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Issues for Classification of Intermediaries in Services Transactions

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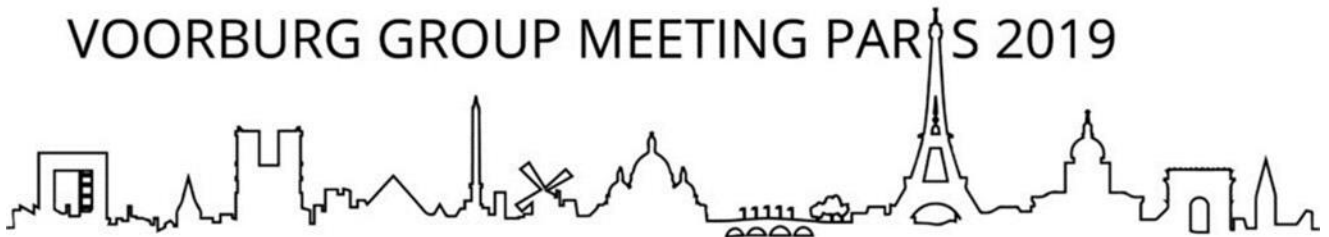
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Paris, France

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*The views and opinions presented in this paper are of those of the author and do not represent the views or opinions of the United States Census Bureau, the Office of Management and Budget Economic Classification Policy Committee, UN TSG-ISIC, or any other group that the author may be affiliated with.

VOORBURG GROUP MEETING PARIS 2019



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Issues for Classification of Intermediaries in Services Transactions

Summary

Session: Cross-cutting topic IV – Intermediaries in the provision of services

Session leader: John Murphy (US)

Classification principles | John Murphy (US) | paper | slides

Output issues, administrative data | Bi, Xinhua (China) | slides

Output measurement of Travel Arrangers and Tour Operators | Jennifer Winters (Canada) | paper | slides

SPPI perspective of broker activity in sea transport | Cristina Cecconi | Italy | paper | slides

SPPI issues | Mark Lomax (Netherlands) | slides

The four presentations offered different approaches to dealing with intermediaries in service transactions. These approaches varied from classification based on the actual function, classification to a single internet intermediaries industry, and classification as IT services.

Presentation of Issues

Over the past decade, the presence of intermediaries participating in services transactions rapidly expanded. Examples include facilitating transactions between owners of vacation properties and interested clients, bringing together owners of automobiles and people looking to hail a ride, and even bringing together owners of agricultural or construction equipment and users in need of such equipment on a short term basis. There has also been a substantial increase in third party retail services. These intermediaries refer to themselves as platforms, technology companies, agents, vacation planners, retailers, and even transportation companies. While the terminology for these intermediaries varies, the classification practices and principles should be consistent to ensure comparable data across programs and countries as well as presenting data that are fit for use.

The 33rd meeting of the Voorburg Group held on September 24-28, 2018 in Rome, Italy included a session on addressing the classification of these intermediaries in ISIC. The session chair presented the guidance from the UN Expert Group on International Social and Economic Classifications adopted in 2017. China, Canada, Italy, and the Netherlands presented specific experiences with the classification of intermediaries generally as well as for specific travel and transportation arrangement entities. The range of approaches presented in Rome highlights the need for consistent practices in the classification and measurement of intermediaries in services production.

The general approaches in use can be described as follows: 1) classify all platforms together in a single industry because they are all digital intermediaries; 2) classify all platforms together in IT services based on the fact that they are digitally intensive in their processes; and 3) classify intermediaries based on the

function that they perform and the customers that they serve. Each approach will result in different potential uses of the data and potentially different measurement concepts for the outputs.

This issue paper looks at the disparate classification possibilities in light of the strategic mission of the Voorburg Group, *“...to establish an internationally comparable methodology for measuring the constant dollar outputs of the service industries. The focus of the VG is to develop concepts, methods, and best practices in the area of services. The scope of the VG is centered on producer price indices (PPIs) for services, turnover by products, and classifications.”*¹

Different classification approaches in ISIC can result in different product definitions, different price measurement practices, and even different basic output measurement. An internationally comparable methodology for intermediaries in services transactions requires consistent classification of units within ISIC.

The guidance from the Expert Group on Economic Classifications focuses on the characterization of these activities as outsourcing part of the process of services production:

“...outsourcing of part of the production process of services – the transactional aspects that are necessary for all market based activity - bringing together the producer and consumer of service and facilitating a transaction. When a barber pays for advertising time and space, he has outsourced his outreach. If a barber pays for credit card processing services, he has outsourced part of the financial aspect of the transaction. The barber still affects the condition of the customer who requested the haircut.

ISIC Rev. 4 provides clear guidance on the classification of principals and contractors involved in outsourcing. Principals that outsource part of the production process are classified in the industry of the complete process. Contractors are classified to the industry of units producing the same services on their own account. The barber who outsources advertising and payment processing is still classified as a barber in ISIC.

*ISIC Rev. 4 does not have a generic industry or section for agency or intermediation between service providers and service consumers that is equivalent to wholesale trade or retail trade. ISIC does however have separate classes identified for specific transactional services when they were identified as significant. For example, ISIC includes a class for travel agency activities because they were significant and fairly homogeneous. Similar industries were created for real estate agency, stock brokerage, and reservation services. However not all agency services are specifically identified. In practice, the selling of a service on a commission or fee basis is classified to the industry of the service being sold if there is not a separate class in ISIC. For example, selling lottery tickets on a commission basis is classified with gambling activities and selling transit passes on a commission basis is classified with transit services. This results in a way to connect the outsourced activities with the service being performed. This worked well historically for separately identified classes and defaulting the others to the industry of the primary activity. The Internet and growth of digital technologies has increased the number and variety of intermediaries in service transactions.”*²

¹ <https://voorburggroup.org/aboutus-eng.htm> accessed 4/23/2019

² <https://unstats.un.org/unsd/classifications/expertgroup/egm2017/ac340-10.PDF>

Country experiences for intermediaries in travel and freight arrangement follow this basic guidance. These are fairly mature areas that are identified with separate classifications in ISIC Rev.4. The problem arises with “new” activities associated with the increase in Internet commerce and greater flexibility to outsource parts of the production process to specialist entities. This paper summarizes the discussions of the Voorburg Group and presents issues that impact data collection, output measurement, price measurement, and the resulting data uses. These issues are subject to change if there is a conceptual shift in how ISIC classifies intermediaries in services transactions. The guidance from the Expert Group is applied to some extent by all of the experiences presented but various suggestions result in different problems for classification and measurement.

Voorburg Discussion

After the presentations in Rome, the VG delegates engaged the presenters in a question and answer period. Overall, the group noted that in many cases classification is based on what is being done while in other cases, classification is being based on how something is done. This essentially identifies two major methods of classification – what is the service being provided by an intermediary in the market vs. how is a service being produced by an intermediary. ISIC currently uses a variety of classification criterion including inputs, outputs, and process so either of these basic approaches is conceptually valid in ISIC. There are very different implications for the use of data depending on the classification approach used.

An example of how these different approaches would impact data followed, using the example of an intermediary in short stay accommodations while away from home. The intermediary brings together providers of short stay accommodations in private residences with potential consumers of accommodations in private residences. The intermediary does not provide accommodation services but links producers and consumers.

If the intermediary is classified by what they do, they would be classified as accommodation reservation services in ISIC. They are essentially booking agents between private homeowners and consumers. This approach allows the identification of the service provided and allows some sort of allocation of the service back to accommodations to develop value added. This approach does not provide any indicator of technology intensity or digital impact at the class level in ISIC. It does however facilitate the generation of national accounts.

If the same intermediary is classified based on how they produce their services, the classification would be in IT services or possibly in a separate class for intermediaries or platforms if one were created in ISIC. This would allow data in technologically intensive areas to be separated and potentially measured to generate innovation measures, digital economy impacts, or other areas of policy interest. This approach would not easily generate a linkage back to the ISIC class that is supported by the intermediary service. Development of national accounts would require some method outside of ISIC to assign the commission or fee services back to the complete provision of a service. This might be accommodated through expense data, alternative data sources, or some other appropriate method of allocating the services back to the consuming industry.

Agency or intermediary services should be measured on a net output basis. The goal is to properly relate the margin or net output for these services back to the actual service provider to accurately measure output. The actual providers of the service should be measured as gross output. When determining the

actual activities performed, the classifier must understand the business model. If a unit is taking on capacity risk, they are classified to the same industry as the principal but care must be taken to avoid double counting. If they are only providing agency or intermediary services, they may or may not be classified to the industry of the principal. That will depend on whether or not ISIC has a specific intermediary industry. The business model and employment relationships can also impact a classification decision. If independent contractors are actually providing the service, rather than traditional employees, that must also be considered.

The choice of classification method needs to be aligned with the measurement of the output and prices. In the case of goods, value of production is added to wholesale and retail margins, transportation margins, etc. A similar choice can be made for disaggregated components of services transactions. Using the accommodation example, the actual provision of accommodation services could be added to the service of arranging or reserving the space. This would require an output measure of the reservation service from the intermediary to be net of the value of the accommodation service. Prices would also need to measure accommodation services and reservation services using appropriate methods.

To address at least some of the classification inconsistency for intermediaries in services transactions in the short term, classification rulings or case law could be provided. If structure changes are pending, new classes where the activity is significant could be created in ISIC or a more general inclusion of more support services for intermediaries and other activity classes might help. As described below, UNSD is looking at these issues.

Technical Subgroup of the Expert Group on International Classifications – ISIC (TSG-ISIC)

Since the meeting in Rome, the Expert Group has created a technical subgroup to assess the need for revisions to ISIC. At a June 2019 meeting in New York, the TSG-ISIC discussed a wide range of activities and their classification in ISIC. Many of the areas addressed are areas where technology is being applied in a more intensive manner such as Fintech.

The TSG-ISIC prepared questionnaire (not yet circulated as of this writing) to specifically question users of ISIC in NSOs and other capacities for input on these issues. One of the points being surveyed is the Expert Group Guidance on the classification of intermediaries in services transactions.

The draft language of the inquiry is:

The increasing use of Internet enabled technologies is rapidly changing the business practices of several industries. For example, the traditional local travel agencies are declining, and Internet based reservation services are increasingly being used by both businesses and households. New service transaction intermediaries also bring together producers and consumers in new ways. Intermediaries have created the ability for a local traveler to arrange a ride with a local driver in the absence of a traditional local taxi service provider. Intermediaries can also bring together owners of real estate with customers looking for short-term accommodation. In 2017, the Expert Group adopted guidance for classification of these intermediaries (ESA/STAT/AC.340/10 - 15 August 2017 available at <https://unstats.un.org/unsd/classifications/expertgroup/egm2017/ac340-10.PDF>).

-Based on this guidance, is there a need for new categories in ISIC for more intermediaries in service activities?

-Are the existing categories still relevant? How do you think we can better address this issue in ISIC?³

One potential way to improve comparability is to include more specific ISIC index entries focusing on these new activities in the absence of any changes to the current guidance. **The Voorburg Group may wish to generate a list of possible entries for consideration by the TSG-ISIC.** Even if an expanded index is not created, a list of areas of concern will help make sure that problems are considered and addressed moving forward. **The Voorburg Group might wish to suggest new classes for ISIC in the future.** Any output from the group will be forwarded to the TSG-ISIC for consideration during a review of ISIC.

Issues

1. There is no current practical agreement on the classification of intermediaries across countries. As the presentations showed, different countries have made different classification decisions on a case-by-case basis. Although the guidance of the Expert Group applied in many cases, the problems were apparent when an intermediary covered multiple services or a combination of goods and services.
2. If the concept of capacity risk is used in classification, identification of that risk is not easy. Additionally, the mixture of intermediary activities with and without capacity risk creates ambiguities in classification and potentially unstable classification over time as business shifts.
3. Expert Group guidance results in the need to measure output differently (some gross, some net) within many ISIC classes when no separate agents class is identified.
4. Mixture of employer and nonemployer units is often required. In many cases, individuals or households are the producers of the services provided in the market. For example, short term accommodation services or ride sharing services are provided by many nonemployers while the intermediary is an employer. To obtain all aspects of the transaction, survey scope needs to account for different units.
5. The inclusion of intermediary services and the provision of the base service within the same ISIC class requires different output measures and pricing methods based on the different definitions of the services provided. Based on the reported prevalence of detailed product level output and prices from Voorburg progress reports, there will be substantial difficulty publishing different measures within an ISIC class.
6. No single classification process will meet the variety of data uses that are being discussed by policy makers and other data users.

³ Unpublished at the time of this writing. The questionnaire will be available at: <https://forms.gle/fpnBx5HWey9PsB826>. Responses can be sent in MS Word format to business_stat@un.org