

Mismatch between physical movement of goods and IFFs

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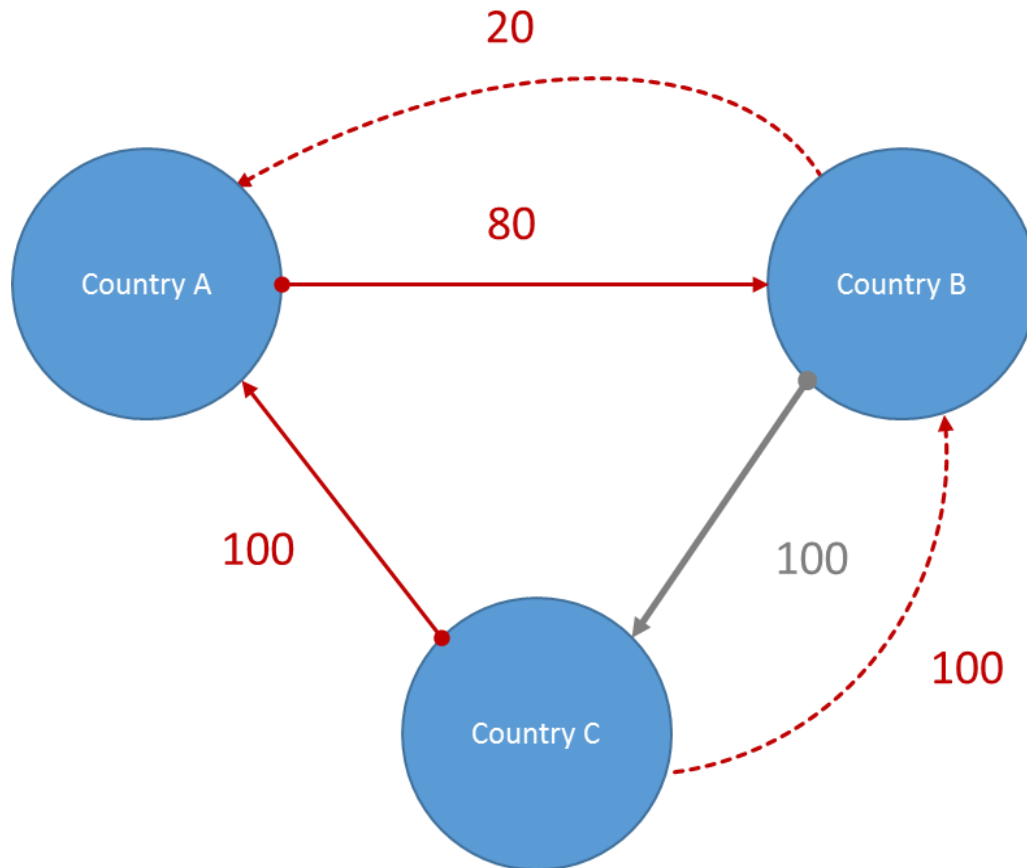
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Another relevant problem in defining IFFs using bottom-up approach is related to the possible geographical mismatch between the movement of goods and the related financial flows

In the last decades, the emergence or the increasing relevance of peculiar trading practices (such as *merchanting*) – which are largely practiced also in illegal markets – generated a progressively greater mismatch between the path of movement of goods, and the related financial flows in international trade

The problem arises from the difference in the (physical or financial) residence of the owner of the given good (say country A) and the country (say B) from which the good moves to the country (say C) in which it is physically imported

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Let analyse the following scenario

Country C imports a good for a value of 100 from Country B. The owner of the good physically (and financially to make things easier) resides in Country A

In this scenario, two situations may emerge:

- 1) The resident in Country A has a branch unit in Country B (which acts as a resident unit in that territory)
- 2) The resident in Country A has not a branch unit, but acts as a pure broker

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Considering case 2...

The grey arrow represents the physical movement of the good from Country B to Country C (for a value of 100). Country C pays a financial resources for 100 to Country B (in which the owner of the good resides). From country B, an inflow of financial resources of 80 arrives to Country B as payment for the acquisition of the good. Taking Country A perspective, the difference between the value of inflows (the payment of the good from Country C) and outflows (the payment of the good to Country B) represents the value of *merchandising*, which can be thought off as a gain on trading

Considering case 1...

The owner of the good (still residing in Country A) has a branch unit in Country B. In this scenario, Country C pays directly the branch unit resident in Country B (dotted red arrow), avoiding the mismatch between physical and financial paths of the transaction. In this context, the following red dotted arrow represents a financial outflow of income (for a value of 20) generated by the branch unit resident in Country B to the final owner in Country A. In this case, a flow of 80 remains in Country B, representing the original value of the good

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In both situations, the balance of the transaction for each country is obviously the same: Country C pays 100 to import the good; Country B receives 80 (100 minus 20 in the second case); Country A receives 20 (as *merchanted* in case 1, as income in case 2)

In case of **legal transactions**, for which custom statistics register the physical movement, the value, and counterparts (including residence) related to transactions, the way in which the scenario is dealt with depends on the residence of the owner: if a branch unit exists, **case 1 applies**; if the branch unit does not exist, **case 2 applies**

In case of **illegal transactions**, the absence of data about counterparts makes the issue very complex. Indeed, counterparts (their physical or financial residence, which can differ) and their organizational set-up (existence of something similar to a branch unit) are unknown. This problem is even more relevant when the measurement of IFFs is obtained using bottom-up approaches that are based on physical transactions

In this context, assuming the presence of a branch unit (independently from the physical or financial residence of the counterpart) may be considered the best solution

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That notwithstanding, from the perspective of the SDG indicator on IFFs, this choice is not neutral

If **case 1** applies, total IFFs (the sum of outflows and inflows) are 180 for Country A (inward and outward), 100 for Country C (only outward), and 80 for Country B (only inward)

If **case 2** applies, total IFFs are 20 for Country A (only inward), 100 for Country C (only outward), and 120 for Country B (inward and outward)

The difference is generated by the fact that operating through a branch unit in other countries reduces the incidence of cross-border movement of IFFs from the income generation perspective (there is only one cross-border financial transaction rather than two). At the same time, IFFs involved in income management operations do not offset the “loss” of IFFs in income generation

Thank you.
Gracias.

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