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**Comparison of Bilateral Balance of Payments Between Portugal and Germany**

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  The comparison of the bilateral balances of payments (BOP) data between Portugal and Germany is the second study recently carried out to analyze the asymmetries in partner country BOP statements within the European Union[1].  Discrepancies in the bilateral balances of payments seriously hamper the compilation of the balance of payments for the European (Monetary) Union by means of consolidating the individual BOP statements of the member states. As in the near future one cannot expect a common European BOP data collection system, this aggregation method is so far the only alternative. The correction and completion of the individual countries' figures is a major problem that needs to be regularly solved by the Statistical Office of the European Communities (Eurostat) and by the European Monetary Institute in order to compile a European balance of payments statement. Because this reconciliation of the country data is only a second best solution, member states should try to assess and improve the quality of their balance of payments statistics. Bilateral comparisons may thus identify areas where there is still a need to harmonize concepts, definitions, and compilation methods. In addition, reporting gaps and weaknesses of the different reporting systems may be detected and may contribute to the debate on devising a future European data collection system.

**Statistical methodology and reporting systems**

  The Portuguese and German methodologies for the balance of payments are largely comparable as far as the statistical concepts of residency, economic territory, valuation, time of recording and the principle of gross recording are concerned. The slight differences that exist in some of these compilation principles (e.g. in the residence of diplomats and their families) do not seem to have significant implications for the bilateral data. Although these theoretical concepts are similar in both countries - as both follow the recommendations of the fifth edition of the IMF Balance of Payments Manual (*BPM5*) - they may lead to bilateral discrepancies if they are not applied properly in practice. The time of recording of a transaction for example may lead to bilateral discrepancies when transactions are carried out around the end/beginning of a reporting period and the same transaction is reported in different reporting periods by the two countries. Although the concept for the time of recording is the same (the change of ownership is decisive), in practice there is no way to control whether the reported transaction time corresponds with the *BPM5* concept of change of ownership.

  A major difference in the compilation practices exists with respect to the transactions concept. The Banco de Portugal publishes a monthly balance of payments on a cash basis with some geographical breakdown. A balance of payments on a transactions basis is set up every quarter and is published with semi-annual periodicity. In Germany instead, all BOP publications are based on the transactions concept.

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[1] A first study was carried out for the German-Dutch balance of payments; see F.E. Ouddeken, "A comparison of the bilateral balances of payments between Germany and the Netherlands", De Nederlandsche Bank, Statistical Information and Reporting Department, SIR-papers nr. 94.3, October 1994, Amsterdam.

Therefore, some items in the bilateral account are not fully comparable (e.g. transport account). In order to have comparable figures at least for the merchandise account, the Portuguese settlement data were replaced by the trade figures of the Statistical Office and adjusted to the balance of payments methodology.

The classification of transactions in Portugal is largely in line with the "Standard components" of *BPM5*. As Portugal introduced a new reporting system in 1993 the IMF classification has been taken into account immediately. In Germany the adaptation to *BPM5* - as far as the introduction of adequate transaction codes for the reporting is concerned - is still in progress. Although a very detailed classification is available, the definition of transactions in some cases does not fully comply with *BPM5* definitions. Some discrepancies reflecting different classifications of transactions may therefore appear, especially in some services items.

Portugal and Germany make use of an International Transactions Reporting System (ITRS). In Portugal the ITRS is a so called "closed" system, where the banks have to report all transactions which change their external position. Transactions which are not settled through the domestic banking system must be reported direct to the Banco de Portugal by the resident conducting the transaction. In addition, there are some enterprises which report all transactions settled through the domestic banking system and through foreign and clearing accounts direct to the Banco de Portugal (*Déclarants Directs Généraux - DDGs*). There are additional statistical reporting requirements for the banks in the case of transactions in domestic securities and for domestic investors in the case of transactions in foreign securities because the reports on foreign payments in this field are not sufficiently detailed. Reports on certain financial transactions (direct investment, long-term loans, transactions in real estate) complete the information for the balance of payments statistics. Reports below the simplification threshold of Escudo 1 million may be submitted without giving the code number of the firm, the country code, and the transaction code. Estimates are used only for converting goods imports data from a customs, insurance, and freight (c.i.f.) basis to a free-on-board (f.o.b.) basis. When drawing up the (global) balance of payments on the basis of transactions, however, figures may include estimates if reliable information indicates that a revision is necessary.

In Germany, on the other hand, there is an "open" reporting system. Foreign trade figures are collected by the Federal Statistical Office. Some supplementary items are added for balance of payments purposes and imports are converted to an f.o.b. basis. Reports on outgoing payments are forwarded to the Bundesbank through domestic banks, while incoming payments (with the exception of export proceeds) and foreign account transactions are reported direct to the Bundesbank by the resident entity. There is an exemption threshold of DM 5,000 for incoming and outgoing payments. The banks have special reporting obligations in the German reporting system, too. In addition to their own transactions, they report their customers' portfolio transactions on their customers' behalf as far as these are settled through the domestic banking system as well as coupon payments for domestic securities and transactions in foreign travel (domestic and foreign notes, check and credit card transactions). To calculate short-term financial transactions, the banks must also report their short-term external positions while non-banks report their short-term assets and liabilities arising from financial operations and trade credits. Estimates play an important role in Germany's balance of payments. Many items of the balance of payments are ascertained with the help of estimates or are supplemented by them. These are either

items in which transactions below the exemption threshold play an important role (e.g. labor income, investment income) or which cannot be correctly recorded methodologically by means of the payment reports (e.g. transport, supplementary trade items, reinvested earnings).

**Main discrepancies and their reasons**

In this section, the main discrepancies in the bilateral balances of payments are described and some of their sources are explained. Plausible explanations are not available for all of the major discrepancies. In some cases additional information would be necessary in order to draw conclusions on the plausibility of either the German or the Portuguese data. Even if possible influences were identified, often the appraisal of the size of the resulting discrepancies was not possible because supplementary information was lacking. As the comparison was based on the bilateral data for 1993, the year of the introduction of the new reporting system in Portugal, some discrepancies may have arisen because of difficulties in implementing the new reporting rules, the lack of experience with the new transaction codes (which are much more detailed than in the old coding system) etc. Although the Banco de Portugal involved and informed the banks and enterprises at a very early stage, difficulties in reporting cannot be ruled out in the transition period. The impact of this change in reporting systems can only now be evaluated because data for several years are available on the same basis and, although a better quality of data has been achieved with the new system, a transition period did occur during 1993.

The comparison was based on the bilateral balances for the year 1993, using the Eurostat reporting scheme. The short term financial account and the reserve position were excluded for the purposes of the comparison. Large bilateral asymmetries occurred in almost all of the main items of the balance of payments. The current account discrepancies amount to almost 9 per cent of the gross figures on the German credit/Portuguese debit side and to more than 20 per cent of the German debits/Portuguese credits. In the financial account - as far as it was - the discrepancies were considerable, too. An exception was the direct investment account where the bilateral figures coincided quite well.

The largest part of the current account asymmetries on both sides stemmed from the merchandise goods account. Apart from the recording of cash settlements for goods in the Portuguese BOP, these asymmetries were caused by the geographical allocation of German imports to the country of origin instead of the country of consignment and to the exclusion of goods for processing in the German merchandise goods account (on this point, the German methodology was adapted to the *BPM5* recommendations at the beginning of 1995). By correcting the bilateral figures for these methodological differences, the discrepancies were reduced substantially on the German import/Portuguese export side. A significant discrepancy of about 10 per cent of the gross figures remained on the German export/Portuguese import side which could partly be related to the initial problems with the Intrastat[2] reporting procedure (an underestimation of imports was assumed in most cases) or to the differences in methods of converting from a c.i.f. to a f.o.b basis (at the time, the Portuguese c.i.f. adjustment was very high, but has now been revised downwards and historical data corrected).

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[2]    A trade reporting system introduced in 1993 for internal European Union trade in goods.

Within the services account considerable discrepancies were discernible particularly in the transport and the travel items. In the case of <u>transport</u> services, the compilation methods of the two countries differ radically. Whereas in the Portuguese BOP the payment reports form the basis for the compilation of the transport account and a correction is made on the Portuguese expenditure side for the import freight services rendered by foreign carriers, in Germany the use of the payment reports in this area is very restricted. The estimations for the German transport services items are based on information from transport statistics and supplementary information from trade statistics. As a result, the bilateral gross figures were not fully comparable. Furthermore, discrepancies may arise because of different geographical breakdowns of the transport services due to the difficulties in determining the residency of the carrier (depending on the contractual conditions, the use of agencies, the involvement of third countries).

The <u>travel</u> account on the other hand is compiled in both countries in a very similar way, by the different means of payment. Nevertheless, bilateral discrepancies were quite high. However, 1993 did not seem to be a particularly suitable reporting year for a bilateral comparison as the discrepancies showed a different image in the previous and the following year. Usually, there is a significant discrepancy only on the Portuguese credit side (lower credits than German debits), which could be explained to some extent in connection with the workers' remittances (see below).

The bilateral discrepancies in <u>investment income</u> were due to the income from portfolio investment and the income from credits/deposits. Both the Portuguese and the German balance of payments record much higher receipts than the corresponding expenditure shown by the partner country. This seems odd because it is precisely in the case of investment income that receipts are usually assumed to be underestimated. An explanation for some of the differences concerning portfolio investment income is the adjustment to the German data for accrued interest on bonds: the estimated adjustment has to be deducted from the actual interest payments on bonds. The interest accrued which has arisen between the last coupon payment date and the selling date and which the purchaser of the securities has to pay to the seller is not included in the German balance of payments. The Portuguese figures on receipts and expenditures reflected only the payment reports (this has now been changed; the accruals principle is now applied to the income arising from foreign portfolio investment in domestic securities; this led to a revision of figures in both the investment income and the portfolio investment accounts in the Portuguese balance of payments from 1993 onwards). Moreover, a significant part of the securities are held in custody with international clearing houses like Euroclear or Cedel. The receipts on those securities can be attributed correctly to the investing country whereas on the expenditure side interest payments will most probably be recorded under Luxembourg or Belgium. Nevertheless, for the remaining discrepancies in portfolio and other capital income further studies of the underlying stocks and corresponding interest rates would be necessary.

The bilateral current transfers account was seriously distorted by the <u>workers' remittances</u> to Portugal which were more than four times higher in the Portuguese than in the German balance of payments data. Apart from an obvious mistake that occurred in the German data, the discrepancies are likely to be related to official transfers data which showed a discrepancy in the reverse direction. Pension payments account for a large part of Germany's official transfers. They may be reported by the

Portuguese resident banking system as workers' remittances because Portuguese emigrants have special bank accounts which they retain when they come back to Portugal. The German figures on foreign workers' remittances may also be underestimated if foreign workers carry checks with them to credit their accounts in their home country. The debit to the German account is probably not reported as a transfer by a foreign worker but rather as a travel expenditure. The Portuguese bank, on the other hand, can classify the transaction as a workers' remittance.

When comparing the bilateral <u>direct investment</u> data a wrong geographical allocation was discovered which occurred because the transaction was settled via a third country. The asymmetry in German direct investment in Portugal deteriorated hereby. Although the recording of direct investment transactions differs somewhat regarding the treatment of credit transactions, the discrepancies occurred were mainly due to differences in the time of recording of the transactions. Some direct investment transactions took place at the end or beginning of the reporting year and were attributed to different years in the balances of the two countries.

The difficulties in comparing bilateral data on <u>portfolio investment</u> are well-known. Portugal and Germany use the debtor principle for the geographical allocation of their assets. On the liabilities side both apply the transactor principle as transactions in domestic securities between third countries are not known by the compiling economy. The data are therefore not comparable as long as secondary market transactions play an important role. The turnover in German securities was found to be many times higher according to the German BOP than recorded in the Portuguese BOP while the geographical allocation problem should result in higher Portuguese data on this side. It emerged that a different classification of many of the transactions in German bonds was the main cause of the discrepancies. Most of the German bonds traded between Germany and Portugal are acquired and resold by the Banco de Portugal. Consequently, these transactions are not found under portfolio transactions in the Portuguese BOP but under reserve assets. In addition, weaknesses in the Portuguese reporting system for transactions in foreign securities (underreporting of transactions settled via foreign accounts or through international clearing houses) may also have contributed to the large discrepancies. Transactions in Portuguese securities by German residents are concentrated in public debt securities issued abroad. If Deutschemark bonds are sold by a German lead manager to third countries, these sales are reflected in the German BOP as a reduction in the claims on Portugal; similarly, purchases from third countries are recorded as increases in the claims on Portugal. These transactions in the secondary market cannot be recorded in the Portuguese BOP. As the reporting system for domestic securities in Portugal is considered to be more reliable than the system for foreign securities, the geographical allocation problem seems to be the main reason for the bilateral asymmetries.

The large discrepancies in the <u>other long term capital</u> account could not be analyzed as the breakdown always refers to the domestic sector. This prevents the comparability of the detailed data.

**Conclusions**

Common classifications and definitions are of course a prerequisite for the comparability of balances of payments. However, in the case of the bilateral balances of payments for Portugal and Germany differences in concepts and definitions or deviations from recommendations of *BPM5* were not

decisive for most of the discrepancies. This is due to the fact that the harmonization process within the European Union on the basis of *BPM5* is well advanced - although there is still a need for further adaptation in most countries. Discrepancies that arise because of the remaining differences in concepts and definitions should therefore decrease further in the future. The present case study for Portugal and Germany showed clearly that a harmonization of theoretical concepts is not sufficient. Essential is a common approach to the practical application and interpretation of concepts and definitions. For large parts of the BOP the European Union. member states have already agreed on such common rules for the compilation of the balance of payments.

Moreover, different data sources (e.g. estimations, settlement data) have a major impact on BOP asymmetries. For this reason, a common approach to the collection or the estimation of the data should be envisaged. Consequently, a harmonization of balance of payments statistics in the European Union should not be confined on an "output-oriented" harmonization. At least, the harmonization of some elements of the reporting systems should be taken into consideration as well, in order to produce more consistent results for an overall European balance of payments by using the individual balances of payments data of the member states. The "building of bridges" between the different data collection systems could be seen as a first step towards a common collection system which seems to be the only solution that could provide fully consistent data.

**Initial discrepancies, corrections and remaining discrepancies between the bilateral balances of payments of Portugal and Germany for the year 1993 (in Millions Portuguese escudo)**

| | initial discrepancies | credit Germany | debit Portugal | corrections Germany | Portugal | credit Germany | debit Portugal | remaining discrepancies |
|---|---|---|---|---|---|---|---|---|
| Current Account | - 65,937 | 706,401 | 772,338 | + 28,129 | - 72,872 | 734,530 | 699,466 | 35,064 |
| Goods, Services and Income | - 63,157 | 706,013 | 769,170 | + 28,129 | - 72,872 | 734,142 | 696,298 | 37,844 |
| Merchandise | - 64,206 | 565,567 | 629,773 | + 30,359 | - 84,670 | 595,926 | 545,103 | 50,823 |
| Services and Income | 1,049 | 140,446 | 139,397 | - 2,230 | + 11,798 | 138,216 | 151,195 | - 12,979 |
| Unrequited Transfers | - 2,780 | 388 | 3,168 | + 0 | + 0 | 388 | 3,168 | - 2,780 |
| Direct Investment | - 1,112 | 4,656 | 5,768 | + 0 | + 0 | 4,656 | 5,768 | - 1,112 |
| Portugal to Germany | - 65 | 97 | 162 | + 0 | + 0 | 97 | 162 | - 65 |
| Germany to Portugal | - 1,047 | 4,559 | 5,606 | + 0 | + 0 | 4,559 | 5,606 | - 1,047 |
| | | assets | liabilities | | | assets | liabilities | |
| Portfolio Investment | - 71,165 | - 137,633 | 66,468 | + 97 | + 0 | - 137,536 | 66,468 | - 71,068 |
| Other Long Term Capital | - 69,197 | - 53,734 | - 15,463 | + 3,686 | + 0 | - 50,048 | - 15,463 | - 65,511 |

| | initial discrepancies | debit Germany | credit Portugal | corrections Germany | Portugal | debit Germany | credit Portugal | remaining discrepancies |
|---|---|---|---|---|---|---|---|---|
| Current Account | - 166,975 | 665,956 | 832,931 | + 31,135 | - 71,816 | 697,091 | 761,115 | - 64,024 |
| Goods, Services and Income | - 130,067 | 637,925 | 767,992 | + 21,436 | - 72,883 | 659,361 | 695,109 | - 35,748 |
| Merchandise | - 104,865 | 446,072 | 550,937 | + 45,490 | - 63,220 | 491,562 | 487,717 | 3,845 |
| Services and Income | - 25,202 | 191,853 | 217,055 | - 24,054 | - 9,663 | 167,799 | 207,392 | - 39,593 |
| Unrequited Transfers | - 36,908 | 28,031 | 64,939 | + 9,699 | + 1,067 | 37,730 | 66,006 | - 28,276 |
| Direct Investment | 1,584 | 29,001 | 27,417 | + 3,686 | + 16,244 | 32,687 | 43,661 | - 10,974 |
| Portugal to Germany | - 1,853 | 97 | 1,950 | + 0 | - 1,022 | 97 | 928 | - 831 |
| Germany to Portugal | 3,437 | 28,904 | 25,467 | + 3,686 | + 17,266 | 32,590 | 42,733 | - 10,143 |
| | | liabilities | assets | | | liabilities | assets | |
| Portfolio Investment | 25,193 | 46,072 | - 20,879 | - 10,766 | + 0 | 35,306 | - 20,879 | 14,427 |
| Other Long Term Capital | 25,102 | 25,412 | - 310 | + 0 | + 0 | 25,412 | - 310 | 25,102 |