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**TRADE IN SERVICES IN THE GLOBALISATION CONTEXT: ISSUES OF DEFINITION AND
MEASUREMENT**

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TRADE IN SERVICES IN THE GLOBALISATION CONTEXT: ISSUES OF DEFINITION AND MEASUREMENT

1. The creation of internationally integrated production and financial networks by multinational enterprises on the basis of foreign direct investment -- the globalisation process -- affects a great number of economic areas. But the compilation of statistics on the diverse aspects of this process has lagged behind its dynamics. At the moment, only one OECD country -- the United States¹ -- systematically collects the data required for analytical purposes.

2. This note focuses on one aspect, globalisation-related trade in services. In this area, international institutions, mainly EUROSTAT and the OECD, have initiated methodological work with a view to setting up a reporting system. In the following, the issues of definition and measurement that have emerged, in the course of this initiative are examined.

3. As a result of the international discussions in the field, a consensus has evolved regarding the following premises:

- the system to be developed should contribute to the implementation of the General Agreement on Trade in Services (GATS²);
- the system should be consistent with the OECD Benchmark Definition on Foreign Direct Investment (OECD Benchmark Definition)³;
- the system should also be compatible with the IMF Balance of Payments Manual (IMF Manual)⁴.

I. The Definition of Trade in Services

4. Until recently, the term "trade in services" was used synonymously with "international trade in services". Both terms applied to service transactions in the balance of payments context, relating to transactions between the residents of one country with non-residents (i.e. the residents of the outside world).

5. Since the adoption of the GATS, the two terms are differently defined. "International trade in services" is confined to transactions between residents and non-residents.⁵ On the other hand, GATS⁶ defines "trade in services" in a large sense. It covers, on one side, international trade in services in the three forms of supply:

- from the territory of one Member into the territory of any other Member;
- in the territory for one Member to the service consumer of any other Member;
- by a service supplier of one Member, through presence of natural persons of a Member in the territory of any other Member."

On the other side, it includes, in addition, supply of services by a service supplier of one Member, through commercial presence in the territory of any other Member (as commercial presence in other countries represents non-residents, this form of supply reflects transactions between non-residents).

6. "Commercial presence" is defined in the GATS⁷, as "any type of business or professional establishment, including through (i) the constitution, acquisition or maintenance of a juridical person, or (ii) the creation or maintenance of a branch or a representative office within the territory of a Member for the purpose of supplying a service."

7. Trade realised through a commercial presence was labelled "establishment trade" (ET) by EUROSTAT.⁸ It has still to be clarified whether this term is equivalent to the GATS concept of "supply of services through commercial presence" (and, hence, be limited to sales) or whether it encompasses also purchases of services (and of goods).

II. Definition of globalisation-related trade in services

8. As has already been noted, foreign direct investment lies at the heart of the globalisation process. Consequently, globalisation-related trade is linked to direct investment enterprises. In the OECD Benchmark Definition,⁹ a direct investment enterprise is defined as "an incorporated or unincorporated enterprise in which a foreign investor owns 10 per cent or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent or an unincorporated enterprise".

9. Globalisation-related trade in services would, therefore, be sales and purchases of services by foreign direct investment enterprises (often called foreign affiliates). These sales and purchases cover (i) transactions with partners in the country where the affiliates are located, and (ii) transactions with partners residing in foreign countries.

III. The universe of foreign affiliates

10. In the globalisation context, two measures of the coverage of foreign affiliates have been used. The first corresponds to the general definition of foreign direct investment indicated in paragraph 8, i.e. enterprises in which foreign investors own 10 per cent or more of the ordinary shares or voting power. This definition of foreign affiliates underlies the US table on intra-firm trade in private services (Annex I).

11. The second restrains this universe by raising the numerical guideline mentioned in paragraph 10, to more than 50 per cent or by replacing it by the concept of control. GATS¹⁰ distinguishes the two notions by indicating that a juridical person is:

- (i) "owned" by persons of a Member if more than 50 per cent of the equity interest in it is beneficially owned by persons of that Member;
- (ii) "controlled" by persons of a Member if such persons have the power to name a majority of its directors or otherwise to legally direct its actions.

12. EUROSTAT has opted for the criterion described in paragraph 11(i). According to this criterion, the universe covers those enterprises of which more than 50 per cent of equity capital is beneficially owned by foreigners. This definition of foreign affiliates underlies the US table on "Sales by non-bank majority-owned affiliates" (Annex II).

13. As regards the 50 per cent ownership criterion, the question has emerged on how to proceed if an affiliate is owned by more than one foreign enterprise, with each investing enterprise owning less than 50 per cent. In line with the definition of foreign direct investors in the OECD Benchmark Definition,¹¹ the 50 per cent criterion applies to individual enterprises and to groups of related enterprises.

IV. Coverage of globalisation-related trade services

14. In analysing foreign affiliates' trade, two kinds of distinctions have to be made:

a) A geographic distinction:

- (i) country of residence of the affiliate : **A**
- (ii) country of residence of the parent company : **P**
- (iii) all other countries ("rest of the world") : **R**

b) A distinction by partners:

- (i) the parent company in **P**
- (ii) affiliated partners (other than the parent company) in **A, P and R**
- (iii) unaffiliated partners in **A, P and R**.

15. The sales and purchases of services by an affiliate resident in A of a parent company in P consist of:

a) Sales to and purchases from affiliated enterprises (intra-firm trade):

- (i) to/from parent company in P
- (ii) to/from other affiliates in A (local sales/purchases)
- (iii) to/from other affiliates in P
- (iv) to/from other affiliates in R

b) Sales to and purchases from unaffiliated partners:

- (i) to/from partners in A (local sales/purchases)
- (ii) to/from partners in P
- (iii) to/from partners in R.

V. Geographical allocation

16. For the geographical allocation of the parents of affiliates, two principles are used:

- the country of immediate (direct) ownership or control;
- the country of ultimate beneficial ownership which differs from the country of immediate ownership or control if the immediate owner is a holding company.

17. In line with the OECD Benchmark Definition,¹² EUROSTAT proposes to apply the principle of immediate ownership.

VI. Activity and product classifications

18. Trade in services can be classified according to two approaches:

- on the basis of a product classification; this is the basis of the US table "Intra-firm trade in private services" (Annex I);
- on the basis of an activity classification, with allocation according to the main activity (or primary industry) of the affiliates covered; an example of this approach is the US table "Sales by non-bank majority-owned affiliates" (Annex II).

19. EUROSTAT expressed preference for a classification on the basis of activities because trade-in-services data are used in relation with enterprise statistics. Data on foreign affiliates are also related to all enterprises of the economy. These considerations apply to turnover, employment and value added. A breakdown of turnover by product is considered to be useful, but has a low priority due to the difficulties of collecting such data.

20. As activity classification, EUROSTAT proposes NACE (whose 1- and 2- digit items are identical to ISIC Rev.3), and the CPA (classification of products by activities) which allows for consistency between activities and products.

21. If direct investor and foreign affiliate do not belong to the same industrial sector the question arises as to which sector the affiliates' activities should be attributed. EUROSTAT is in favour of giving preference to the activity of the affiliate (and not to the investor).

VII. Inward and outward investment

22. For analytical purposes, data on transactions of resident affiliates of foreign parents (linked to inward direct investment) as well as on transactions of foreign affiliates of resident parents (linked to outward direct investment) are necessary.

23. There is, however, a tendency to give priority to inward over outward investment. On the one hand, inward investment is considered of greater economic importance because of its direct impact on production and employment of the country considered.

24. On the other hand, the compilation of data on inward investment is easier than that of outward investment. For flows in each direction, data can be collected in foreign direct investment surveys. But, for inward investment, there is an additional data source: the linkage between enterprise registers that make a distinction between foreign-owned (or controlled) enterprises and others, and general enterprise statistics.

ANNEX I

US Intra-firm trade in private services (US - \$ million)

		1991	1992
1.	Receipts	14 343	16 115
	a. by US parents from their foreign affiliates	9 694	10 222
	b. by US affiliates from their foreign parents	4 649	5 893
2.	Payments	9 602	9 970
	a. by US parents to their foreign affiliates	5 260	5 342
	b. by US affiliates to their foreign parents	4 342	4 628

Source: US Department of Commerce, Survey of Current Business, September 1994, pp. 119-120

!Unexpected End of Formula

NOTES

¹ Fahim-Nader, M. and W.J. Zeile (1995), Foreign Direct Investment in the United States, US Department of Commerce, Survey of Current Business, May, pp. 57-81, and J.A Sondheimer and S.E.argas, US International Sales and Purchases of Private Services, Survey of Current Business, September 1994, pp. 98-138.

² GATS (1994), The General Agreement on Trade in Services.

³ OECD (1995), Benchmark Definition of Foreign Direct Investment, Third Edition.

⁴ IMF, Balance of Payments Manual, Fifth Edition, 1993.

⁵ IMF Manual, paragraph 13.

⁶ GATS, Article I, paragraph 2.

⁷ GATS, Article XXVIII, paragraph (d).

⁸ EUROSTAT (1995), The Definition of Establishment Trade Statistics, STD/SERV(95)3.

⁹ OECD Benchmark Definition, paragraph 7.

¹⁰ GATS, Article XXVIII, paragraph (n).

¹¹ OECD Benchmark Definition, paragraph 6.

¹² OECD Benchmark Definition, paragraph 46.

ANNEX II

US sales by non-bank majority-owned affiliates

	1991	1992
1. Sales by foreign affiliates of US companies	143 990	153 674
a. to affiliated persons	20 496	22 012
b. to unaffiliated persons	123 494	131 662
1.1 To US persons	12 367	12 089
a. to US parents	7 475	6 976
b. to unaffiliated persons	4 892	5 113
1.2 To foreign persons	131 623	141 585
a. to other foreign affiliates	13 021	15 036
b. to unaffiliated foreign persons	118 601	126 549
1.2.1 Local sales	116 811	124 998
a. to other foreign affiliates	5 249	5 563
b. to unaffiliated foreigners	111 562	119 435
1.2.2 Sales to other countries	14 811	16 587
a. to other foreign affiliates	7 772	9 472
b. to unaffiliated foreigners	7 039	7 114
2. Sales by US affiliates of foreign companies	127 707	134 541
2.1 To US persons	119 520	126 989
2.2 To foreign persons	7 187	7 551
2.2.1 to the foreign parent group	3 675	3 481
2.2.2 to foreign affiliates	210	199
2.2.3 to other foreigners	3 302	3 871

Source: US Department of Commerce, Survey of Current Business, September 1994, p. 134.

!Unexpected End of Formula