OFFICE OF MANAGEMENT AND BUDGET

2007 North American Industry Classification System (NAICS)—Updates for 2012

AGENCY: Office of Management and Budget, Executive Office of the President.

ACTION: Notice of Solicitation for Proposals to Revise Portions of NAICS for 2012.

SUMMARY: Under the authority of the Budget and Accounting Procedures Act of 1950 (31 U.S.C. 1104(d)) and 44 U.S.C. 3504(e), the Office of Management and Budget, through the Economic Classification Policy Committee (ECPC), is soliciting proposals from the public for changes to the North American Industry Classification System (NAICS) structure and content to be included in a potential 2012 revision. The ECPC is also seeking public input on several clarifications to the existing classification system (please see Parts I–VI in the **SUPPLEMENTARY INFORMATION** section, below). The clarifications relate to ongoing changes in how businesses organize and structure themselves to efficiently provide goods and services in the economy.

In Part I, the ECPC provides background on the NAICS classification system. In Part II, the ECPC is soliciting public comments on the advisability and desirability of reducing national industry detail in the manufacturing sector during a 2012 revision of NAICS. Part III includes a solicitation of proposals for new and emerging industries. Part IV presents notification of a method to publicize corrections for errors and omissions that are identified in NAICS 2007. Part V solicits public comments on the classification of distribution centers, logistics service providers, and sales offices of publishers within NAICS. Part VI solicits public comments and suggestions to clarify the classification of establishments that outsource manufacturing transformation activities and provide manufacturing services in the market given the increasing specialization and globalization of business activities in the economy.

In soliciting comments about revising NAICS, the ECPC does not intend to open the entire classification for substantial change in 2012. The ECPC will consider public comments and proposals for changes or modifications that advance the goals of NAICS. The ECPC is also seeking and will consider comments related to consistent classification in an era of greater specialization and globalization.

DATES: To ensure consideration of your comments or proposals related to the potential revision of NAICS for 2012 detailed in this notice, comments must be in writing and received no later than April 7, 2009. Please be aware of delays in mail processing at Federal facilities due to tightened security. Respondents are encouraged to send both a hard copy and a second copy via fax or e-mail.

ADDRESSES: Correspondence concerning the ECPC intent to review and possibly revise NAICS for 2012, comments on the business organization clarifications, and all proposals for new industries in NAICS for 2012 should be sent to John Murphy, Chair, Economic Classification Policy Committee, Bureau of the Census, Room 8K157, Washington, DC 20233–6500. Responses may also be submitted by e-mail to *John.Burns.Murphy@census.gov* or by fax at (301) 763-8636. Mr. Murphy can be reached at (301) 763–5172.

Comments may also be sent via *http://www.regulations.gov*—a Federal E-Government Web site that allows the public to find, review, and submit comments on documents that agencies have published in the **Federal Register** and that are open for comment. Simply type ''NAICS for 2012'' (in quotes) in the Comment or Submission search box, click Go, and follow the instructions for submitting comments.

All comments regarding this notice received via the Web site, e-mail, fax, hardcopy, or other means, are part of the public record as submitted. For this reason, do not include in your comments information of a confidential nature, such as sensitive personal information or proprietary information.

Please consider including contact information and a phone number or e-mail address with your comments to facilitate follow-up if necessary.

Electronic Availability: This document is available on the Internet from the Census Bureau Internet site at *http://www.census.gov/naics.* This WWW page contains previous NAICS United States **Federal Register** notices, ECPC Issues Papers, ECPC Reports, the current structure of NAICS United States 2007, and related documents.

Public Review Procedure: All comments and proposals received in response to this notice will be available for public inspection at the Bureau of the Census, Suitland, Maryland. Please telephone the Census Bureau at (301) 763–5172 to make an appointment to enter the Federal Center. OMB will publish all ECPC recommendations for changes to NAICS for 2012 resulting from this notice in the **Federal Register** for review and comment prior to final action.

FOR FURTHER INFORMATION CONTACT: John Murphy, Chair, Economic Classification Policy Committee, Bureau of the Census, Room 8K157, Washington, DC 20233–6500. Mr. Murphy can be reached at (301) 763–5172, by fax at (301)763–8636, or by e-mail at *John.Burns.Murphy@census.gov.*

SUPPLEMENTARY INFORMATION: The **SUPPLEMENTARY INFORMATION** section of this notice is divided into six parts. Part I provides background on NAICS 2007; Part II solicits views regarding the advisability of reducing industry detail in the manufacturing sector; Part III includes a solicitation for proposals for new and emerging industries; Part IV notifies the public of the location where corrections of identified errors or omissions in NAICS 2007 will be publicized; Part V requests public input on the classification of distribution centers, logistics service providers, and sales offices of publishers; and Part VI solicits public comment and proposals for the classification of establishments that outsource manufacturing transformation activities in light of increasing specialization and globalization.

Part I: Background of NAICS 2007

NAICS is a system for classifying establishments (individual business locations) by type of economic activity. Its purposes are: (1) To facilitate the collection, tabulation, presentation, and analysis of data relating to establishments; and (2) to promote uniformity and comparability in the presentation and analysis of statistical data describing the North American economy. NAICS is used by Federal statistical agencies that collect or publish data by industry. It is also widely used by State agencies, trade associations, private businesses, and other organizations.

Mexico's Instituto Nacional de Estadística, Geografiía Informática (INEGI), Statistics Canada, and the United States Office of Management and Budget (OMB), through its Economic Classification Policy Committee (ECPC), collaborated on NAICS to make the industry statistics produced by the three countries comparable. NAICS is the first industry classification system developed in accordance with a single principle of aggregation, the principle that producing units that use similar production processes should be grouped together in the classification. NAICS also reflects in a much more explicit way the enormous changes in

technology and in the growth and diversification of services that have marked recent decades. Industry statistics presented using NAICS are comparable, to a large extent, with statistics compiled according to the latest revision of the United Nations' International Standard Industrial Classification (ISIC, Revision 4).

For the three countries, NAICS provides a consistent framework for the collection, tabulation, presentation, and analysis of industry statistics used by government policy analysts, by academics and researchers, by the business community, and by the public.

The four principles that guided the initial development of NAICS were:

(1) NAICS is erected on a production-oriented conceptual framework. This means that producing units that use the same or similar production processes are grouped together in NAICS.

(2) NAICS gives special attention to developing production-oriented classifications for (a) new and emerging industries, (b) service industries in general, and (c) industries engaged in the production of advanced technologies.

(3) Time series continuity is maintained to the extent possible.

(4) The system strives for compatibility with the two-digit level of the International Standard Industrial Classification of All Economic Activities (ISIC Rev. 3) of the United Nations.

The ECPC is committed to maintaining the principles of NAICS as it develops further refinements. NAICS uses a hierarchical structure to classify establishments from the broadest level to the most detailed level using the following format:

Sector	2-digit	Sectors represent the highest level of aggregation. There are 20 sectors in NAICS representing broad levels of aggregation.
Subsector	3-digit	Subsectors represent the next, more detailed level of aggregation in NAICS. There are 99 subsectors in NAICS.
Industry Group	4-digit	Industry groups are more detailed than subsectors. There are 313 Industry groups in NAICS.
NAICS Industry	5-digit	NAICS industries are the level that, in most cases, represents the lowest level of three country comparability. There are 721 five-digit industries in NAICS.
National Industry	6-digit	National industries are the most detailed level of NAICS. These industries represent the national level detail necessary for economic statistics in an industry classification. There are 1175 U.S. industries in NAICS United States, 2007.

The implementation of the first vintage of NAICS—NAICS 1997—affected almost half of the industries that were available for use under the 1987 Standard Industrial Classification (SIC). Subsequent NAICS revisions in 2002 and 2007 were more modest. Complete details of those revisions were published in the **Federal Register**. Revisions for 2002 were published on April 20, 2000 (65 FR 21242–21282), and the revisions for 2007 were published on March 16, 2006 (71 FR 28532–28533).

The development of NAICS represented a significant improvement over the previous classification systems used in North America. To ensure the accuracy, timeliness, and relevance of the classification, NAICS is reviewed every five years to determine what, if any, changes are required. The ECPC recognizes the costs involved when implementing industry classification revisions in statistical programs and the costs for data users when there are disruptions in the comparability of data. The ECPC also recognizes the economic, statistical, and policy implications that arise when the industry classification system does not identify and account for important economic developments. Balancing the costs of change against the potential for more accurate and relevant economic statistics requires significant input from data producers, data providers, and data users.

Part II. Detail in the Manufacturing Sector of NAICS United States 2007

NAICS is the Federal standard used to produce government economic statistics. Its structure and detail must be appropriate for large-scale programs, such as economic censuses or censuses of employment and wages as well as for sample survey programs of smaller size or more frequent periodicity. The greater the number of industries included in these surveys, the greater their costs in terms of reporting burden imposed on respondents and in terms of the resources used to collect, collate, and disseminate the individual industry data. The manufacturing sector of NAICS United States 2007 contains 472 six-digit industries. Of these, 407 are national level detail that is used only in the United States. In 2003, to reduce both respondent burden and production costs, the Annual Survey of Manufactures (ASM) produced by the U.S. Census Bureau collapsed separate industry data for 239 six-digit industries into higher level aggregates. (The details are available at *http://www.census.gov/mcd/asmind/*.)

While the ECPC recognizes that the loss of some level of detail in manufacturing will affect a wide range of data users in government, business, and academia, the ECPC is soliciting comments on the advisability and desirability of making similar changes to the structure of NAICS for 2012. Specifically, the ECPC is soliciting comments on the desirability of reducing the number of detailed national (six-digit) U.S. manufacturing industries while adhering to the structure of the 184 NAICS five-digit industries.

Part III. New and Emerging Industries

NAICS was developed to be a dynamic industry classification. Every five years, the classification is reviewed to determine the need to identify new and emerging industries. The ECPC is soliciting public comments on the advisability of revising NAICS for new and emerging industries in 2012 and soliciting proposals for these new industries.

When developing proposals for new and emerging industries, please note that there are two separate economic classification initiatives underway in the United States. NAICS, the industry classification, is the subject of this notice, while the complementary North American Product Classification System (NAPCS) initiative is also underway. The NAPCS product system described below will complement the NAICS industry system and provide an alternate way of classifying output.

NAICS was developed to classify units according to their production function. NAICS results in industries that group units undertaking similar activities using similar resources but does not necessarily group all similar products or outputs. NAPCS is being developed to classify the outputs of units, or in other words their products or transactions, within a demand-based conceptual framework. For example, the

hypothetical product of a flu shot can be provided by a doctor's office, a hospital, or a walk-in clinic. Because these three units are classified to three different NAICS industries, data users who want information about all flu shots provided must be able to identify the individual products coming out of the units, which NAPCS is designed to do. Thus, in many cases, the need for specific statistical data is better addressed by aggregating product data across industries rather than by creating a new industry. This is particularly true with NAICS, which groups establishments into industries based on their primary production function. Proposals for new industries in NAICS for 2012 will be evaluated within the context of both the industry and product classification systems to determine the most appropriate resolution. For a detailed description of the NAPCS initiative, see the April 16, 1999, **Federal Register** notice (64 FR 18984–18989) available at *http://www.census.gov/napcs*.

Proposals for new industries will be evaluated using a variety of criteria. As previously mentioned, each proposal will be evaluated based on the application of the production function concept, its impact on comparability within North America and with other regions, and its impact on time series. For any proposals that cross three-country levels of agreement, negotiations with Canada and Mexico, our partners in NAICS, will also influence the ECPC's recommendations on those proposals. In addition, other criteria may affect recommendations for adoption. From a practical standpoint, industries must be of appropriate size. At the national level, this is generally not a major concern but there are a variety of statistical programs that produce industry data at the regional, State, MSA, or even county or local level. Proposed industries must include a sufficient number of establishments so that Federal agencies can publish industry data without disclosing information about the operations of individual firms. The ability of government agencies to classify, collect, and publish data on the proposed basis will also be taken into account. Proposed changes must be such that they can be applied by agencies within their normal processing operations. Any recommendations for change forwarded by the ECPC for consideration will also take into account the cost of making the changes. These costs can be considerable and the availability of funding to make changes is critical. The budgetary environment will be considered when the ECPC makes recommendations. As mentioned above, certain proposals may be more adequately addressed through the identification and collection of product data.

Proposals for new or revised industries should be consistent with the production-oriented conceptual framework incorporated into the principles of NAICS. When formulating proposals, please note that an industry classification system groups the economic activities of producing units, which means that the activities of similar producing units cannot be separated in the industry classification system.

Proposals must be in writing and include the following information:

a) Specific detail about the economic activities to be covered by the proposed industry, especially its production processes, specialized labor skills, and any unique materials used. This detail should demonstrate that the proposal groups establishments that have similar production processes that are unique and clearly separable from the production processes of other industries.

b) Specific indication of the relationship of the proposed industry to existing NAICS United States six-digit industries.

c) Documentation of the size and importance of the proposed industry in the United States.

d) Information about the proposed industry in Canada and Mexico if available.

Proposals will be collected, reviewed, and analyzed. As necessary, proposals for change will be negotiated with our partners in Canada and Mexico. When this process is complete, the OMB will publish a **Federal Register** notice that contains the ECPC recommendations for additional public comment prior to a final determination of changes to NAICS for 2012.

Part IV. Changes to Account for Errors and Omissions in NAICS 2007

No significant errors or omissions have been identified in NAICS. Any errors or omissions that are identified in the future will be corrected and posted on the official NAICS Web site at *http://www.census.gov/naics*.

Part V. Clarification of Distribution Centers, Publishers' Sales Offices, and Logistics Service Providers in NAICS United States

Clarification on the classification of distribution centers is relatively straightforward. Options might include wholesale trade because of the function of breaking bulk, storage and warehousing because of the characteristics of the facilities, or even trucking terminals as cross-docking practices develop and improve. Sales offices of publishers could be classified either to publishing or to wholesale trade. Classification of logistics services may hinge on the treatment of outsourcing or the separate identification of logistics products.

Clarification of the classification of these units is intended to improve the consistency of classification and the comparability of data from various producers using the NAICS classification. The ECPC is soliciting comments or proposals related to the classification of distribution centers, publishers' sales offices, and logistics service providers for the 2012 revision.

Part VI—Clarification of the Treatment of Manufacturing Units That Outsource Transformation

The structure and organization of many businesses engaged in the production of goods continues to change as they attempt to increase efficiency and reduce costs by employing new and improved processes. One very noticeable and rapidly growing activity is and has been the outsourcing of part or all of the manufacturing production process of goods. The growth in outsourcing of the manufacturing transformation of goods to specialized providers is now quite commonplace as firms continue to explore new paths to increase revenues and reduce costs of production. The expansion of competition globally and the formation of highly specialized business activities create unique problems for an industrial classification system such as NAICS. When producers subcontract portions of the production process to separate affiliated or unaffiliated units, the production function changes at the establishment level. As described in Parts I and III, above, the production functions define the industries in NAICS to the extent possible.

In this particular case, NAICS United States 2007 does not provide clear or adequate guidance on the classification of units that perform only part of the complete production process for goods. Further, because there is no clear guidance for NAICS to provide a consistent and transparent classification framework for the development of comparable statistics across programs and agencies, differences in classification practices across programs may lead to erroneous signals on the direction of the economy that could potentially result in faulty policy decisions. For example, if employment is classified in manufacturing in one

program while the associated output is classified by another program in wholesale trade, estimates of productivity and GDP may potentially provide erroneous signals if the differences are not well understood and accounted for when developing the relevant statistics.

Because of this concern, the Economic Classification Policy Committee (ECPC) chartered a Manufacturing Transformation Outsourcing Subcommittee to review options for the consistent classification of establishments that outsource manufacturing transformation. The ECPC is soliciting public input to assist the subcommittee in its work.

As noted earlier in this document, NAICS is based on a production-oriented or production function conceptual framework. A production function describes any economic activity in which inputs, such as the services of types of labor and capital equipment, raw and intermediate materials, and, in many cases, intangible inputs such as intellectual property are used to manufacture a material good or to render a service.[1]

In describing the production process, the preliminary work of the subcommittee has identified three general types of units involved in the production of goods: (a) Traditional or integrated manufacturers, (b) manufacturing service providers, and (c) ''factoryless'' goods producers.[2] Below we broadly define and list the characteristics of these units:

A. Traditional or Integrated Manufacturers

The traditional or integrated manufacturer utilizes inputs such as capital, labor, and energy to transform material inputs into a new product to be sold. Characteristics of integrated manufacturers include:

- Performs transformation activities;
- Owns rights to the intellectual property or design (whether independently developed or otherwise acquired) of the final manufactured product;
- Owns the product they manufacture;
- Controls and facilitates the production process; and
- Sells the final product.

An integrated manufacturer can provide a full accounting of input costs and output values.

B. Manufacturing Service Providers

The manufacturing service provider provides contract manufacturing services—defined tasks specified by a contract—that utilize inputs such as capital, labor, and energy to transform material inputs according to the contract specifications. Characteristics of manufacturing service providers include:

- Performs transformation activities;
- Receives contract to perform transformation activities;
- Does not own rights to the intellectual property or the design of the new product;
- Does not own the manufactured products contracted to produce;
- Controls the facility but does not control the production process (i.e., the manufactured product is made to the contract's specifications); and
- Does not sell the final product.

The manufacturing service provider can provide information on the value of the contract work, the types of transformation activities it performed, and the value of the labor and the plant and equipment utilized in the transformation activities. However, this type of provider cannot report the market value of the final product.

C. Factoryless Goods Producers

The factoryless goods producer outsources all of the transformation steps that traditionally have been considered manufacturing, but *undertakes all of the entrepreneurial steps and arranges for all required capital, labor, and material inputs required to make a good.* Characteristics of factoryless goods producers include:

- Does not perform transformation activities;
- Contracts with manufacturing service provider to perform transformation activities to its specifications;
- Owns rights to the intellectual property or design (whether independently developed or otherwise acquired) of the final manufactured product;
- Owns the manufactured product it contracted another establishment to produce;
- Controls and facilitates the production process; and
- Sells the final product.

A factoryless goods provider can provide information on the purchase of the manufacturing service, that is, the cost of the contract, but would not necessarily have production worker payroll or capital expenditures on plant and equipment. However, this type of provider can provide data on the number of units that were arranged to be produced and the market value of the final product.

In reality, businesses producing goods use a variety of strategies that can involve outsourcing some or all of the transformation steps to one or more manufacturing service providers. Substitution of one input for another is inherently part of many production processes within the manufacturing sector. Sector classification does not change if raw materials are produced within a unit or purchased from independent companies. Regardless of whether a manufacturer leases the factory where the transformation occurs or uses its own, it remains classified within manufacturing. If a manufacturer hires independent contractors or uses the services of a professional employer association rather than hiring and managing employees directly, it would remain classified in the manufacturing sector. Input substitution decisions affect the establishment production function but not the overall process of producing goods. A producing unit could be considered as changing the payment method of acquiring the inputs of capital, labor, and materials used in production.

As noted in NAICS United States 2007, units that perform chemical, physical, or mechanical transformation of inputs into new outputs are usually classified in manufacturing. This includes integrated manufacturers and manufacturing service providers that operate factories, plants, or mills, even if they outsource or subcontract some transformation to others. The growth of manufacturing service providers domestically and overseas is the result of traditional integrated manufacturers substituting away from direct expenditures on capital and labor (that is, factories and production workers) to purchases of capital services and labor services and new producers choosing this input mix from the beginning. With the exception of the apparel industries, NAICS classifies integrated manufacturers and manufacturing service providers together by industry. One classification option to consider is whether integrated manufacturers and manufacturing service providers should be separately identified in the structure of NAICS.

As noted above, the classification of units that do not operate factories, plants, or mills, yet are a driving force behind goods being available in the market, is not clearly defined in NAICS. A preliminary review of classification

[1] For more information see The Economic Classification Policy Committee ''Issue Paper No. 1'' *http://www.census.gov/eos/www/naics/history/docs/issue_paper_1.pdf.*

[2] This terminology appeared in a 2004 discussion paper ''Outsourcing Manufacturing Activities—Measurement and Classification Implications'' by John Murphy, Assistant Division Chief for Classification Activities at the United States Bureau of the Census.

choices for factoryless goods producers, that is, units that perform all of the entrepreneurial functions of a manufacturer but outsource the actual transformation to one or more partners or manufacturing service providers, was narrowed down to two possibilities by the ECPC. First, these units could be classified within the manufacturing sector because without these units, the goods would not be produced and brought to market. Alternatively, these units could be classified within the wholesale trade sector, because they purchase critical input transformation services from others and are more like a traditional wholesaler who buys and sells goods. In addition, the ECPC considered classification in Sector 54, Professional, Scientific, and Technical Services, because factoryless goods producers could produce their own designs or intellectual property. However, unless the designs or intellectual property are sold or licensed to others, the production would not be measurable as manufactured output. Further, factoryless goods producers could acquire designs or intellectual property developed by others, thus bearing no resemblance to research and development units. The ECPC also considered classification to Industry 551114, Corporate, Subsidiary, and Regional Managing Offices. In this case, a single establishment arranging for and overseeing the production of goods (*i.e.*, an operating unit) would be classified to the industry defined by enterprise support units or auxiliaries, *e.g.*, central administrative offices in the former Standard Industrial Classification. A single operating unit cannot be a domestic support or auxiliary unit by definition.

Classification of factoryless goods producers to the manufacturing sector would result in the full value of goods, including returns to intellectual property and entrepreneurial risk, being included in manufacturing. Classification to wholesale trade would result in margins that include the returns to intellectual property and entrepreneurial activities, but limit manufacturing to units that are undertaking physical transformation. When the domestic production boundary is crossed, the ability to properly identify transactions for goods and transactions for services will be difficult, yet critical. Once a sector classification for factoryless goods producers is chosen, they could be merged into the existing NAICS industries or separately identified at the industry level.

Classification of factoryless goods producers to either manufacturing or wholesale trade will affect current statistical programs and the estimates that they produce. All of the agencies represented on the ECPC share a concern about the ability to identify and consistently classify factoryless goods producers regardless of the ultimate classification. Beyond that common concern, specific impacts on statistical programs addressing input/output analysis, industry gross domestic product, trade in goods, trade in services, producer prices, productivity, and balance of payments must be considered.

Additionally, the impact on international standards such as the 2008 revision to the System of National Accounts and the Balance of Payments Manual must be considered.

In summary, the ECPC is soliciting public comments regarding the classification of units that outsource all transformation activities within the NAICS system, taking into consideration the framework of existing statistical programs and the interrelationships and interdependencies of economic data produced in the United States.

Susan E. Dudley,

Administrator, Office of Information and Regulatory Affairs.

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