The Impact of Multi-National Companies on Balance of Payments and National Accounts

J. Steven Landefeld, Brent Moulton, and Obie Whichard

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Measuring the Nation's Economy.
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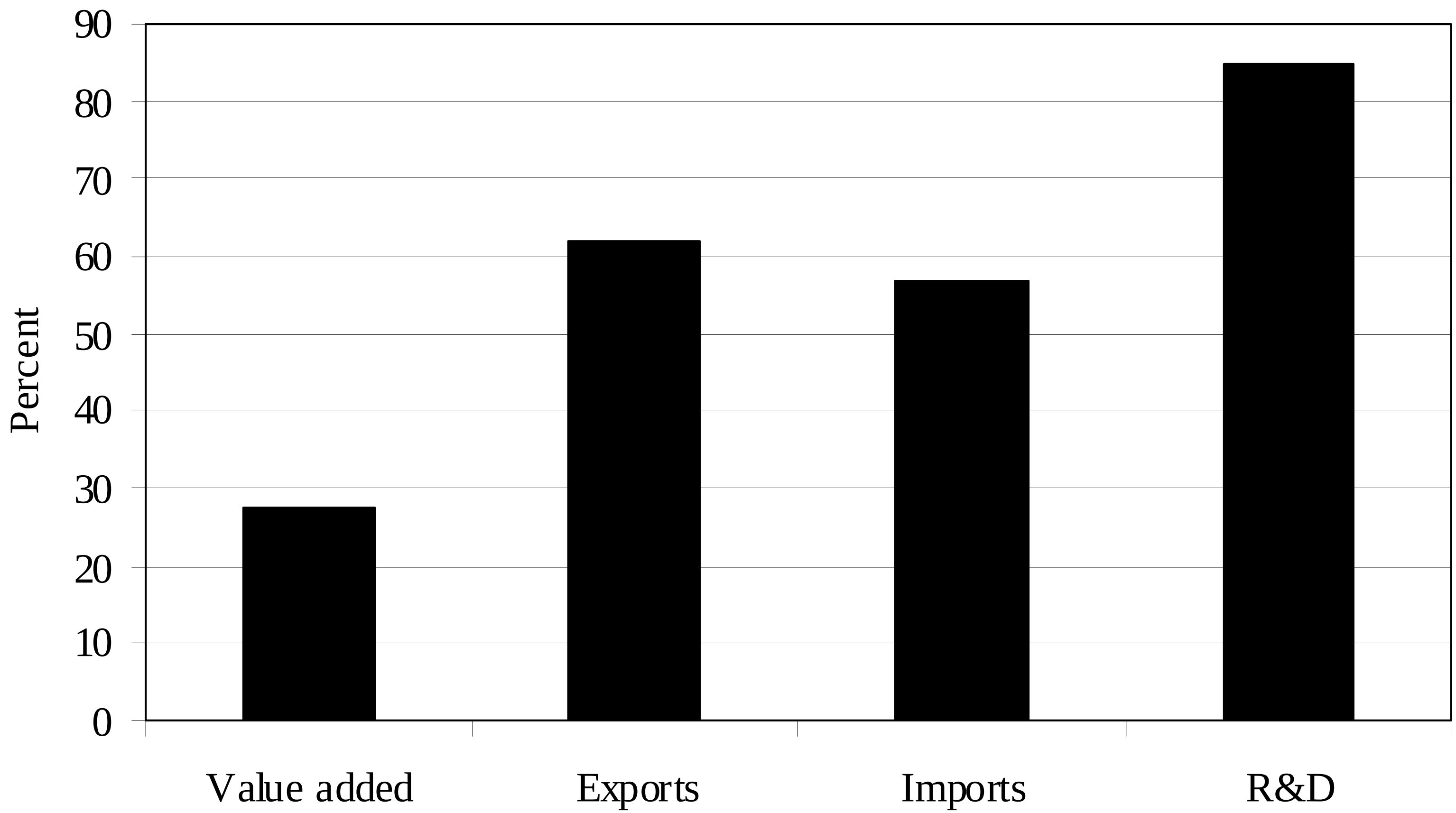
Measurement Challenge

- Multinational Companies (MNCs) present special measurement challenges for national and balance of payments accounts:
  - MNC goal to maximize company-wide <u>global</u> after-tax profits.
  - MNCs allocate resources, price intra-company transactions, and bill transactions to meet this goal.
  - As a result, MNC's accounting for transactions may not align well with the underlying economic activities.

Importance of MNC's to GDP and Trade

Chart 1. MNC Shares in U.S. Production, Trade, and R&D, 2005



R&D Research and development

Transfer of Intangible Assets

- U.S. parents can lower their global tax burden by:
  - Reducing their U.S. taxes during the development period by booking expenses in the United States
  - Thereafter shifting the income from the intangible to a low-tax country, where it can be shielded from U.S. taxes until it is repatriated.

Growing Importance of Transfers of Intangible Assets

Table 1. U.S. Parents' Receipts for Royalties and License Fees from Foreign Affiliates in Tax-Haven Countries*

[Millions of dollars]

	1977	1982	1989	2005
Belgium	104	149	326	580
Ireland	10	39	255	4,285
Luxembourg	2	1	5	91
Netherlands	107	166	633	1,589
Switzerland	45	83	255	4,160
Bermuda	2	10	4	(D)
UK Islands, Caribbean	0	0	0	(D)
Hong Kong	3	14	94	393
Singapore	10	24	151	2,278
Tax haven total	283	486	1,723	13,995
Worldwide total	2,173	3,585	10,082	37,771
Tax haven share (percent)	13	13.6	17.1	37.1

Source: * The list of lower tax-haven destinations for FDI is from Martin A. Sullivan, "U.S. Multinationals Move Profits to Tax Havens," *Tax Notes* (weekly newsletter of www.taxanalysts.com) February 9, 2004; receipts are from BEA.

Other Means of Reallocating Income

- Establishing finance or holding company affiliates in low-tax countries
- Structuring transfer prices to shift net income toward subsidiaries in lower tax countries;
- Establishing offshore factoring corporations in low tax countries that bill and collect for the parent's worldwide sales; and
- Inverting the corporate ownership structure, with an overseas entity in a low-tax country becoming the parent that collects net income for the MNC's worldwide corporate structure.

Growing Importance of Investment in Lower-Tax Countries

Table 2. U.S. Direct Investment Position in Tax-Haven Countries*

[Millions of dollars]

	1977	1982	1989	2005
Belgium	4,612	5,549	7,710	48,409
Ireland	986	2,031	4,665	71,255
Luxembourg	677	1,098	1,560	69,746
Netherlands	4,534	6,760	19,160	184,614
Switzerland	7,182	12,863	21,144	81,048
Bermuda	7,708	11,519	18,297	103,454
UK Islands, Caribbean	336	1,425	6,123	79,728
Hong Kong	1,328	2,854	5,412	32,577
Singapore	516	1,720	2,998	54,500
Tax haven total	27,879	45,819	87,069	725,331
Worldwide total	145,990	207,752	381,781	2,135,492
Tax haven share (percent)	19.1	22.1	22.8	34

Source: * The list of lower-tax countries that are a destination for FDI is from Martin A. Sullivan, "U.S. Multinationals Move Profits to Tax Havens," *Tax Notes* (weekly newsletter of www.taxanalysts.com) February 9, 2004; the position data is from BEA.

Other Issues in MNC Allocation of Income

- MNCs allocate profits, retained earnings, and record transfer prices in ways that differ from the underlying economic transactions for strategic as well as tax reasons.

- Also, MNCs are worldwide corporations and, for many transactions, place limited importance on national boundaries.
  - As a result their business records may not support more accurate reporting of geography to statistical agencies.

Impacts of Global Allocation of Income

- On Nominal GDP & BOP:
  - Lower recorded GDP and exports, and raise imports, in high tax countries
  - Raise recorded GDP and exports, and lower imports, in low tax countries

Possible Solutions

- Limited potential for improvement on tax-motivated transfer pricing issues
- However, some MNC reporting practices may be amenable to consistent reporting with international guidelines, through:
  - Respondent outreach efforts
  - Clarification of instructions
  - Cognitive work to redesign survey forms

Possible Solutions (continued)

- Other solutions:
  - Further work by national accountants and business accountants on valuing and accounting for intangible assets.
  - Collection of data on the basis of the "ultimate beneficial owner."

Impact of MNCs and Offshoring on Real GDP

- Domestic producers switch from domestic suppliers to non-comparable imports
  - Difference in price between foreign supplier and domestic supplier not reflected in price indexes.
    - Import price index measures prices only from foreign suppliers; producer price index measures prices only from domestic producers.
  - Understatement of real imports and intermediate inputs
  - Overstatement of real GDP and Productivity

Impact of MNCs and Offshoring on Real GDP

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- Overstatement of U.S. real GDP and productivity may not be large:
  - 0.1 percentage point on real GDP growth and 0.2 on productivity.
  - Also, understatement of imports (17% of U.S. GDP) may be more than offset by similar problem with switch to new goods and services produced domestically.

Possible Solutions

- Given the pervasive nature of the “new goods” problem and the absence of a clear solution, it may be difficult to develop a global “fix”
  - However, further research into direct comparisons, indirect estimates (Feenstra, Reinsdorf, and Slaughter), hedonic, and other techniques (Aizcorbe and Nestoriak) may yield solutions.