be compressed into two-digit categories.

3. Deviations from the CPC

As mentioned earlier, the Draft Classification closely follows the CPC and is based on the nature of services rendered or acquired. The two exceptions to this approach are the categories for travel and government services n.i.e., which are based on the consumers of the services and, therefore, have no corresponding categories in the CPC.

Travel is treated in this manner because data are collected from the consumers of these services and most countries present the data in this form in their balance of payments statements. This treatment is also helpful to the national authorities that are engaged in promoting international tourism. Thus, keeping in mind the feasibility of collecting data, a separate category for travel covering, in addition to services, purchases of goods by travelers for their own consumption or for donating to others, is provided for in the Draft Classification. However, if a direct link to the CPC for this item is considered necessary, this could be done through further disaggregation of "Travel" in a supplementary table or a satellite account.

Government services n.i.e. includes the consumption of goods and services by embassies, consulates, military, and other establishments of a foreign government, of diplomatic and consular staff and their dependents in the country where they are stationed, and of international and regional organizations. This category also includes public administration and other services provided by governments and extraterritorial organizations.

Another departure from CPC is that, whereas CPC treats all processing and repairs as service items, the Draft Classification classifies only processing on site, minor processing such as packaging etc., and repairs on noninvestment goods, as service categories. Processing activity that involves not only the movement of goods across borders but their substantial

- 7 -

transformation, and the value of repairs on investment goods, are classified as commodity rather than service flows. This treatment is consistent with that of the SNA. The Draft Classification defines major processing as the transformation of goods to such an extent that after processing it would be classified in a different group of the CPC. In other words, when goods are returned after minor processing, e.g., packaging, sorting, or grading, they should be classified in the same group of the CPC as before they were sent abroad and the amount of value added would be considered as a service transaction.

4. Proposal for a Joint OECD-Eurostat Trade-in-Services Classification

This proposal (referred to as the Joint Proposal hereinafter) was presented at the Joint OECD-Eurostat Meeting of Balance of Payments Experts held in November, 1990 in Paris. It is fully compatible with the IMF's Draft Classification at the one-digit level. It is also linked to the CPC, but the linkage has been kept tentative and flexible mainly because the CPC is geared more to domestic than to international transactions and it is still in the process of elaboration with some of the explanatory notes remaining incomplete or unavailable.

The Joint Proposal is more elaborate than the Draft Classification in some respects. For example, in the transportation category, the Joint Proposal has a number of additional items, such as "Land Transport" with a further breakdown of "Rail Transport," and "Space Transport," and "Supporting and Other Services." Similarly, it has, inter alia, a breakdown of communications into postal, courier, and telecommunication services (see Appendix II of the Joint Proposal).

Other major differences between the Joint Proposal and the Draft Classification include a broader coverage of repair and processing items in the merchandise component of the former, while the latter includes in goods the following two types of processing and repair:

1. "Goods for processing" covers exports (imports) of goods crossing the frontier for processing abroad (in the compiling economy) that involves a substantial physical change and subsequent reimport (reexport) of the goods, valued before and after processing. Examples of such processing are oil refining, metal processing, vehicle assembly, clothing manufacture, etc.

2. "Investment goods for repairs" covers repair activity that involves substantial reconstruction work on, for example, ships, aircrafts, etc. Unlike goods for processing, these repairs are to be valued at the price (fee paid or received) of the repair, not as the difference between the value of the goods before and after repair.

- 8 -

Another deviation between the two classifications is that merchanting transactions are included in the merchandise item in the Joint Proposal, whereas they are included as part of other business services in the Draft Classification.

V. Summary

The Draft Classification is compatible with the GPC mostly at the three-digit level and with the Joint OECD/Eurostat Proposal broadly at the one-digit level and in some cases at the three- or four-digit level. It can be expanded or contracted according to the needs and the circumstances of national compilers.

In preparing the Draft Classification, the IMF's Statistics Department has sought and received active cooperation from other international and regional organizations as well as national compilers. The present version reflects comments already received from various groups, and the final version will give due consideration to the views expressed at this meeting and at the early 1992 meeting of balance of payments experts, as well as those of other international fora and national authorities that might be available later.

Balance of Payments: Classification of International
Transactions in Goods and Services

Current account

	<u>Section</u>	<u>Division</u>	<u>CPC 1/ Group</u>	<u>Class</u>
Goods and services				
a. Goods				
1. Merchandise				
2. Goods for processing (involving substantial physical change of goods)				
3. Repairs of investment goods				
4. Procurement of goods in ports by carriers				
b. Services				
1. Transportation	7			
1.1 Sea transport			721+Part of 745	
1.1.1 Passenger				7211
1.1.2 Freight				7212
1.1.3 Other			7213+7214+	
			Part of	
			sea-going	
			vessels in	
			745	
1.2 Air transport		73		
1.2.1 Passenger			731	
1.2.2 Freight			732	
1.2.3 Other			733+734+746	
1.3 Other transport 2/				
1.3.1 Passenger				
1.3.2 Freight				
1.3.3 Other				
2. Travel	...			
2.1 Business	...			
2.2 Personal	...			

Note: ... No correspondence.

1/ Section = One-digit; Division = Two-digit; Group = Three-digit;
Class = Four-digit.

2/ Comprises the following groups of the CPC, viz., 711, 712, 713, 722,
741-744, part of 745, and 747-749.

Current account

	<u>Section</u>	<u>CPC 1/</u>		<u>Class</u>
		<u>Division</u>	<u>Group</u>	
3. Communications		75		
4. Construction services		51	511-518	
5. Insurance services			812+814	
5.1 Freight insurance 2/				
5.2 Other insurance				8121+Part of 8129
6. Financial services (other than insurance)		Part of 81		
7. Computer and information services		84+	962	8921+8922
8. Royalties and license fees			892	
9. Other business services 3/				
9.1 Merchanting and other trade-related		62		
9.2 Operational leasing or rental without operators		83		
9.3 Research and development		85		
9.4 Legal, accounting, management consulting and public relations			861+862+865+Part of 864	
9.5 Advertising and market research 4/			871	
9.6 Architectural, engineering, and other technical			867	
9.7 Agricultural, mining and on-site processing		88		
9.8 Other			866,872-879,	
10. Other personal services	9			
10.1 Educational		92		
10.2 Health		93		
10.3 Other		96+97(excl 962)		
11. Government services, n.i.e.		...		

Note: ... No correspondence.

1/ Section = One-digit; Division = Two-digit; Group = Three-digit;
Class = Four-digit.

2/ Freight insurance has correspondence to CPC at the 5-digit level
(81293 subclass) only.

3/ Comprises the following divisions of the CPC, viz., 62, 83, and 85-88.

4/ Market research has correspondence to CPC at the five-digit level
(86401 subclass) only.

Notes to the Draft Classification of
International Transactions in Services

In the classification shown in Appendix I, in general, departures from the fourth edition of the BPM will include the subsumption of most aspects of the former category "shipment" into transportation and an expansion of the "other" services standard components to nine. These components are communications; construction; insurance; financial; computer and information; royalties and license fees; other business services; other personal services (education, health, cultural, etc.); and government services n.i.e. Other aspects of the revised classification are outlined as follows:

1. "Transportation" covers most of the services performed by residents for nonresidents and vice versa, formerly included in "Shipment" and "Other transportation" in the fourth edition of the BPM. It excludes freight insurance which is covered by insurance services. Items covered by this standard component comprise freight and passenger transportation by all modes of transportation, and other distributive and auxiliary services including rentals of transportation equipment with crew but excluding financial leases or long-term operational leases (time charters).

Passenger transportation has the same coverage as the component for passenger services in the fourth edition of the BPM, i.e., in addition to the services covered by fares, passenger transportation includes any other services for which passengers make expenditures on board carriers or for which they pay charges to carriers, such as those for excess baggage and for personal effects that accompany them, e.g., automobiles.

2. The scope of freight transportation and the "other" category which covers auxiliary transportation services such as storage and handling is defined in a manner consistent with the valuation of merchandise exports and imports at the customs border of the exporting country. Consequently, certain service transactions are included in commodity flows.

As to services not included in merchandise, freight covers the freight services (a) performed by residents of the compiling country on merchandise and most other movable goods acquired or owned by nonresidents and (b) performed by nonresidents on merchandise and most other movable goods acquired or owned by residents. Such services on passengers' effects accompanying the passengers are included in passenger transportation.

3. Travel covers goods and services, other than the international carriage of travelers included in passenger transportation, acquired from an economy by travelers during their stay in that economy to use themselves or give away. It includes expenditures of students other than on educational

services and of medical patients other than on health services, as well as expenditures in the domestic economy by nonresident workers.

In addition to the services covered by division 64, hotel and restaurant services, of the CPC, this item may also include services covered by other divisions of the CPC. However, this item does not include passenger transportation, which is covered in items 1.1.1, 1.2.1, and 1.3.1.

4. "Communications" covers postal (including courier) and telecommunications services, transmitting sound, images, or other information by various modes, and associated maintenance by (for) residents by (for) nonresidents.

5. "Construction services" covers work abroad on construction and installation projects by resident enterprises and their personnel, on a temporary basis, that either is not undertaken by a foreign affiliate of a resident enterprise (direct investment) or by an unincorporated site office that is equivalent to a foreign affiliate if it meets certain residency criteria.

6. "Insurance services" covers the provision of various types of insurance to nonresidents by resident insurance enterprises (and vice versa). It comprises two components (i) freight insurance and (ii) other insurance, including life (encompassing pension and annuity services), other casualty or accident, health, general liability, fire, marine and aviation, reinsurance, etc. The value of international insurance service charges is measured as the difference between the sum of gross premiums earned (from nonresidents) and the sum of claims due to nonresidents. International insurance services are valued by the amount of service charge included in gross premiums earned not by the gross premiums themselves. By convention, because of data constraints, estimates of the insurance service charge ignore investment income on technical reserves for casualty insurance in respect to goods, although inclusion of that income conceptually would represent a better estimate. Thus, for exports of goods, the insurance service charge for resident issuers (credit) is the difference between premiums earned and claims payable on goods lost or destroyed in transit. For imports, the service charge for nonresident issuers (debit) can be derived by applying the ratio of estimated service charges to gross premiums for exports of insurance services to gross premiums paid to nonresident issuers. In respect of other types of insurance (life, etc.), and the management of pension funds, the ratio of estimated service charges to gross premiums for resident insurance enterprises, or the ratio of administrative costs to contributions received by resident pension funds, may be applied to the international flows of premiums paid by resident to nonresident insurers and to contributions paid by residents to nonresident pension funds. For reinsurance, net service charges are equal to net premiums received (paid), less losses paid (recovered) to (from) nonresident ceding companies.

7. "Financial services" covers financial intermediary and auxiliary services (except those of insurance enterprises and pension funds) conducted between residents and nonresidents. Included are fees for intermediaries' services, such as those associated with letters of credit, banker's acceptances, lines of credit, financial leasing, foreign exchange transactions, etc.; commissions and other fees related to transactions in securities--brokerage, placements of issues, underwritings, redemptions, arrangements of surveys, options and other hedging instruments, etc.; commissions of commodity futures traders; and services related to asset management, administration of stock and other financial market exchanges, etc. Service charges on purchases of IMF resources are included among an economy's financial service payments, as are charges (similar to a commission fee) associated with undrawn balances under stand-by or extended arrangements with the IMF. Also included is an imputed financial intermediary service charge reflecting services that are not explicitly charged but that may be imputed or derived from the difference between an appropriate "reference" interest rate (such as an interbank rate) and the interest rate actually applied to loans (paid by borrowers) and deposits (received by depositors). This method of estimation of the "imputed financial intermediary service charge" is that recommended in the SNA (under revision), subject to the views of national balance of payments compilers, and is equivalent to reclassifying part of interest payments as payments for financial services.

8. "Royalties and license fees" is regarded as payments' for the production of services for intermediate consumption in the revised SNA and not as income as in the present SNA. The receipts from royalties or fees from the use of patents, copyrights, trademarks, processes, franchises, etc., are regarded as sales of output used as intermediate inputs. The treatment of this item in the fifth edition of BPM is therefore changed to a service category, in contrast to its treatment in the fourth edition as property income.

9. "Computer and information services" covers hardware consultancy, software implementation, information services (data processing, database and news agency), and maintenance and repair of computers and related equipment.

10. "Other business services" covers merchanting, a service that is provided when goods are acquired from a resident of one economy and then sold to another nonresident without leaving the frontier of the economy in which their temporary owner (merchant) is a resident. This category also covers other trade related services; operational leasing (renting machinery and equipment) as distinct from financial leasing; research and development; legal, accounting, management consulting and public relations; advertising and market research; architectural engineering and other technical; agricultural, mining and on-site processing; and a residual group of

business services such as those related to placement and supply services of personnel, packaging services, etc. /9

11. Item 9.2, "operational leasing or rental without operators" covers leasing other than financial leasing (where a change of ownership from lessor to lessee is imputed).

12. "Government services, n.i.e." covers transactions of embassies, consulates, and military and other establishments of a foreign government, of diplomatic and consular staff and their dependents in the country where they are stationed, and of international and regional organizations. In addition, government services, n.i.e., includes public administration and other services provided by governments and extraterritorial organizations.