Volume Title: The Role of Middleman Transactions in World Trade

Volume Author/Editor: Robert M. Lichtenberg

Volume Publisher: NBER

Volume ISBN: 0-87014-378-6

Volume URL: http://www.nber.org/books/lich59-1

Publication Date: 1959

Chapter Title: Front matter, The Role of Middleman Transactions in World Trade

Chapter Author: Robert M. Lichtenberg

Chapter URL: http://www.nber.org/chapters/c2562

Chapter pages in book: (p. -20 - 0)

The Role of Middleman Transactions in World Trade

ROBERT M. LICHTENBERG

OCCASIONAL PAPER 64

NATIONAL BUREAU OF ECONOMIC RESEARCH, INC.

1959

NATIONAL BUREAU OF ECONOMIC RESEARCH, INC.
261 Madison Avenue, New York 16, N. Y.

Typography by Oscar Leventhal, Inc.
Printing and Binding by the Leebo Printing Company
Library of Congress catalog card number: 57-11100
Price: $1.50

2,005,980

National Bureau of Economic Research, Inc.

Lichtenberg, Robert M

The role of middleman transactions in world trade. [New York] National Bureau of Economic Research, 1959.

86 p. 23 cm. (National Bureau of Economic Research. Occasional paper 64)

1. Commerce. I. Title. II. Title: Middleman transactions in world trade.

MATERIAL SUBMITTED BY PUBLISHER.

Relation of the Directors to the Work and Publications of the National Bureau of Economic Research

1. The object of the National Bureau of Economic Research is to ascertain and to present to the public important economic facts and their interpretation in a scientific and impartial manner. The Board of Directors is charged with the responsibility of ensuring that the work of the National Bureau is carried on in strict conformity with this object.

2. To this end the Board of Directors shall appoint one or more Directors of Research.

3. The Director or Directors of Research shall submit to the members of the Board, or to its Executive Committee, for their formal adoption, all specific proposals concerning researches to be instituted.

4. No report shall be published until the Director or Directors of Research shall have submitted to the Board a summary drawing attention to the character of the data and their utilization in the report, the nature and treatment of the problems involved, the main conclusions, and such other information as in their opinion would serve to determine the suitability of the report for publication in accordance with the principles of the National Bureau.

5. A copy of any manuscript proposed for publication shall also be submitted to each member of the Board. For each manuscript to be so submitted a special committee shall be appointed by the President, or at his designation by the Executive Director, consisting of three Directors selected as nearly as may be one from each general division of the Board. The names of the special manuscript committee shall be stated to each Director when the summary and report described in paragraph (4) are sent to him. It shall be the duty of each member of the committee to read the manuscript. If each member of the special committee signifies his approval within thirty days, the manuscript may be published. If each member of the special committee has not signified his approval within thirty days of the transmittal of the report and manuscript, the Director of Research shall then notify each member of the Board, requesting approval or disapproval of publication, and thirty additional days shall be granted for this purpose. The manuscript shall then not be published unless at least a majority of the entire Board and a two-thirds majority of those members of the Board who shall have voted on the proposal within the time fixed for the receipt of votes on the publication proposed shall have approved.

6. No manuscript may be published, though approved by each member of the special committee, until forty-five days have elapsed from the transmittal of the summary and report. The interval is allowed for the receipt of any memorandum of dissent or reservation, together with a brief statement of his reasons, that any member may wish to express; and such memorandum of dissent or reservation shall be published with the manuscript if he so desires. Publication does not, however, imply that each member of the Board has read the manuscript, or that either members of the Board in general, or of the special committee, have passed upon its validity in every detail.

7. A copy of this resolution shall, unless otherwise determined by the Board, be printed in each copy of every National Bureau book.

(Resolution adopted October 25, 1926 and revised February 6, 1933 and February 24, 1941)

FOREWORD

This paper is one of a series to emerge from the Study of the Structure of World Trade and Payments undertaken at the National Bureau of Economic Research with the assistance of a grant from the Ford Foundation. While it is sufficiently integrated to stand alone, the significance of the investigation dealing with a major problem raised by the world trade study may be more fully understood if it is placed in this broader context.

Social accounting for the product and income, money flows, intrasector relations, and external relations of national economies has flowered as governments have accepted a measure of responsibility for the level and character of economic activity under their control. Similarly, as the United States government and others acting cooperatively come to accept some responsibility for the level and character of world economic activity (profoundly influenced by the policies and actions of the larger countries, reflecting the actions of all, but controlled by none), the need emerges for an extension of social accounting to encompass the world economy. In the study of which this investigation is a part we are seeking to develop one such extension. The aim is to construct a set of accounts for a recent period showing the different types of transactions of the several parts of the world economy with each other. Such a set of accounts will link the flow of goods and services between countries with the flow of claims and funds; it will reveal the division of labor among nations and the extent and design of the multilateral pattern by which countries in the period 1950 to 1954 have succeeded in employing net earnings from one part of the world to cover deficits with another.

Problems of constructing a set of meaningful international trade and payments accounts were discussed in a paper presented in October 1954 to the Income and Health Research Conference on the international comparability of national accounts. Subsequent progress was reported in a paper before the Universities-National Bureau Committee Conference on international economics, giving transactions between five world areas for the single year 1951, and in a monograph extending the analysis to cover the period 1950-1954 and dealing with the trading patterns of a larger number of country groupings and of individual countries. In this and later reports at Congressional hearings I benefited from special studies of petroleum and transportation transactions by Cornelius J. Dwyer and by Herman F. Karreman,[1] as well as from this study of middleman transactions by Robert M. Lichtenberg.

Our efforts to construct a record of merchandise transactions between five world areas for the four years 1950-1953 revealed a persistent pattern of divergence between the records kept by buying and selling countries. The United States and Canada as an area persistently bought more from the sterling area, Latin America, and Eastern Hemisphere countries outside the European Payments Union than these sources reported; every partner area reported selling more to the nonsterling countries of the EPU than the latter group reported buying; and in turn nonsterling EPU countries reported selling more to the sterling area, the U.S., L.A., and among themselves than these partners on the buying side reported. While the divergence in reporting was frequently only a small percent of the gross trade between paired areas, it was often a large proportion of the net balance traded or settled between them because of the high degree of balance in interarea trading. Consequently, the existence of a fairly small uncertainty in accounting for the level of trade between paired areas, while perhaps tolerable for a study of the pattern of gross trade, impairs measurement of net interarea balances and produces a measure of uncertainty regarding the extent and character of multilateralism in the world economy.

[1]The following are cited in this paragraph:

Herbert 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; "Transactions between World Areas in 1951," abstract, *Review of Economics and Statistics*, Supplement, February 1958; "Observations on the Structure of World Trade and Payments," *Hearings before the Subcommittee on Foreign Economic Policy of the Joint Committee on the Economic Report*, 84th Cong., 1st sess., November 10, 1955, reprinted in revised and extended form in *World Politics*, July 1956; "The World Trade and Payments Pattern," *Hearings before Subcommittee on Customs, Tariffs, and Reciprocal Trade Agreements of the House Committee on Ways and Means*, 84th Cong., 2nd sess., September 24, 1956.

Cornelius J. Dwyer, "The Oil Trade in the International Balance of Payments in 1951," abstract, *Proceedings of the Business and Economic Statistics Section*, American Statistical Association, 1955-1956.

Herman F. Karreman, "World Transportation Account, 1950-1953," abstract, *Review of Economics and Statistics*, Supplement, February 1958.

Various explanations can be advanced for differences in accounting merchandise transactions between world areas. Persistence of the divergence over a four-year period rules out an explanation depending on leads and lags in reporting; rather, the pattern of divergence points to the indirect character of some international trade as an important source of the uncertainty in accounting. According to the International Monetary Fund *Balance of Payments Manual* of 1950, merchandise transactions are to be adjusted to show imports according to country or area from which purchased and exports according to purchasing partner, but few countries keep basic trade records on these principles. Consequently few conform to the IMF request in this respect but reflect in their regional merchandise accounts the directional principles characterizing their customs records or exchange control (on which some rely). We thought that if we could learn more of the extent and nature of the indirect trade between countries we might gain a fuller understanding of observed divergences in the reporting of merchandise transactions, and perhaps develop a quantitative basis for adjusting existing payments accounts consistently to the purchase-sales basis. We were thus led to undertake a special study of the role of middleman countries in world trade.

At the beginning of Lichtenberg's study we held the tentative hypothesis that middleman trade is largely re-export trade involving a temporary transfer of ownership of internationally traded merchandise to the consignee in the country of re-export. If this hypothesis proved valid and if the residual divergences between our adjusted merchandise trade records of buying and selling countries proved to be primarily the result of variations in methods of reporting re-export trade, a straightforward approach appeared feasible. A standardized record of commodity trade between countries which we had compiled would be used to study divergences between records of exporting and corresponding importing countries. These divergencies would be used as a guide to identify the middleman component of the divergences, to correct the total merchandise trade accounts of countries, and would at the same time provide a basis for adjustment of merchandise trade to a consistent purchase-sales basis.

Although, as Lichtenberg shows, some analysis of this nature is fruitful, he found it more useful to develop his study on the basis of a broader, somewhat unusual concept of middleman trade and with the aid of a different set of data. He expanded his conceptual approach to take account of the possibility, which he later verified, that a substantial part of this trade involves temporary control by the middleman without moving the commodity to his country of residence – the so-called "offshore merchanting." An investigation of current methods of reporting led to the conclusion that, for quantitative estimation of this additional class of middleman activity, only records of those countries reporting trade both by country of origin and country of purchase would be adequate. Lichtenberg made an intensive study of the records of the few countries reporting both ways and developed from that data a description of the structure of world middleman trade by country and commodity group, and an estimate of its total magnitude.

For our objective – development of a set of meaningful international trade and payment accounts – a finding of particular interest is that a large part of middleman activities involves channeling the trade of overseas dependencies through the mother country: sterling area trade through the United Kingdom; Continental trade through Continental middleman (notably Netherlands and Belgium); Canadian and some other dollar trade through the U.S. Consequently, an analysis of interarea trade employing a system of grouping which combines the U.K. with other sterling area countries, combines Continental countries with each other and their overseas territories, and combines the U.S. with other dollar sources will eliminate most of the discrepancies resulting from the different principles used for recording the direction of trade and re-exports. Conversely, an analysis which seeks to distinguish the merchandise transactions of the U.K., the U.S., and Continental metropoles from those of countries trading principally with them will be subject to greater uncertainty owing to the difficulty of adjusting for the trade of affiliated countries conducted through their principal trading centers.

What can be done to reduce this uncertainty? Since comparison between the estimated middleman trade and available data on reconsignment trade indicates that a high percentage of this trade is "offshore merchanting" without physical movement to the middleman's country of residence, the adjustment of the trade of affiliated territories to a purchase-sales basis raises treacherous statistical questions and questions about "residence." Solving these problems appears to require extensive and detailed study of the structure and conduct of particular trades, such as Dwyer made for petroleum trade. Without such detailed studies for the twenty or thirty items making up most of middleman trade, progress would require a revision of the current methods of reporting trade and payments statistics by countries. Suggestions to this end emerging from this statistical analysis may be of interest to those international organizations now studying proposals for standardizing trade statistics. Lichtenberg's paper throws some light, in particular, on the inadequacies of using a single system of reporting trade – such as the consignment-consignment system – to develop statistics useful for analysis on the basis both of origin-destination and of purchase-sales of internationally traded commodities.

Clearly, revisions suggested for middleman transactions as well as revisions we have made for other factors responsible for divergences between trade records of buying and selling countries would not be worthwhile if these divergences resulted primarily from spurious and inaccurate reporting, as contended recently by Oskar Morgenstern.[2] In view of his excessive skepticism, certain findings of Lichtenberg are notable: the high agreement between recorded amounts of world exports and world imports of selected major internationally traded commodities; and evidence that large intercountry divergences reflect chiefly the peculiarities and statistical practices of country statistical offices. The divergences are thus systematic and can, with some help from these offices, be analyzed; there is little reason to suspect that they are the result of deliberate falsification of records or mistakes in reporting.[3]

The study of middleman transactions is of broader interest than the problems of measurement I have been discussing. Just as the effort to account for interarea transactions as a whole is but a technical expression of an endeavor to increase our understanding of international economic problems, so also interest in the study of middleman activities transcends the problem of measurement. The very uncertainty in accounting for the regional direction of transactions, which plagues efforts to construct a matrix of merchandise transactions around the world, is symptomatic of a lack of knowledge or control by governments of certain transactions, particularly those involving middlemen. When governments are vitally concerned with the currency composition and magnitude of their foreign balances, certain operations of middlemen, especially those discussed in this paper in the section on switch trade, become matters of high policy. Similarly, the evidence given on the importance and relative growth of offshore middleman activities by industrial countries appears to describe an adjustment on their part to world economic development, permitting

[2] Oskar Morgenstern, *The Validity of International Gold Movement Statistics*, Princeton University Press, 1955, p. 40; and, by the same author, *On the Accuracy of Economic Observations*, Princeton University Press, 1950, p. 54.

[3] See also Dwyer's paper "A Partial Audit of International Petroleum Trade in 1951," National Bureau of Economic Research (mimeo), March 1955.

them to maintain a substantial income from trade of the relatively underdeveloped parts of the world despite the decline in entrepôt trade.

Moreover, in a world of rampant nationalism it is important to be clear about the trades conducted by residents of the country of origin directly with residents of the country of ultimate consumption and those involving the services of residents of third countries. To insist on thinking about international trade as though it consisted of the exchange of goods produced entirely from the factors of production of a single national economy – an assumption underlying much of trade theory – is to miss an important aspect of reality. To be viewed realistically international economic life must be recognized as multinational in character, involving combinations of the productive services supplied by residents of two or more countries along a productive line spanning national boundaries.

HERBERT B. WOOLLEY
Director, Study of the Structure of World Trade and Payments

Acknowledgments

My chief debt is to Herbert B. Woolley who suggested the general topic and gave valued and frequent counsel throughout the study. Two sections of the paper lean heavily upon the work of others. That on Netherlands trade statistics was abstracted from an unpublished manuscript by Herman F. Karreman, and that on petroleum trade is based on data in a manuscript by Cornelius J. Dwyer, later published in abstract form.

Ilse Mintz, Herman Karreman, and Boris Swerling critically reviewed an earlier draft and gave me many helpful suggestions. Among the directors of the National Bureau of Economic Research, Solomon Fabricant, Geoffrey H. Moore, Willard L. Thorp, Gottfried Haberler, and Jacob Viner read the manuscript, and their comments proved helpful in the final revision.

I am indebted to Tom Teng-Pin Yu for a large part of the computations, and to Margaret T. Edgar whose editing of the manuscript improved its readability.

This paper was presented in summary form at the American Statistical Association annual meeting, December 30, 1955, before a session on "Statistical Needs for Analyzing the International Trade and Payments Situation." An abstract appeared in *Proceedings of the Business and Economic Statistics Section* of the Association, 1955-1956.

ROBERT M. LICHTENBERG

CONTENTS

Tables