Conference on Transfer Pricing
IDS. March 6th - 10th 1978

Transfer Pricing and the State

by Robin Murray

Transfer Pricing and the State

By transfer pricing I refer to the price assigned to goods, services and finance as they circulate within a planned system of production. We are concerned with transfer pricing in one such system - the private corporation - and I have referred to it as a 'planned system' because the range over which planned, non-independent relations take place does not always coincide with the range of formal ownership. Some large corporations, for example certain conglomerates, are formally single entities, but in substance are mere aggregations of independent parts which treat with each other as if they were autonomous entities. In other cases, a large firm may have a set of satellite firms which are nominally independent but effectively part of a single planned system bound in by detailed contracts. The prices at which 'commodities' circulate between them are planned prices. Since our concern is with transfer prices as distinguished from market prices, it is the zone of planned relations rather than the formal zone of ownership which we need to examine. By emphasising the planned system rather than ownership I hope to provide another way in to the discussion of what proportion of ownership is sufficient to qualify international trade flows as 'intra-firm trade'. [1]

Transfer pricing as defined above is associated with the growth of large firms. But it is striking that the literature on the subject substantially post-dates the early waves of corporate concentration. The first article, written by an accountant, appeared in 1929, and it was not until the 1950's that there was any extensive discussion in the managerial literature on intra-firm pricing, and not until the 1960's that international transfer pricing became an issue. [2] In part this may reflect the fact that decentralisation(via divisionalisation and control through profit centres)became a more sensitive issue with the increasing possibility of centralisation that was opened up by the development of information and communication technology. In part it may be the result of the growth of overhead joint costs within the large corporation. Certainly the increased -

concern with international transfer pricing reflects the discontinuous post-war growth of international firms, and the sensitivity of governments, particularly in underdeveloped countries - to the possibilities open to these firms of by-passing exchange and other forms of control.

The literature is now substantial. There are perhaps 200 books and articles in the English language relating to the subject. I want to distinguish five different approaches which are apparent in this general body of work, paying particular attention to theoretical differences between them:

1. Optimisation in a decentralised firm - This approach has been concerned with the effects of different methods of transfer pricing on resource allocation within the firm treated as an economy. The concepts used are those of marginal analysis, and the problems discussed - particularly in the business economic and accounting literature - are those familiar to marginal micro-economics more generally: problems of optimisation with technological or demand interdependence, with differential transaction costs, with imperfect competition, and so on. Some authors, such as Hirschleiffer, even introduce the central management, as public finance theory introduces the state, to tax some departments, and give bounties to others in order to surmount imperfections.[3] The framework can quite easily be extended to a general equilibrium analysis with two stages of production. It extended to an analysis of implications of transfer pricing for international resource allocation, though there have been few contributions in this field.[4] At its most abstract this general approach is distinguished by its concern to assess, against the background of a perfectly competitive economic system, the effects of differing 'imperfections' - whether they be indivisibilities, externalities, imperfect information, or 'arbitrary' state interventions - and the decision rules for transfer pricing which 'optimise' profits in these imperfect conditions.

2. Optimisation in a centralised firm - Whereas the first approach discusses transfer pricing within a divisionalised firm, a second body of business literature has concentrated on transfer pricing within a centralised firm. Here prices -

are not set ex ante, and decentralised divisions left to profit maximise in relation to them, but they are set to determine the distribution of income within the firm. With the decentralised firm, optimum transfer pricing may allow divisional profits to be taken as a measure of performance.[5] In the centralised firm profits are no such measure. Rather they are varied to determine the flow of funds within the firm, and minimise external levies on the firm as a whole. This is not an issue for domestic firms where there is freedom of capital movement within the country, and where taxation is levied on consolidated income. But it is of course a major issue for international firms. For this reason the discussion of transfer pricing in centralised firms has been largely confined to a lengthening literature on international financial management. This runs from general optimising models, like those of Rutenberg, to detailed tax avoidence manuals, such as that of Edwardes-Ker.[6] We should also include here the studies of international firm practises, such as those carried out by Business International, Schulman, and Arpen, though these are not confined to centralised firms.[7] Whereas the literature on decentralised firms concentrates on differing conditions in the private sphere of the firm's production and marketing structures, the literature on centralised firms mainly deals with optimising in conditions of differing state requirements: tax rates, exchange controls, tariff duties, financing obligations and so on. As a number of authors have pointed out, these differences in external 'public' conditions imply quite different sets of transfer prices than those dictated by differing internal conditions, a difficulty which can be overcome by keeping two sets of books.[8]

3. Reclaiming the market by account - The first two approaches both consider transfer pricing from the perspective of corporate optimisation. The remaining ones look at the problem from the viewpoint of public policy. How should nation states, faced with these non-market prices, assess their validity for various areas of state control? One suggested method has been to try and calculate what a market price should be in these non-market

situations. This has been the course pursued by customs and taxation departments in developed countries, by the OECD Committee on International Investment and Multinational Enterprises, and by some parts of the United Nations.[9] In the words of the Brussells definition of customs value:

"For the purpose of levying duties of customs, the value of any goods imported for home consumption shall be taken to be the normal price, that is to say, the prices which they would fetch at the time when the duty becomes payable on a sale in the open market between buyer and seller independent of each other".[10]

The problem of course has been how to determine such a normal price, and the literature and conferences which follow this approach have been concerned above all with establishing rules of thumb and guidelines for estimating supposed 'arms length prices'. They have also been concerned with harmonising these guidelines between countries, in order to prevent double taxation, and with developing double taxation treaties between countries to regularise such agreements. There are some similarities between this approach and the first one concerned with corporate decentralisation, though in this case the consideration is the extraction and distribution of tax revenue (or duties) internationally, rather than with optimising allocation within the firm. For both, however, there is some notion of a perfect market price which the authority - central management or state - should try and 'reclaim by account'.

4. Reclaiming the market through competition - An alternative approach is to restore free market prices by attacking the conditions of abusive transfer pricing, namely the monopoly power of international firms. This approach is associated with the Manufactures Division of UNCTAD, and is directed particularly at the use of transfer pricing to expatriate superprofits from underdeveloped countries.[11] If anti-monopoly legislation was more vigorously enforced internationally, and if the countries concerned restricted high rates of effective protection, monopolistic franchises, the use of restrictive contracts and licenses, then there would be no super profits to transfer. This approach has not yet dealt with the problems

of funding head office deficit spending from third world 'normal profits', nor with international tax avoidence when such avoidence may be an important part of international competition,[12] but it certainly offers a distinct strategy for governments to follow in order to limit 'abusive' transfer pricing.

5. <u>Beyond the market to bilateral monopoly bargaining</u> - A growing number of authors have taken the monopoly analysis to transfer pricing further.[13] Their approach can be summarised as follows:

a) the growth of international firms has created large zones of administered economic systems, inside and outside of which the notion of a free market has little if any meaning.

b) their size and power is assymetrical to that of many third world countries, and is based on the monopoly of technology and know-how, and a protected home market.

c) this power is used by the firms to transfer large amounts of surplus from the 'periphery' to the 'core' countries, where it is used to fund further research and development, and thereby reproduce their international monopoly of knowledge.

d) it is impossible to simulate or re-introduce a free market in these circumstances; what can be done is to reduce some of the monopoly conditions which third world countries have themselves created (patent laws, restrictive contracts,) and strengthen the power of states in their dealings with international firms (inter-country co-operation as in the Andean Pact), consolidation of government departments dealing with foreign firms, development of alternative source of international supply, and of domestic technological capabilities.

e) on the basis of the above to bargain with international firms over the conditions of entry, the level of transfer prices and of the tax offtake.

What is distinctive is that the model of perfect competition is abandoned, and the state's role changes from a guardian or imposer of competitive conditions, to an active intervenor in a power struggle over the international distribution of surplus.[14] This approach is only tangentially interested in establishing guidelines for the fixing of arms length prices. Researchers have shown themselves eclectic in establishing bases against which to judge transfer prices. Moreover the relevance of some arms length prices - particularly those for technology - are disputed on the grounds that they represent a general monopoly of information preserved by international patent law. Rather the main concerns have been with identifying the channels used by firms for expatriating funds, and gathering information on world costs and prices (thus eroding one of the key monopoly advantages of international firms) so that restrictions on financial outflows can be more effectively enforced.

Clearly the differences in these approaches is partly one of standpoint. The first represents the standpoint of the central management of a large corporation, the second that of the international firm, the third that of developed country governments, and the fifth that of the governments of the third world. At times the arguments advanced by each, the estimates of the significance of the problem, and the moral codes alluded to can be understood merely as self interest. But at their best, the approaches have theoretical positions which must be examined in their own right. The most notable distinction in this respect is between those approaches which take the free market as the base against which to assess transfer pricing, and the last approach which denies the possibility and even the validity of using a notional free market in this way, and instead argues for a perspective based on power - the state counterpart to the literature on international financial management and tax avoidence.[15]

Transfer Pricing and the Development of Capitalism.

In order to assess the validity of these approaches, and the soundness of the positions that follow from them - particularly relating to the place and form of state policy towards pricing - it is necessary to explain how the 'problem' itself arose. All the approaches identify the cause of the 'problem' with the rise of the large/international firm: hence the literature on the stages of corporate growth and the changing structure of the world market,[16] or on the expansion of overseas investment and intra-firm international trade.[17] These have been very valuable additions to our understanding of the international economy, and have already forced re-assessments of many of the old assumptions and problems of traditional international economic theory: the debates on comparative advantage and the terms of trade, on traditional trade and macro economic policies, on the theory of regional integration policy, and so on.

I want to suggest an alternative way in to the 'problem' - which may also suggest an alternative way out. Instead of entering via the institutional form of the firm, I want to examine transfer pricing in terms of the changing place of the market in allocating resources - or to put it in a more classical way - in the allocating of social labour. In the early period of capitalism, the market was the dominant '<u>social nexus</u>', the mechanism which bound society together. Commodities, particularly those produced by artisans, had unequivocal costs (predominantly living labour time) and they could be sold individually on the market. It is this feature of the marketability of commodities rather than the competitive conditions existing on the markets which is important. The market was <u>adequate</u> in measuring the inputs into the specific commodities which were purchased.

Even at this early period there were some goods and services which could not be adequately circulated by the market (as

Adam Smith himself recognised). The administration and enforcement of law was one 'service' which could not be produced by private capital and sold as a commodity. Nor for similar reasons could the army. These are examples of public goods from traditional economic theory. They are 'public' because the very character of the 'services' - impartial judgement, preservation of the rights of property - requires that command over them be separated from the power of money as expressed in market demand. The judge - in principle at least - should not sell his judgement to the highest bidder. A private police force would run the danger of being hired to appropriate the property of others as much as defend what rights already exist. The character of the service 'contradicts' the sale of the service as a commodity. In these cases the market is inadequate as a mechanism for allocating social labour.

A second class of outputs for which the market is inadequate are those whose marginal cost of production like the use of a road is effectively zero. There may have to be rules about usage, but the actual costs are the fixed costs of the initial investment. While a price can be placed on use in order to recover the fixed investment, that price will contradict the optimum use of the resource, since it will restrict use when the marginal cost of such use is zero. There are problems in short of selling as individual commodities those things which have been produced jointly. Equally, there are problems with selling commodities individually whose consumption is joint. Here is a third class of outputs.

The above is sufficient acknowledgement to the literature on public goods in its concern with the problems of allocation in sectors where the market is inadequate. What this literature does not do is to place these 'awkward' sectors in historical perspective. Once we do this it is clear that they have tended to increase with the development of capitalism. Fixed costs have increased, and with them the gap between average and

marginal costs. Individual commodities are more and more the outcome of joint production. The cause of this trend is that increases in productivity have been won in the long run by increases in mechanisation, organisational scale, and in the extent of preparatory research and development. These are the fixed and joint costs of modern production. In their operation are to be found economies of scale.

Now the point about this long run tendency is two-fold. First, the growing gap between marginal and average costs, in the short, medium and even the long run, makes the market problematic as the 'social nexus' for an ever larger number of commm-ities. Second, within these zones of scale economy production, the market has already been surpassed.
Although each stage of industrial textile production could in principle be owned separately and related through price and free exchange, it has been found much more efficient to collectivise ownership (for instance in the joint stock company), place the machines side by side, co-ordinate their plan of production, their throughput, pace, quality control, standards, and dispense with the market until the final product is sold. Buying and selling costs money, takes time, introduces uncertainty. The development of specialised instruments demanding co-ordination and synchronisation with others, of the possibilities for circulating information and enforcing control more efficiently than through the uncertain abstractions of the market, has meant that the labour of increasing numbers of people are now organised/allocated directly rather than through the mechanism of selling their products individually on the market. I call this the tendency to the direct socialisation of labour.[18]

Of course what I have said is not new. But it is the emphasis which is important for our discussion. For as yet I have not hardly mentioned institutions. I have not equated the state with public goods or with directly socialised labour, nor economies of scale with large firms or monopolistic competition. I have rather concentrated on the changes in the material characteristics of the processes of production and circulation,

and in particular the increasingly problematic role of the market as the main instrument in the allocation of social labour. These changes underly the extension of the state in the capitalist economy, the growth of large and now international firms, the development of new territorial structures such as the EEC. But if we enter the problem at the institutional level we are in danger of neglecting the nature of the problem which all these institutions face, public or private, namely commensurability - how can the costs of individual goods and services be measured and thus equated with others in a period of increasingly socialised labour.

One thing which particularly concerns us in this situation is the changing role of price. If the market is rendered problematic, so necessarily is price. In the era of simple commodity production - or perfect competition in the formulation of the textbooks - price performed a double function. First it represented the real transfer of resources from the buyer to the seller with which the seller could fund production afresh. Money was here a means of payment. Second, the price when compared to other prices served as a sign of both relative efficiency, and 'effective demand'. Money here acts as a unit of account. According to these quantitative signs, the composition of social production would be revised, resources would be shifted. According to the real flow of income embodied in the price, the most efficient producers would be favoured, and the least efficient squeezed. Price thus embodied within it two mechanisms, one of distribution, the other of steering.

What happens with those outputs for whose circulation the market is inadequate? Quite simply the unity of the two functions in price is ruptured, their effects have to be achieved through other means. In the case of goods which cannot be sold a new economic principle comes into play: the levy/ bounty relation. The goods are now circulated freely, and their costs are paid by raising a levy (voluntary through donation, or forced through taxes or conscription). Since the area

over which the levy is raised and the bounty distributed must be defined, there is a tendency for levy/bounty economies to become territorially exclusive.[19] This is the material basis for the nation state.

The levy/bounty relation still leaves open the problem of 'steering'. With states at least, the levy is forced: taxes are not paid according to the benefits the individual taxpayer voluntarily considers he is receiving from the state. The key mechanism that has developed as a 'steering' device in advanced capitalist societies is the institution of "representative government" pivoting on the vote. But this is clearly a much cruder mechanism in the economy's own terms than individual purchasing on the market. Attempts have been made to overcome the problem by re-inserting the quantifications of the market into the heart of the levy/bounty economy through cost-benefit analysis. Here individual prices are once more resurrected as signs and linked in to the free exchange sector of the economy (the world market for Little-Mirlees) as a base point for guiding though not financing the non exchange economy. But such attempts must necessarily remain problematic since they seek to introduce prices into an area of the economy which is only organised as it is because price and the market were no longer adequate mechanisms for the circulation of their output.

Large firms are precluded from raising levies for their joint/fixed/overhead/social costs. They may either raise the necessary funds by a single indivisible sale, or by a subvention from an institution capable of levying - the state, or by adding a proportion of the general costs to each commodity sold, that is to say by fixing a price for general 'services' where no individual price unambiguously exists. This may meet the resources requirement of the firm, but it in no way meets the steering requirement. The development of socialised labour/general costs within the firm also serves to rupture the unity of price as distributor and sign which held in the prices of simple commodities.

We are now in a position to look again at the question of transfer pricing. There are two sources of difficulty addressed in the literature. The first - which concerns the managerial literature on transfer pricing in the divisionalised firm - is the problem of steering and incentives within a large organisation. The second - around which the international literature is arranged - is the problem of the allocation of income. The first is concerned with transfer pricing as part of a system of signals, the second with transfer pricing as part of a system of distribution.

Transfer Pricing as Signs

At this point we need only note one point about the question of pricing within a divisionalised firm. This is that most of the accountants and economists writing on the subject are attempting to 'reclaim the market by account' so that the system of allocation and incentives can operate in the same way as it would do if the divisions were in fact independent. But they are doing this in circumstances where price has, on our previous arguments, become a problematic sign. As Hirschleiffer pointed out the market price is an adequate sign only when there is a perfectly competitive market together with technological and market independence. If there is technological interdependence then Hirschleiffer admits there is no solution and technological interdependence is the very circumstance which has so often led to the growth of the firm in the first place. Author after author examines different rules of thumb - pricing by marginal cost, average cost plus, final price minus, external 'market' price, inter-divisional negotiated price, and so on. Each rule is shown to be deficient because they do not encourage or reflect efficiency in at least some of the departments involved. It is not that these formula are not adopted. The National Industrial Conference Board study of Interdivisional Pricing showed clearly that they are, since some formula has to be used if a firm is to run on a profit centre basis.[20] But both the accountants and the business acknowledge their sub optimality. As the firms

who used 'market price' transfer pricing reported to the NICB: they adopted it so that they could satisfactorily appraise divisional performance, identify inefficient operations, and encourage cost reduction. The problem they found was that it was often difficult to obtain a market price. Here then is the essence of the matter.

Few writers dwell on one implication of the impasse: that it may be advisable to abandon the attempt to recreate the perfect market with its neutral prices as a system of assessment and incentive within a single firm. But as Solomon concludes in his book Divisional Performance: Assessment and Control;

> "The profit spur is not the only way to maintain efficiency. Non-divisionalised businesses are not, invariably, markedly less efficient than those which are divisionally organised and so long as every effort is made to find and use other means of keeping the efficiency of service centres high, resorting to the profit motive for segments of a business where it is not appropriate is likely to do more harm than good."[21]

Abandonment of the profit centre in favour of direct assessment of performance: this at least is one way out of the 'insoluble' problem posed by directly interdependent production for the traditional system of price as sign.

Transfer prices and distribution

There is no such solution when it comes to the problem of transfer pricing as part of a system of distribution. For the internal corporate economy there is no problem. It owns income wherever it is declared, and it can move real money resources between its component parts at will. There is no necessary link within a firm between the amount declared as income or profit by one part, and the amount available to it for reinvestment.

The problem occurs when there are differential outside claims on income of the component parts. These claims may come from shareholders, workers, or governments. In all these cases it matters how the firm distributes profits/income between its affiliates, for on this will depend the total drain of income from the firm as a whole. This is the issue involved in international transfer pricing.

From the firm's point of view the issue is entirely practical: how to adjust transfer pricing to minimise tax, maximise subsidy, reduce exchange and other risks, and so on. The issue may not just be how much profit is declared, but how far net assets are 'exposed', or where liquidity is stored. Since the price of goods is no longer a privileged conduit for the movement of money in the firm, other channels can be used. All forms of intra-firm relations can be classed as transactions and can be given a price: advisory services, blue prints, factoring, insurance, general management, capital goods servicing, and of course the loan of money. Or lump sum charges can be made for brand names, or head office overheads, or future research and development, or simply 'goodwill'. Each command that is made can be given a price, each 'phone call, letter, meeting attended - any aspect of normal intra-corporate interchange can be set up as if it were a transaction. The firm will choose those channels which achieve its ends for the interaffialiate allocation of income at least cost. This is the subject of the ingenious

business literature on international financial management and tax avoidance.

What cannot be claimed is that the resulting international distribution of income is in any way optimal, as some proponents of international business have done. The model in terms of which optimality is judged is that of utilitarian trade theory and the perfect market. The intervention of states to disturb equilibrium prices can only serve to distort, and thus anything (such as transfer pricing) which undermines the power of the state to distort (through tariffs, withholding taxes, exchange controls) will also help to restore optimality. Now quite apart from the many objections to the free market optimality model itself - scale, economies of agglomeration, barriers to labour mobility - the undermining of the state's power to tax at the same time undermines a key tenet of this traditional model which holds that the surplus which has been maximised as the result of the free market can then be redistributed to those who have been extruded from the accumulation process - notably the unemployed or peripheral areas outside the agglomerations. Even were we to assume a tendency for central states to consistently and sufficiently redistribute surplus to the margins of the world economy, the existence of transfer pricing as a means of tax minimisation raises the question of whether the surplus can be appropriated from the sphere of private capital in the first place. The very limits set by international firms to state power to 'interfere' with the perfect market, are also limits to state power to redistribute the results of this perfection.[22]

For international firms, therefore, international transfer pricing is an operations rather than a conceptual problem. For states it is both. The keystone of the levy/bounty economy - the power to levy - is challenged. The power of international firms to shift the location of their declared profits induces individual states to create conditions which

will encourage profits to be declared within their borders. It sets state against state, heightening the anarchy of the international economy.

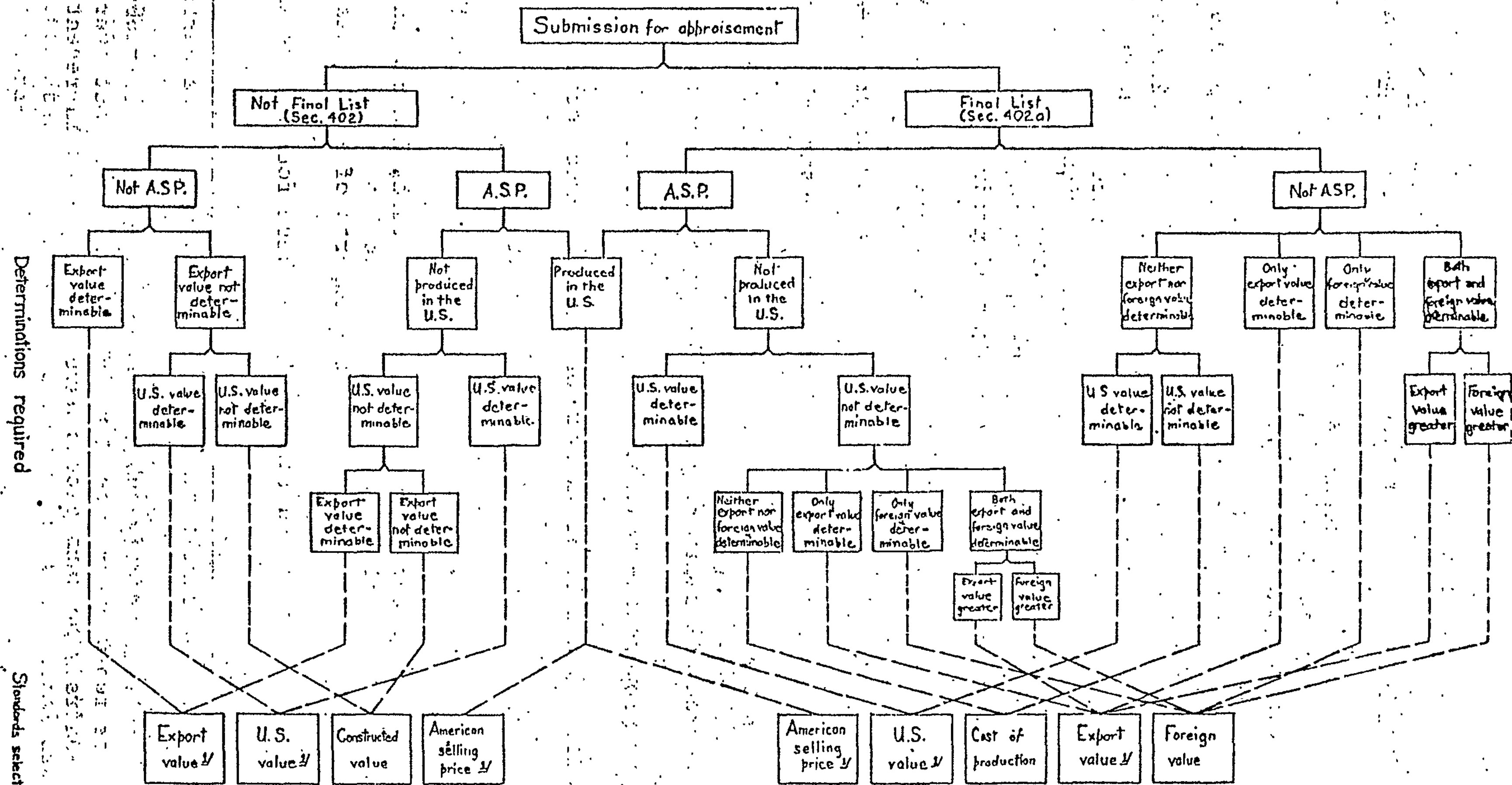
Inter-state competition may take the form of a down bidding of tax rates, duties and controls. The extremes are found in tax havens. They tend to be small, even fictitious countries, with little production, a small population, weakly organised labour, and a restricted state budget (with low, even zero, military expenditure). With little if any income tax, the main duties tend to be initial start up dues, and some indirect taxes on expenditure. The infinity point of tax havens is represented by the reef of Minerva.[23] Larger countries have created low tax enclaves, entrepôts of labour, finance and trade - the export processing and free trade zones that have spread through competition to more than fifty countries in the semi- and less-developed world. These countries can gain through transfer pricing, gaining necessarily at the expense of others. But it is a non-zero sum gain: what one gains the other loses more of.

A second form of competition takes the form of tax enforcement, and the more effective control of transfer pricing. This is the main subject of this conference. While there are areas of collective interest between high tax countries wishing to restrict the minimising effects of the low, there is also an individual rivalry since what one high tax country gains another may lose. One commentator even sees policy towards the control of transfer pricing as an instrument in the arsenal of trade war.[24] We must keep this discordance in mind when considering both the reasons for tax havens continuing to exist, and the different remaining approaches to transfer pricing control.

Let us recall that the third approach I discussed at the beginning tried to solve the indeterminacy of international profit distribution by resort to the notion of arm's length

prices. This was true of the leading accepted guidelines on customs valuations, and on tax determination by revenue authorities. The problem in both cases is how to establish such a price. The Customs literature shows how problematic contemporary prices, particularly for international trade, can be. It is no longer merely a question of a specified price - say 10p - for an unequivocal commodity - a bag of nails. First the commodity has to be specified. It may be unique as in the case of capital goods, new or second hand. It may be part of a package whose individual use and therefore value will depend on its relations to other parts of the package. It may carry with it trade marks, or other distinctive features. In all these cases - cases which increase with time - it will be difficult to establish what a comparable article would be.

Second the price has to be specified: the currency and its rate of exchange, the time period of payment, the extent of discounts and rebates, the terms of delivery, the transportation and insurance costs, the market in which a comparable price might be sought. All these considerations render the setting of arm's length prices by means of other market prices difficult if not impossible. The Valuation Standards used in the United States as of 1973 reveal the difficulties (see diagram). The following are possible 'comparable' prices to which appeal is made: the export value of similar goods in the exporting country either sold or merely offered for sale, the price at which the export good is offered for sale in the domestic market of the exporting country (the foreign value); the price at which similar imported goods are freely sold or offered for sale in the US market (the US value); the price at which similar goods produced in the US are sold or freely offered for sale in the US market (American Selling Price). In each case allowances have to be made - added or subtracted - to get the import price, and these deductions are themselves the subject of alternative specification (the US value for section 402a goods for example must have deducted from it a



1/ Although there appear to be identical standards under both sections 402 and 402a, each standard has a distinct definition, either in differences in wording or interpretation.

Note.--The determinations and order of selection of standards for articles subject to A.S.P. valuation under sec. 336 of the Tariff Act of 1930, but not like or similar to articles produced in the United States is the same as for non-A.S.P. items.

commission not exceeding 6%, or profits not exceeding 8% and general expenses not exceeding 8%).[25]

Each of these possible criteria for determining a free market price can produce very different results. The US Tariff Commission found that to value all goods under Section 402a (where the principal difference was that prices were those offered for sale rather than 'sold or offered for sale', plus the specified percentage reductions) would, according to the guidelines of Section 402, cut import duties by 5%. The Hearings into the International Grain companies, and specifically into alleged claims of price rigging of international markets, in part hinged on whether the grain quotes were for lots sold or merely offered for sale.[26] The EEC have objected strongly to the use of the American Selling Price standard, and said that the complete removal of tariffs as part of the Kennedy round would only take place if the ASP was abandoned.[27] These examples show the problematic character of a market price approach to value in international trade, particularly in an era of differentiated products, monopoly restrictions, and international firms. As the International Chamber of Commerce commented on the retrogressive method of establishing market prices (a sales-price minus), the results could only be established by a set of completely arbitrary decisions which would result in a bargain between fiscal authorities and the importer into which the concept of the definition of value does not enter.[28]

As far as customs practice is concerned, the US Tariff Commission study reported that US customs rarely used the price of identical or similar goods as a basis for their calculations. The main standard is the purchase price of the goods under discussion (75% of the value of all ad valorem imports). The other standard (used in the remainder of the cases) is that based on the cost of production of the goods in question.[29] What is striking in the customs' literature, however, is the relative lack of discussion on how these costs are determined.

The Dutch require that a royalty be included in the declared value of the good (where it stands to be paid), and the Brussels Definition of Value specifies (Article III) that the value of the right to use a patent, design, or trade mark in respect of imported goods should be covered in their price.[30] Other than these ways of taking account of technology costs, and 'goodwill', there is no public detailed discussion that I have come across on the problems of overhead allocation, embodied know-how, contribution to future R&D and other joint costs.

Inland Revenue literature has been more explicit on costs. Whereas customs valuation has been seen as a problem for all forms of international trade - with intra-firm trade being considered as a form of uncompetitive relation likely to induce a departure from free market prices - the Inland Revenue's concern with international values has from the first been linked with international firms and transfer pricing. As with the guidelines on customs valuation, most developed country revenue departments take an arm's length price as the basis of comparison. Maurice Collins' paper submitted to the UN Expert Group on Tax Treaties sets out the approach and procedures very clearly. What is evident is that while the formula for estimating market prices are similar to those used by customs authorities (uncontrolled market price, unrelated third party price, resale price minus, cost plus) there is a less specific discussion as to which market (overseas, domestic, export, import, home) than in the customs literature, and a more detailed consideration of costs.[31]

What is also notable is an uneasiness with all the methods for large classes of taxpayers. Maurice Collins, for instance, suggests that uncontrolled market prices may be suitable for assessing natural produce or mass market manufactured goods but that "there is clearly a wide range of goods where evidence of such uncontrolled sales is lacking". The resale price method is easiest to use where the goods are simply re-sold

by the purchaser, and least easy to use "where the goods are processed and incorporated in a manufacture before being resold". With the cost plus method there are problems of estimating the appropriate profit mark up, the allocation of joint costs such as start up advertising, depreciation of heavy capital equipment and administrative overheads. On allocating indirect costs he writes that "it does not appear that any general rules can be devised and the only practicable solution seems to be to adopt a case by case approach".[32]

This lack of a clear, general set of guidelines is evident in all developed country experience. In Germany the courts acknowledge that customs and tax departments' estimate of an arm's length price for the same transaction may differ, and that there is no basic way in which they can be made to coincide other than mere factual compromising of the parties. The French Note on transfer pricing of May 1973 acknowledges that the nature of the imported product " often makes it awkward to use terms of comparison"; that the apportionment of joint research, production, purchasing or sales costs raises "very difficult problems whenever definite mandatory rules for such apportionment do not exist"; and that turnover, gross proceeds and asset value are all possible bases for use in such apportionments. Similar problems have arisen in the administration of US arm's length guidelines. In the USIRS words: "US experience has demonstrated that, even with detailed guidelines, the safe haven rules, and substantial disclosure requirements, an arm's length profit margin or mark up is still often an elusive phantom".[34]

The USIRS put their emphasis on the difficulties of information. The point I want to bring out is the conceptual difficulties. As we saw in the case of private business practice, the problem is that much of the circulation of goods, skill, knowledge within a firm can no longer be unambiguously priced. What seems an adequate price from one point of view is unsatisfactory from another. This does not apply to all intra-firm trans-

actions. There are some, such as those mentioned by Maurice Collins, where the 'market' price guidelines do give a meaningful basis for comparison. But the more integrated the economic system, the larger the proportion of joint costs, R&D, central administration and capital equipment, the wider the gap between average and marginal costs of production, then the less adequate will the very concept of the market and an arm's length price be for 'commensurating' costs and results by commodity and division within a firm.

My argument is that these areas of interdependent production are increasing. They carry with them as a corrolary an increase in the size of firms, and this very size may further influence the external market price system through different forms of market power. We would thus expect to find the problem of transfer pricing more acute, and more difficult to pin down through comparison with external market prices the larger the firm.

Arpan found just such a correlation in his study of non-US systems of transfer pricing: the larger the parent firm, the more likely it was to use a cost oriented system of pricing. The reasons given by the large corporations in question were: a) that product differentiation often meant that there was no close market equivalent; b) that their cost systems were more complex than small companies, with larger joint costs, and given sophisticated auditors they could present highly complex and confusing cost formulae to government agents, and c) they have a significant influence on the market price itself.[35] These points refer to a correlation of size and cost based methods of the corporations themselves, and it is interesting that both the Business International and Conference Board studies report a predominance of cost oriented systems in US international firms. The fact that large businesses are forced to dispense with market based systems for their own internal pricing reflects the underlying developments in integrated/non-market systems of production.

Because of this Revenue Departments are likely to have as much difficulty in using price based formulae as the firms. In the US Treasury Report of the International Cases involving Section 482 it was found that the uncontrolled sales method was used in 46% of the cases of adjusting the transfer pricing of goods. The resale method was used in 5% of the cases, the cost plus in 18%, and 31% of the cases were settled by other methods. However they reported that under 30% of all potential pricing adjustments were successfully made (compared to 53% for intangibles, 67% for interest, 52% for services, 84% for the allocation of expenses, and 89% for the allocation of net income), and that more than half (56%) of the adjustments not made had used the uncontrolled sales formula. In fact only 21% of adjustments made used this formula, 11% used resale price, 28% cost plus, and more than 40% of successful adjustments used a variety of other formulae.[36]

These data suggest that even the USIRS, well-staffed, with sophisticated methods, has found it extremely difficult to make re-assessments of transfer pricing of tangibles stick. They have had more success with adjustments of interest and the pricing of invisibles and services, but less because there is an objective market price (financial interest is perhaps an exception here), than because it is relatively more straight-forward to apply a rule on allocation of a stream of services or know-how than it is to compose the price of individual commodities.

In discussing developed country guidelines and practices I have not wanted to argue that allocations cannot be made. Indeed they clearly have to be made. What I have tried to establish is that there is no unambiguous way of allocating profits between subsidiaries of an integrated international firm, there is considerable latitude, and the choice of method will reflect the interest of the body doing the assessing: the firm, a customs department, the inland revenue department, a less developed as against a more developed country, a trade union.

There can be no way of 'reclaiming the market by account' unambiguously for many of these cases. The underlying model of the perfect market, with its implications for free circulation, welfare optimisation, and 'just prices' can in these circumstances no longer be invoked - in spite of its magnetic presence in the literature we have been discussing. Rather what is at issue is a struggle over the distribution of profit, between private capital, governments and workers on the one hand, and between different government or different groups of workers on the other.

This is recognised by the resort of revenue departments to the method of allocating world income. This was used in 7% of the successful adjustment cases reported by the US Treasury, and has been invoked in a number of well known cases in the US - those involving Pittsburgh Plate Glass, Johnson Bronze, the Lufkin Foundry and Machine Co. and the Eli Lilly case. Moreover, as Edwardes-Ker notes in his tax avoidance manual, regardless of theory, "there seems little doubt that providing a reasonable profit is made in a country by a subsidiary the local tax authorities are far less likely to query its intra-company pricing arrangements than if little or no profits are made". The reality is that most revenue departments are not primarily concerned with re-establishing notional free world market prices by whatever means. They are interested in laying claim to a portion of world profits as their share of the levy. The arguments advanced on the basis of a supposed system of free prices will play a part in this struggle over distribution. But they can no longer claim - even within their own terms - the status of a privileged criterion for the allocation of income over and above other criteria based on equity or market power.

The third approach rests on the propositions that:

i) free market prices can be established

ii) that those free market prices are the legitimate basis for allocating international profit between tax authorities.

The fourth approach by implication accepts these propositions but argues that the re-establishment must not be by account but on the basis of anti-trust action. It is here that approaching the problem via the nature of the social nexus rather than institutions in the market becomes important. For my argument on the social nexus implies that it is the growing indivisibility in production which is the material basis for large firms, and, in some periods, for large firms which are also monopolies. In spite of the magnificent quixotic thrusts of North American and EEC trust busters, we have seen how confined are the limits on decomposing these great aggregations of contemporary integrated production systems. The confines are set by the impetuous drive to increase productivity, and the tendency to interdependence of production systems as the requirement for achieving these increases of productivity. No national anti trust authority can ignore these twin necessities. To attempt to reimpose short term competition by breaking up large firms, and/or shearing them of their short term monopolistic advantages, would be to undermine, in any particular national instance, the potential of long run international competitive success. I would not of course deny the room for anti-trust action which clipped rather than sheared. But as a major answer to the problem of transfer pricing the reintroduction of competition as traditionally conceived is as contradictory in terms as the reintroduction of the market in zones of the economy where price has lost its voice.

Power and Price.

The fifth approach - which I have distinguished as an admini-

strative, bargaining approach - shares with the operational business literature the virtue of micro realism. Rooted in the perspective that it is the world market, dominated by the monopoly power of large firms and the developed country states, which has led to the severe poverty and unemployment that exists in the third world, this approach is geared to preventing the continued drain of surplus by mobilising and consolidating what power the underdeveloped country states have got. For them there is no 'just' price, rather the relevant price is the minimum (imports) or maximum (exports) that they can obtain in the face of the power of the inter-nationals firms and their domestic states.

It is here that the theoretical issue becomes particularly sharp. For one of the features of modern socialised production is that fixed costs tend to be high and marginal costs low. In principle a firm should be willing to sell its product as long as it earns a normal rate of return on its marginal costs. Given that a national market can be largely isolated from other markets, and that a low price will not then reduce overall world revenue for the firm, the underdeveloped countries as marginal markets could in principle expect to enjoy one of the benefits of being a 'latecomer', namely low prices.

For firms this fact of modern production is most uncomfortable. To produce more efficiently they have to invest more in research, development and heavy machinery, but are then in a weak bargaining position with consumers who owe no allegience (in the jungle of the real market) to sunk costs. The states of advanced capitalist countries (where these sunk costs tend to be incurred) have developed four ways of protecting their firms from this contradiction between the nature of modern production processes and the reality of the market. They have taken on some of the fixed costs themselves and funded them out of levies (Research and Development). They have left the firms with the fixed costs but lowered their

levies (depreciation allowances, capital grants, investment credits - all effectively amounting to a grant of bounty from the state). They have provided tariff protection so that fixed costs can be recovered by sales in the home market, and exports in the world jungle can then if necessary fall to marginal cost plus without driving the firm out of business (this is the basis of Otto Bauer's famous fortress theory of the nation state). Finally they have provided monopoly power for a fixed period of time in the form of patent rights, or trademarks. Fixed costs are thus either funded by the state, or the firm is given a monopoly zone in time and or space to recover them. There is no immediate reason why an underdeveloped country - which rarely plays host to such fixed investment - should participate in state protection or funding of sunk costs. If the jungle principle is strictly followed, foreign firms should be allowed to cover their international marginal cost plus a normal rate of return. That is to say, costs allowed would be the total costs of production of the underdeveloped country facilities, plus any incremental cost that the international firm had incurred elsewhere as the result of its investment. For a particular commodity, the price would be composed of average local costs, plus marginal foreign costs.

Applying this to transfer pricing, imported intermediates would be valued at their marginal, not average costs, which effectively means they should be valued at dumping prices. Machinery, too, should be valued at its marginal cost - in spite of suggestions by tied aid agencies that average cost is the relevant benchmark. Know-how, and formula, should be valued at their marginal cost which is usually close to zero. On this basis, the high marginal profits created in the third world - which are normally transferred under average pricing codes - would be realised where they were created and taxed accordingly.

Various average cost pricing formula have been advanced

against this: average international cost at historic value, average international cost at replacement value, and average expanded reproduction cost. The first argues that firms should be paid what they have invested. The second that they should be paid what they will have to invest to maintain the same rate of output, and the third that they should be paid to allow for an expanded rate of output. All of them assume that the firm should have sufficient returns to reproduce itself. In some instances a third world country might see itself as having an interest in funding the continued existence of international firms, but it should then be seen for what it is, a contribution towards future expenditure rather than a payment for what has been incurred in the past.

In the era of socialised production, accounting, like price, becomes increasingly ambiguous, and the very standards such as those argued currently in inflation accounting debate can be seen to represent different interests.[38] So, too, with cost. Each time a joint cost or a sunk cost is discussed we will often find the argument turning on conflicting material interests. This is why it is so important to be clear about the nature of cost and what it represents.

To take one recent example, that of the pricing of intermediates of the drugs Librium and Valium by Roche Products. The UK Monopolies Commission produced figures which (leaving out UK selling and administrative expenditure) suggested an international marginal cost of production of the two drugs of respectively £76 and £77 per kilo. The Commission accepted the principle of some contribution to joint costs, which in the case of R & D they felt for practical reasons could not take the form of payment for sunk costs, but a portion of current R & D expenses. They made it clear that this allowance was to ensure that the company maintained its research, and not that it should fund a "cumulative increase in research cost". This is equivalent to international

average historic costs, or 'simple reproduction' costs and amounted to more than four times the marginal cost. Roche Products argued their case in part on the basis of average international replacement cost: "The research costs you have got to recover, which are not the research costs on that drug, have gone up, perhaps, by twice,"[40] hence the need for a higher current price and some protagonists of Roche, in arguing for a price which gives an incentive for expansion, were effectively advancing an argument for 'expanded reproduction' costs. This stood at ten and twenty-five times marginal cost for the Librium and Valium respectively. What will determine the price granted will be the interest a country has in any of these outcomes: the provision of the drugs alone, or their provision with various levels of continued existence for the international firm who makes them.

Thus the fifth approach starts from the principle of allowing international firms to cover their marginal international costs, together with any allowances for further expansion. Sunk costs are recognised only in so far as allowing them is necessary to encourage expansion in the future.

On the import side, therefore, the argument is that the incremental profits should be declared where they are realised, for it is either local labour which has produced the profits, or - if there is local protection - the excess profits are effectively value appropriated from elsewhere in the economy. In either case, profit has been produced locally and should be taxed locally.

On the export side the argument is somewhat different. Here the key concept is rent. In major international raw materials and primary production there commonly exists what in most versions would be seen as a differential rent. In many sectors this rent is appropriated almost entirely by the international firms, and accumulated largely outside the primary export economy. Costs allowed by firms in the

transfer export price may in these cases not even cover national marginal costs, (Frank Ellis has found the banana price in Central America on occasion so low that it does not cover the wage bill.)[41] In these cases the fifth approach would argue that the relevant method is to allow the firms the international marginal costs plus normal rate of return on their upstream operations, deduct that from the world market price, and appropriate the rent for the holders of the land (usually the government) as in traditional economic theory. This method was that used by Jamaica in her calculation of the appropriate tax to levy on bauxite exports, though they agreed to distribute the rent equally by stage of production rather than appropriate it entirely to themselves.[42]

With both imports and exports, the transfer price will be fixed not so much at a notional arms-length but at an actual fists-length. Whereas the third approach was interested in individual costs in order to estimate a national free market price, the fifth approach is interested in market prices in order to estimate individual costs. And it is here that the difficulties remain. For the cost figures relevant for estimating both international marginal costs, and international rent are both privatised within the international firm. The accounting ambiguities of modern production make the matter more difficult, for the costs relevant for the bargaining country are not some objective costs that can be independently established. They are the costs as the international firm sees them. Frequently bargains of this kind, which may start on issues of pricing principle, finish as disputes about costs, discount rates, allowances for risk, and so on, whose actual magnitudes only the firm knows.[43]

Thus while for the third approach the problem is pricing the unpriceable, for the fifth approach it is one of divining the costs of the costable. While in practise the US IRS and the Colombian Division of International Price control may follow similar procedures, what I have tried to establish is

that the contradiction between the growth of directly socialised labour on the one hand and the continuation of the market as the dominant social nexus on the other is vividly indirectly expressed in the very terms of the problem of transfer pricing, and in the differences and incongruities of the conceptual attempts to deal with it.

Control

It will already be clear that the conceptual issues bear closely on the practical matter of control. This is partly because the conceptual arguments used are part of the power relations of control, and partly because each approach has different implications and emphases for effecting control. Thus the international firm approach presses for as little and as light a control as possible. The notional arms length alternative places importance on establishing certain clear, well defined rules, and then enforcing them with a corps of evidence gatherers, backed by the courts. The anti-trust perspective would direct attention at making the structure of industry more competitive. The bargaining approach seeks to reduce the power of individual firms (seeking out alternative sources of supply,) of international firms generally (abrogating patent laws), and at the same time strengthen the bargaining strength of the state.

It is the last of these which I would like to discuss in more detail. Let me say to begin with in principle it is extremely difficult to control the movement of funds across borders by international firms. My reasons for saying this are as follows:

a) the proportion of intra-firm and related party trade is growing. Gerry Helliner estimates that 45% of US manufactured imports come from related parties, and more than a third of US exports.[44] The UNCTAD Manufacturing Division after their survey of the evidence estimated that perhaps one third of world trade was intra-firm trade.[45] Much less work has been done on trading companies, but the US grain company hearings suggest that here too is an area of intra-firm trade with opportunities for transfer pricing. Between 1970 and 1975 six international companies accounted for 96% of the export of wheat from the US, 95% of corn, 90% of oats, 80% of sorghum, 80% of Argentina's wheat, 90% of Australia's sorghum, 90% of wheat and corn exported from the EEC. Some of the balance was inter-state trade in which the international companies acted as 'fobbing' agents.[46]

Furthermore the movement of royalties, interest, dividends and profits, service payments and capital is also increasingly intra-firm. A study of the UK in 1968 found that intra-firm visible trade movements accounted for less than half the intra-firm movements across the exchanges, movements which were estimated at £4,884 million in one year, nearly four times the volume of UK foreign currency reserves.[47] Such international corporate integration greatly increases the flexibility of firms to move funds by adjusting the price or the timing of its payment.

b) Relatively small adjustments to price are required to move substantial amounts of profit. In the case of Tradax International, its margins of earnings on sales were in the region of 1% for the three years on which we have figures.[48] In manufacturing industry with slower turnovers the margins may be higher. But these margins are commonly much less than either price fluctuations or imperfections in the market. An EEC survey showed for example that prices between different brands could vary by as much as 79% for small transistor radios, 56% for tape recorders, 52% for washing machines, and 27% for coffee grinders - all in the absence of tarif barriers and import restrictions. This makes it very difficult to pin down an intentional 2% intra-firm price increase as a manipulated transfer price, and no doubt in part accounts for the low success rate of the US IRS in its use of market prices as a criterion of transfer price abuse.

c) The firms themselves control the principal information and its form of presentation so that it can be extremely difficult - leaving aside all the conceptual difficulties - to uncover intentional manipulation. Tax avoidence manuals give advice on how to use this information advantage to the best effect. Here is one example on the advisability of appearing to have a rational system of pricing:

"The best way to avoid pricing problems is to be well prepared in advance of court proceedings. The method and reasonableness of inter-company pricing should be carefully documented and detailed. Relying on oral evidence is both

is both unconvincing and unreliable: by the time a re-allocation is proposed staff connected with the transaction may have left the company. If the reasons behind the inter-company pricings are carefully documented with a possible future re-allocation in mind, a tax inspector with a less intimate knowledge of the company's affairs and business conditions will find it more difficult to upset the taxpayer's figures. Arguments in respect of suspect operations should be carefully assembled".[50]

And from the other side of the relationship, this is the US IRS:

"Attempts by the Service to secure information involving international transactions indicate that sophisticated taxpayers are well aware of the audit problems and time involved for an agent to trace a transaction, find a comparable transaction, secure books and records, deal with the peculiarities of foreign law and document the substance of a transaction. Moreover some taxpayers are taking advantage of these complexities to thwart effective investigations by use of passive resistance or not co-operating during the audit".[51]

d) There are numerous ways in which funds can be shifted so that if one is closed, another can be opened up. Again a tax avoidence manual or an international financial management textbook is the best source of the methods that can be used. They cover any form of circulation within the firm: movements of capital, of interest, of goods, of services, management fees, insurance premia, know-how and blue prints. Some firms pay premia to their employees who have remittance rights and who then refund the head office abroad. Others use back to back financing, which is even harder to detect: funding another company's needs in the underdeveloped country, in exchange for a contribution to its profit account from the other companies' overseas funds in return.

Leasing arrangements are another means. "Leasing can be a flexible financing tool and a fine way of avoiding tax ... through careful pricing in the leasing contract, leasing can be a sophisticated way of shifting profits ... Because leasing is so flexible its international scope is vast. Further,

being such a young industry outside the US, other local tax authorities may not yet have grasped the concepts and advantages involved ... In an international context it may be possible to get the best of both depreciation worlds in that both the lessor and lessee may be able to depreciate an asset". And so on. "La musique n'est pas dans les notes. Elle est entre les notes' as Edwardes-Ker quotes approvingly from Debussy at the beginning of his book. The point here is that the more integrated an exonomic system becomes the more difficult it is to control from outside all the routes by which economic items, tangible and intangible, circulate.

e) World wide tax rates on US firms are for most of the leading manufacturing companies, timber companies and banks below the statutory US rate of 48% - see Table 1. This reflects of course the fact that these firms - particularly those in manufacturing - have been granted depreciation allowances, tax credits, and other forms of investment incentive, including the right for some classes of export firms to accumulate unremmitted earnings in tax havens without being subject to US tax. But it is also true that the possibilities of benefitting fully from the various incentives and allowances received by international firms throughout the world may well require the shifting of funds through transfer pricing. We should also keep in mind the question raised first by Constantine Vaitsos, of how far current expenditure has been funded by profit remittances, as is the case with some research intensive sectors. These profits if remitted through transfer pricing will be subject to relatively low duties, and will not appear in the earnings figures in the consolidated accounts.[52]

I do not want to argue that attempts to control transfer pricing are hopeless. The US Treasury Report showed that the US IRS has made adjustments of $ 662 million over approximately a two year period. Colombia estimates that they have saved $ 80 million per annum through their international price investigations. The Greek unit discovered transfer pricing in four major trade sectors of the order of $ 80 million. The Jamaican adjustment of the notional bauxite price, and their re-assessed levy on exports raised tax revenue from J$ 28m

in January 1974 to J$ 210 m in 1975. In Panama the increased tax on the adjusted price of banana exports was $ 11 million in 1973 alone.[53] These orders of magnitude compared with the relatively modest costs of surveillance, indicate that monitoring units can earn rates of return even exceeding those of the firms they monitor. But even these large figures may be relatively small in comparison to the size of the hidden movements we are concerned with.

TABLE 1

Effective Tax Rates of US Companies, 1975, derived from Tax Notes, and presented to Senate Hearings on Grain Companies.

CORPORATE FEDERAL TAX BURDEN, MAJOR INDUSTRIALS[1]

[Dollar figures represent 1975 pretax financial income. Other figures are expressed as percentages of that base.[3] Weighted industry averages—Worldwide rate: 44 percent—U.S. rate: 24.2 percent]

	duPont de Nemours	Ford Motor Co.	General Electric	General Motors	Goodyear Tire	IBM	International Harvester	ITT	Occidental Petroleum	Procter & Gamble	Tenneco Inc.	Union Carbide	Western Electric	Westinghouse	Number of companies[3]
Base figure (in thousands)[4]	$430,300	$293,900	$887,700	$2,111,715	$313,001	[8] $3,720,877	$144,083	$632,337	$602,763	[5] $621,630	$575,150	$730,600	$185,610	[7] $273,265	14
Statutory Rate	48.0	48.0	48.0	48.0	48.0	48.0	48.0	48.0	48.0	48.0	48.0	48.0	48.0	48.0	14
Permanent items:[4]															
Investment credit	(6.2)	(10.3)	(1.7)	(4.5)	(2.5)		(3.0)	(2.9)	(2.6)	(1.7)	(4.7)	(.8)	(7.7)	(4.7)	13
Capital gains			(.5)					(.9)							2
DISC	(3.3)		(6.8)				(5.0)		[8] (5.7)			(1.3)		[8] (11.3)	6
Foreign tax rates	(.2)	11.7			1.9		5.3	5.7	34.2						6
Percentage depletion[9]									(5.1)		(1.6)				2
Miscellaneous[10]	(1.6)	3.2	.4	3.6	(.5)		(.4)	1.0	1.8		2.8	(1.0)	1.9	.1	12
Quasi-permanent items:[11]															
Accelerated depreciation	1.7	(22.2)	(1.4)		(5.8)		(13.8)	(3.3)		(6.7)	(3.0)		(25.8)	(7.8)	10
Unrepatriated foreign earnings			(1.7)												1
Leasing operations														(3.7)	1
Deferred development costs											(5.7)				1
Worldwide rate on:															
Worldwide income	38.4	30.4	36.3	47.1	41.1	46.5	31.1	47.6	70.6	39.6	35.8	44.9	16.4	20.6	14
Share to foreign governments	(1.8)	(74.4)	(13.0)	(6.8)	(19.5)	(25.9)	(36.0)	(35.6)	(67.8)	(7.2)	(11.3)	(18.3)		(13.6)	13
U.S. rate on worldwide income[12]	36.6	(44.0)	23.3	40.3	21.6	20.6	(4.9)	12.0	2.8	32.4	24.5	26.6	16.4	7.0	14

[1] This chart shows the effective tax rate for 14 of the top 25 firms on the Fortune 500 list of major industrials. 9 of the top 25 are oil companies. Their effective tax rates appear in Tax Notes, May 3, p. 12. United States Steel, 1 of the top 25, appears in Tax Notes, May 10, p. 4. Chrysler Corp., also 1 of the top 25, showed a net loss for 1975.

[2] The base figure for the computations summarized in the table is net earnings before Federal income taxes. This base figure is derived by reducing the net earnings before income taxes, as shown on a firm's income statement, by the provision for State income taxes where such taxes are included in the income tax provision. This is done because State income taxes are merely another deduction for purposes of Federal income taxes. The base figure which results from this subtraction is a more accurate standard for comparison with the Federal statutory rate.

[3] Loss company: Chrysler Corp.

[4] Permanent differences are items such as credits, deductions or exclusions from taxable income which are not intended to be recaptured under the provisions of the Internal Revenue Code. The classification of permanent differences shown in the table is based on the corporation's classification of these items in its form 10K reports filed with the Securities and Exchange Commission.

[5] No single item was material enough to require disclosure.

[6] State and local data not reported separately.

[7] Continuing operations only.

[8] Includes possessions corporation and WHTC income.

[9] Primarily for other than oil and gas.

[10] Categories constituting less than 2.4 percent of net earnings before Federal income taxes are not required by the Securities and Exchange Commission to be separately reported. These categories are often shown as "miscellaneous" on SEC reports.

[11] The quasi-permanent items are those portions of deferred taxes which, in the judgment of Tax Notes' accounting consultant, will probably not be recaptured through taxation in future years. Such items, therefore, reduce the current tax bill and will not increase future tax bills. Hence, the tax reductions to which they give rise are permanent in effect.

[12] The table does not state the U.S. rate on U.S. income, because it is not possible to derive the U.S. income figure from the data currently required to be filed with the Securities and Exchange Commission. On request, Tax Notes will compute and publish the U.S. rate on U.S. income for firms submitting audited data making such a computation possible.

CORPORATE FEDERAL TAX BURDEN, PETROLEUM PRODUCTS COMPANIES

[Dollar figures represent 1974 pretax financial income. Other figures are expressed as percentages of that base.[1] Weighted industry averages—Worldwide rate: 37 percent—U.S. rate: 23 percent]

	Ashland[3] Oil	Belco[2] Petroleum	Dresser[3] Industries	Tesoro Petroleum	United Refining	Universal Oil Products	Number of companies
Base figure (in thousands)[1]	$235,949	$58,330	$216,900	$64,235	$8,129	$39,859	6
tatutory rate	48.0	48.0	48.0	48.0	48.0	48.0	6
Permanent items:[4]							
Investment credit	(2.9)	(2.8)	(2.4)	(7.3)	(5.0)	(3.8)	6
Foreign income tax rates	7.5	(2.3)		(1.6)		(3.1)	4
Percentage depletion	(1.0)	(8.7)	(1.0)	(7.6)			4
Capital gains		(7.6)					1
DISC			(3.1)			(4.1)	2
Western Hemisphere Trading Corp		(1.5)					1
Unrepatriated earnings of foreign subsidiaries	(2.9)		(.5)			(6.2)	3
Miscellaneous[5]	.7	.8	1.1	1.7	.3	(.4)	6
Quasi-permanent items:[6]							
Accelerated depreciation	(4.8)	(.4)	(1.0)	(6.9)	(7.4)	(5.1)	6
Intangible drilling costs	(6.6)						1
Warranty costs			2.0				1
Deferred compensation costs			1.2				1
Worldwide rate on:							
Worldwide income	38.0	25.5	44.3	26.3	35.9	25.3	6
Share to foreign governments	(16.8)	(13.1)	(11.8)	(12.4)		(12.1)	5
U.S. rate on worldwide income[7]	21.2	12.4	32.5	13.9	35.9	13.2	6

[1] The base figure for the computations summarized in the table is net earnings before Federal income taxes. This base figure is derived by reducing the net earnings before income taxes, as shown on a firm's income statement, by the provision for State income taxes where such taxes are included in the income tax provision. This is done because State income taxes are merely another deduction for purposes of Federal income taxes. The base figure which results from this subtraction is a more accurate standard for comparison with the Federal statutory rate.

[2] Fiscal year ending Oct. 31, 1975.

[3] Fiscal year ending Sept. 30, 1975.

[4] Permanent differences are items such as credits, deductions or exclusions from taxable income which are not intended to be recaptured under the provisions of the Internal Revenue Code. The classification of permanent differences shown in the table is based on the corporation's classification of these items in its form 10K reports filed with the Securities Exchange Commission.

[5] Categories constituting less than 2.4 percent of net earnings before Federal income taxes are not required by the Securities and Exchange Commission to be separately reported. These categories are often shown as "miscellaneous" on SEC reports.

[6] The quasi-permanent items are those portions of deferred taxes which, in the judgment of Tax Notes' accounting consultant, will probably not be recaptured through taxation in future years. Such items therefore, reduce the current tax bill and will not increase future tax bills. Hence, the tax reductions to which they give rise are permanent in effect.

[7] The tables does not state the U.S. rate on U.S. income, because it is not possible to derive the U.S. income figure from the data currently required to be filed with the Securities and Exchange Commission. On request, Tax Notes will compute and publish the U.S. rate on U.S. income for firms submitting audited data making such a computation possible.

[Dollar figures represent 1975 pretax financial income. Other figures are expressed as percentages of that base. For 1974 figures, see Tax Notes, Apr. 28, 1975, p. 17. Weighted industry averages—Worldwide rate: 23.7 percent; U.S. rate: (0.4) percent]

	Bank-America	Bankers Trust	Chase	Chemical	Citicorp	Continental Illinois	Manufacturers Hanover	J. P. Morgan	Security Pacific	Wells Fargo	Number of companies
Base figure[1] (in thousands)	468,640	79,832	[6]187,630	107,673	673,966	176,340	209,197	283,432	88,969	80,926	10
Statutory rate	48.0	48.0	48.0	48.0	48.0	48.0	48.0	48.0	48.0	48.0	10
Permanent items:[2]											
Investment credit	(.4)		(1.8)	(.6)		(1.4)	(1.9)	(.1)	(2.1)	(2.0)	8
Tax exempt interest income	(11.0)	(24.2)	(28.8)	(37.0)	(6.5)	(14.6)	(13.8)	(14.6)	(19.4)	(17.3)	10
Capital gains			(4.2)								1
Miscellaneous[3]	(1.2)	(2.3)	4.6	.6	(2.5)	4.0	(2.3)	3.8	.1	.2	10
Quasi-permanent items:[4]											
Leasing, primarily accelerated depreciation	(4.1)	(6.4)	(6.2)	(8.3)	(9.9)	(7.3)	(20.1)	(6.4)	(17.0)	(13.9)	10
Unrepatriated foreign earnings			(3.3)								1
Deferred compensation plans					.7						1
Worldwide rate on:											
Worldwide income	31.3	16.1	10.3	2.8	29.8	28.7	9.9	31.7	9.8	15.0	10
Share to foreign governments	(23.3)	(19.6)	(42.0)	(13.1)	(33.1)	(11.3)	(17.0)	(23.9)	(6.1)	(7.9)	10
U.S. rate on worldwide income[5]	8.0	(4.6)	(31.7)	(10.5)	(3.3)	17.4	(7.3)	7.8	3.6	7.1	10

[1] The base figure for the computations summarized in the table is net earnings before Federal income taxes. This base figure is derived by reducing the net earnings before income taxes, as shown on a firm's income statement, by the provision for State income taxes where such taxes are included in the income tax provision. This is done because State income taxes are mostly another deduction for purposes of Federal income taxes. The base figure which results from this subtraction is a more accurate standard for comparison with the Federal statutory rate.

[2] Permanent differences are items such as credits, deductions or exclusions from taxable income which are not intended to be recaptured under the provisions of the Internal Revenue Code. The classification of permanent differences shown in the table is based on the corporation's classification of these items in its form 10K reports filed with the Securities and Exchange Commission.

[3] Categories constituting less than 2.4 percent of net earnings before Federal income taxes are not required by the Securities and Exchange Commission to be separately reported. These categories are often shown as "miscellaneous" on SEC reports.

[4] The quasi-permanent items are those portions of deferred taxes which, in the judgment of Tax Notes' accounting consultant, will probably not be recaptured through taxation in future years. Such items, therefore, reduce the current tax bill and will not increase future tax bills. Hence, the tax deductions to which they give rise are permanent in effect.

[5] The table does not state the U.S. rate on U.S. income, because it is not possible to derive the U.S. income figure from the date currently required to be filed with the Securities and Exchange Commission. On request, Tax Notes will compute and publish the U.S. rate on U.S. income for firms submitting audited data making such a computation possible.

[6] Net of gain on sale of investment.

TIMBER COMPANIES

[Dollar figures represent 1975 pretax financial income. Other figures are expressed as percentages of that base[1] for 1974 figures; see Tax Notes, June 2, 1975, p. 15. Weighted industry average—Worldwide rate: 21.1 percent; U.S. 6 percent]

	Boise Cascade	Champion International	Evans[6] Products	Georgia-Pacific	Louisiana Pacific	Potlach Corp.	St. Regis Paper Co.	Weyer-Haeuser	Willamette	Number of companies
Base figure (in thousands)[1]	96,187	80,558	5,691	221,560	17,380	40,531	124,830	300,086	49,983	9
Statutory rate	48.0	48.0	48.0	48.0	48.0	48.0	48.0	48.0	40.0	9
Permanent items:[2]										
Investment credit	(7.3)	(15.4)	(46.6)	(7.1)	-------	(9.5)	(7.2)	(10.7)	(3.1)	8
Capital gains	(7.5)	(15.2)		(11.5)		(18.7)	(6.4)		(13.4)	6
DISC					(15.3)					1
Foreign rules			16.6							1
Miscellaneous[3]	.4	6.9	139.7	3.8	[4](10.2)	3.0	4.6	(1.2)	2.4	9
Quasi-permanent items:[4]										
Accelerated depreciation	(2.5)	(2.8)	(66.5)	(13.0)	(20.0)	(4.1)	(4.2)	(13.6)	(4.8)	9
Capitalized interest expense				(2.9)	(1.9)			(3.4)		3
DISC								(2.5)	(1.6)	2
Unrepatriated foreign earnings							(7.0)			1
Deferred compensation costs							.4			1
Worldwide rate on:										
Worldwide income	31.1	21.5	90.3	17.3	.6	18.7	28.2	16.7	27.6	9
Share to foreign government	(6.9)	(9.7)	(4.1)				(11.6)	(1.2)		9
U.S. rate on worldwide income[5]	24.2	11.8	86.2	17.3	.6	18.7	16.6	15.5	27.6	5

[1] The base figures for the computations summarized in the table is net earnings before Federal income taxes. The base figure is derived by reducing the net earnings before income taxes, as shown on a firm's income statement, by the provision for State income taxes when such taxes are included in the income tax provision. This is done because State income taxes are merely another deduction for purposes of Federal income taxes. The base figure which results from this subtraction is a more accurate standard for comparison with the Federal statutory rate.

[2] Permanent differences are items such as credits, deductions or exclusions from taxable income which are not intended to be recaptured under the provisions of the Internal Revenue Code. The classification of permanent differences shown in the table is based on the corporation's classification of these items in its form 10K reports filed with the Securities and Exchange Commission.

[3] Categories constituting less than 2.4 percent of net earnings before Federal income taxes are not required by the Securities and Exchange Commission to be separately reported. These categories are often shown as "miscellaneous" on S.E.C. reports.

[4] The quasi-permanent items are those portions of deferred taxes which in the judgment of Tax Notes' accounting consultant, will probably not be recaptured through taxation in future years. Such items, therefore, reduce the current tax bill and will not increase future tax bills. Hence, the tax reductions to which they give rise are permanent in effect.

[5] The table does not state the U.S. rate on U.S. income, because it is not possible to derive the U.S. income figures from the data currently required to be filed with the Securities and Exchange Commission. On report, Tax Notes will compute and publish the U.S. rate on U.S. income for firms submitting audited data making such a computation possible.

[6] The large percentages reflect relatively small dollar amounts and are primarily due to the effects of discontinued operations and the prior year's loss.

[7] Includes effect of timing change in the adoption of the LIFO method of accounting for inventories.

[8] Loss company: Edward Hines Co.

CORPORATE FEDERAL TAX BURDEN, OIL COMPANIES

[Dollar figures represent 1975 pretax financial income. Other figures are expressed as percentages of that base.[1] For 1974 figures, see "Tax Notes," Apr. 22, 1975, p. 7. Weighted industry average—Worldwide rate: 65.3 percent—U.S. rate: 10.0 percent]

	Atlantic Richfield	Continental Oil	Exxon[2]	Gulf	Mobil	Shell	Standard of California	Standard of Indiana	Texaco	Number of companies
Base figure (in thousands)[1]	$861,219	$1,021,260	$9,891,125	[3]$2,712,000	$3,145,228	$867,729	$1,359,169	$1,956,687	$1,811,627	9
Statutory rate	48.0	48.0	48.0	48.0	48.0	48.0	48.0	48.0	48.0	9
Permanent items:[4]										
Investment credit	(4.7)	(1.7)	(.6)		(1.3)	(4.7)	(3.5)	(2.2)		7
Percent depletion[5]	(2.5)	(3.1)	(.8)	(1.1)	(.7)	(1.6)	(.9)	(1.8)	(2.5)	9
Foreign taxes	16.2	20.3	27.3	29.8	31.8		18.5	14.1	23.2	8
Equity in net income of affiliates, net							(18.4)		(14.2)	2
Miscellaneous[6]	2.3	.8	(.5)	(2.5)	(3.5)	(1.0)	(1.2)	1.7	(1.3)	9
Quasi-permanent items:[7]										
Accelerated depreciation	(5.8)	(1.9)		(.8)	(3.0)			(2.7)	(2.2)	6
Capitalized exploration costs	(2.3)								(.3)	2
Intangible drilling costs	(2.7)	(1.1)		(.6)				(2.1)	(4.4)	5
Lease amortization	3.1	.7		(.8)					2.4	4
Worldwide rate on:										
Worldwide income	51.6	62.0	73.4	72.0	71.3	40.7	42.5	55.0	48.7	9
Share to foreign governments	(36.2)	(50.7)	(60.0)	(69.8)	(72.7)	(.1)	(40.5)	(37.5)	(45.3)	9
U.S rate on worldwide income[8]	15.4	11.3	[2]13.4	2.2	(1.4)	40.6	2.0	17.5	3.4	9

[1] The base figure for the computations summarized in the table is net earnings before Federal income taxes. This base figure is derived by reducing the net earnings before income taxes, as shown on a firm's income statement, by the provision for State income taxes where such taxes are included in the income tax provision. This is done because State income taxes are merely another deduction for purposes of Federal income taxes. The base figure which results from this subtraction is a more accurate st ndard for comparison with the Federal statutory rate.

[2] Exxon has reported that it's U.S. ratio on U.S. income is 42.1 percent.

[3] State tax burden not separately reported.

[4] Permanent differences are items such as credits, deductions or exclusions from taxable income which are not intended to be recaptured under the provisions of the Internal Revenue Code. The classification of permanent differences shown in the table is based on the corporation's classification of these items in its form 10K reports filed with the Securities and Exchange Commission.

[5] Figure reflect repeal of depletion allowance for oil and gas in 1975.

[6] Categories constituting less than 2.4 percent of net earnings before Federal income taxes are not required by the Securities and Exchange Commission to be separately reported. These categories are often shown as "miscellaneous" on SEC reports.

[7] The quasi-permanent items are those portions of deferred taxes which, in the judgment of Tax Notes' accounting consultant, will probably not be recaptured through taxation in future years. Such items, therefore, reduce the current tax bill and will notincrease future tax bills. Hence, the tax reductions to which they give rise are permanent in effect.

[8] The table does not state the U.S. rate on U.S. income, because it is not possible to derive the U.S. income figure from the data currently required to be filed with the Securities and Exchange Commission. On request, Tax Notes will compute and publish the U.S. rate on U.S. income for firms submitting audited data making such a computation possible.

There are already a number of papers before this conference which discuss in detail how control programmes can be made more effective, notably the paper presented by the USIRS and that by Reg Green. I want merely to register five points which seem to me important elements of any control package:

1. Reduce international company power by abrogating public regulations and inter-state agreements which enables super-marginal profits to be realised and remitted without effective local tax. The repeal of patent laws is the most obvious example under this heading, but our previous discussion also suggests that underdeveloped countries should look seriously at double tax treaties with developed countries which specify the allocation of developed country fixed costs (including R & D) to the costs of a third world affiliate.

2. Total control. State monitoring and enforcement measures should cover all avenues of international firm transfactions across national boundaries.

I have mentioned a number of these above, and I need only emphasise that the Business literature indicates that firms themselves regard the various channells as alternatives. The NICB study of firms reactions to the US 482 regulations noted that the companies surveyed felt that the analytical approach of the regulations did not coincide with reality. Large firms reported that they frequently consider prices, interest rates, fees as part of a pricing package - concessions granted in one area may be compensated for in another, perhaps to take account of differential local tax or exchange control measures in attempts to reduce the foreign rather than the domestic tax burden. This conference deals with a number of these channells, notably insurance premia, royalty payments, and straight transfer pricing. The one I would like to mention from my research work on technology transfer in Ethiopia is the pricing of machinery. Over-

pricing equipment has a number of advantages: it reduces the effective foreign capital commitment where the latter is set to cover the foreign exchange costs of start up; it inflates the asset base thus lowering the rate of return on net assets; it increases the depreciation provisions which can be set against income lowering the taxable profit; it increases the sum that can be claimed against the government in the event of a takeover; and it is often difficult to detect.

We should note too under this heading that hidden profit repatriation is not necessarily confined to intra-firm transfers. There may also be intra-system transfers, where the parties are formally independent but are effectively joint. This is particularly common in some sectors, such as hotels, airlines, and soft drinks.

3. State as a Monopoly. It is clearly imperative that an underdeveloped country government deals with an international firm as a consolidated rather than a disorganised power. In the case of transfer pricing, the fact that price is not only a distributor of resources, but also a sign for government economic management, means both that many departments are affected by the issue of transfer pricing, and may have divergent interests towards the prices finally settled. The contrary interests between customs and revenue departments is the clearest example, but we should also consider the part that transfer pricing control and monitoring plays for price control, industrial development policy particularly with regards to incentives and tariff protection, compensation commissions considering claims after nationalisation, and departments of labour. It is common to find the departments concerned holding separate and sometimes contradictory information,

and/or making contrary estimates to suit the department's goals. With a more active interventionist role as advocated by the fifth approach, it is clearly necessary to set up machinery first to co-ordinate the information, and second to co-ordinate the investigation and bargaining with the firm. The final conditions which a government yields to a foreign firm operating in its country are as much a package as the various channels which firms use to expatriate profits. The firm is interested eventually in the total package: franchises, tariffrates, various taxes, local purchase and employment provisions, export and import directives and so on. A country may yield on some which are less important in order to hold fast on others. Very often indeed it is a non zero sum question: freedom of imports may be much more important to the firm than it is to the local government, or to take a financial example, a quick pay back period can be yielded to the firm, linked to severe taxation in the longer term, and because of differential discount rates, both parties could gain in present value terms.

4. Underdeveloped countries should consider individually and together what action can be taken to discriminate against what have been called 'blackleg' states, principally tax havens. The curtailment of tax havens would not remove the incentive to transfer price - that will remain as long as there is a tendency for accumulation to take place in the advanced industrial countries. But the removal of the incentive of the large tax savings by transfer pricing to tax havens could be expected to have some positive effect on 'normal' tax third world countries.

5. Open the Books - The question of access to information is perhaps the hub of the issue of control, and i quite rightly one of the central questions of the Conference. I would like to make only three points. First, the tradition of confidentiality which stems from the developed country view of the state as non-interventionist, is quite inappropriate in the circumstances of many third world countries pursuing the administrative, bargaining strategy of the fifth approach. Second, any control department clearly needs matching resources to those of the firms with which it is dealing. This is a problem even for such large and sophis-

ticated bodies as the US IRS. The difficulties are exemplified in a case cited in their Montivideo paper:

"In one of our cases, a company with a foreign parent had a number of agreements, each regulating some aspect of R & D. Some agreements dealt with basic research and some with applied research or technical aspects of the already invented products. The research program was so complicated that, to make a proper audit of such arrangements, it was not sufficient to know merely the techniques of auditing. It was also necessary to understand the industry in technical detail, the technology of production, the flow and mix of products, the value of intangibles, the characteristics of financial arrangements which supported the manufacturing and selling operations, and finally, the laws of a number of countries. Only after a careful analysis of all these factors were we able to formulate an opinion as to whether the respective actions and operations of the MNCs had any substance over and above the consideration to minimise taxes". (p.6)

Thirdly, and this brings me to a final comment on control as elaborated by the fifth approach, there is a real question of whether it is possible to get adequate information from outside a large integrated international firm. There is a question in short about whether international firms can be controlled in the sphere of circulation (monitoring prices and financial flows), or whether in fact it is also necessary to control production itself. The reasons for this concern not only information, but the political power to carry through effectively the strategy outlined by the fifth approach. In as much as power lies ultimately in the power to produce, international firms with that power have been seen to use the market and political advantages to which that power gives rise to establish strong allies against policies advocated by the fifth approach. If this is so, then effective control could in the long run only come about through controlling production, and in doing so once more uniting the spheres of distribution (the national bounty/levy economy) with that of production (directly socialised labour). It may be therefore that it is only along these lines that the control advocated by the bargaining approach could in the end be effectively realised.

NOTES

1. The issue is discussed in: Gerry Helleiner, "Intrafirm Trade and the Developing Countries: Patterns, Trends and Data Problems", paper presented to UNCTAD/IDS Seminar on Intra-firm Trade, November 1977.

2. For the developments in transfer pricing literature, see Jeffrey S Arpan, "International Intra-Corporate Pricing: Non-American Systems and Views", Praeger, 1971, Chapter 2.

3. Jack Hirschleiffer, "Economics of a Divisionalised Firm", in Journal of Business XXX 3, April 1957, pp 96-108.

4. One exception is Copithorne who has argued that transfer pricing does not affect global output and prices of the firm, only the distribution of revenues within the firm. See L W Copithorne, "International Corporate Transfer Prices and Government Policy" in: Canadian Journal of Economics IV 3, August 1971.

5. For reasons why profit is not necessarily a good measure of performance, see H C Verlage, "Transfer Pricing for Multinational Enterprise", Rotterdam University Press, 1975, Chapter 4.

6. David Rutenberg, "Manoeuvring liquid assets in a multinational company: formulation and deterministic solution procedures" in: Management Science, Vol 16 No 10, June 1970, pp B671-B684. Michael Edwardes-Ker, "International Tax Strategy", In-Depth Publishing, 2 vols, 1974-date. Other valuable books include: D B Zenoff and J Zwick, "International Financial Management", Prentice Hall, 1969, the volume edited by A L Stonehill, "Readings in International Financial Management", Goodyear, 1970, and the Harvard study by S M Robbins and R B Stobaugh, "Money in the Multinational Enterprise", Basic Books, 1973.

7. "Business International, Solving International Pricing Problems", New York, 1965; James Shulman, "Transfer Pricing in Multinational Business", PhD dissertation, Harvard, 1966, and a more accessible article by the same author, "When the Price is Wrong by Design", Columbia Journal of World Business, II 3, May-June 1967, pp 69-77; Arpan, op cit.

8. Edith Penrose noted a firm who kept three sets of books, one for internal management, one for the tax authorities, and one for the shareholders. See her book, "The Large International Firm in Developing Countries: the International Petroleum Industry", Allen & Unwin, 1968, p 44, note 1.

9. See the paper by G N Carlson and G C Hufbauer, "Tax Barriers to Technology Transfer", presented to this conference, and also the survey in Edwardes-Ker, op cit.

10. The Brussels Definition of Value is reprinted in Verlage op cit, pp 92 sq.

11. Colin Greenhill developed this approach at the UNCTAD/IDS conference on Intra-firm Trade, November 1977. See the video tape report on the conference. There are indications of it in the UNCTAD paper to that conference, "Dominant Positions of Market Power of Transnational Corporations: Use of the Transfer Pricing Mechanism", but it is not spelled out there explicitly.

12. See for example the testimony of Walter Sauders, Vice President of Cargill Corporation, the international grain traders, to the Senate Hearings on Multinational Corporations:

    "Taxes are a critical cost element in our business. Unlike firms involved in manufacturing operations, commodity traders possess no unique advantages like patents, trademarks, brand franchises, technology or product superiority which enable them to absorb higher tax costs. We all buy and sell the same commodities, dealing with the same sellers and the same buyers. To compete on equal terms, we had to seek tax costs no greater than those accessible to established foreign owned competitors."

    US Congress, Senate, Committee on Foreign Relations, Sub-Committee on Multinational Corporations, Multinational Corporations and United States Foreign Policy, 94th Congress, second session on International Grain Companies, June 18, 23 and 24 1976, Part 16, p 101.

13. The leading contributors to the monopoly approach have been Constantine Vaitsos (see in particular "Inter-country Income Distribution and Transnational Enterprises", Oxford, 1974) and Norman Girvan, "Corporate Imperialism in the Caribbean Bauxite Industry", in his collection of essays, "Corporate Imperialism: Conflict and Expropriation", Sharpe, 1976, pp 98-159, though many other authors have developed this approach to multinational corporations without so detailed a discussion of transfer pricing. We should also note the large body of work produced by the Transfer of Technology Division at UNCTAD which has been based on this perspective.

14. Peter Fitzpatrick's paper to the current conference brings out the legal side of this alternative view very well.

15. A sixth approach was suggested by David Evans during the UNCTAD/IDS conference on Intra-firm trade. He argued

19. In some cases where it is possible to make distinctions other than through area, for example through skin colour or language, the territorial element may be less significant, but it is striking that in such circumstances the state still has problems of confining 'bounty' without some form of spatial separation.

20. National Industrial Conference Board, "Interdivisional Transfer Pricing" in: "Studies in Business Policy", No 122, 1967.

21. Quoted in Verlage, op cit, p 187. It is interesting to note that most of the non-US firms studies by Arpan had no profit centres, see Arpan, op cit, p 75.

22. The relation between the forces of the world market, and the institutional power of international firms and states is discussed more fully in my paper cited in note 18.

23. The Republic of Minerva is a small reef off Fiji and Tonga. The Financial Times (20 November 1972) stated that certain people in California and Nevada had enrolled as Minerva's first citizens and that a Reno doctor, Dr David Williams, the Secretary of the Interior of Minerva's four-man provisional government, intended to start dredging operations to build up the reef to between 10 and 15 feet above sea level. The Financial Times reported that Dr Williams admitted that the reef is "not really livable as it is," but that once the dredgers had been in, "people will be free to do as they damn well please". The Financial Times also reported that the Tongolese were not particularly friendly and that King Taufa'ahau Tupou of Tonga had personally stormed the reef in full military regalia to raise the flag of Tonga, replacing the Republic flag which had been 'bravely' flying on the reef. This is reported in Edwardes-Ker, op cit, Chapter 32, section 3, p 26.

24. Edwardes-Ker, in particular Chapter 5.

25. On the US Valuation standards, see "Customs Valuation, Report of the US Tariff Commission to the Committee on Finance and the Sub-Committee on International Trade", US Senate, March 14 1973.

26. See International Grain Companies hearings, (note 12), and the various discussions surrounding the Trick memorandum.

27. Verlage, op cit, p 91.

28. Ibid, p 86.

29. Tariff Commission Report, op cit, p 78.

30. See reprint in Verlage, op cit, p 93.

that disregarding the points about monopoly and non-marketability within international firms, the price system itself reflected a particular set of social relations which were themselves open to question. The issue was at the centre of the debate between traditional utilitarian international economic theory and the 'new' approaches to trade: neo-Ricardian, Unequal Exchange, and the Marxist social value school. What was clear from this debate was the problematic nature of market prices as in any sense just or desirable prices from the point of view of labour. David Evans himself suggested that the Marxist Circuits of Capital Theory could enlighten the transfer pricing debate, by isolating those sections of the circuit where exchange between independent parties did take place (purchase of labour power, raw materials and means of production, and sale of the final commodity) from those where it did not (circulation of use values within a firm for further processing). In as much as it was the latter aspect of circulation which was under discussion in the transfer pricing debate, then the arguments about non-commensurability were particularly strong. See his note: "Intra-firm transactions and the circuits of capital: a note" in: UNCTAD/IDS Conference,"Intra-firm Transactions and their Impact on Trade and Development, a Report of the Proceedings", prepared by Frank Ellis and Susan Joekes, November 1977.

16. In addition to the authors mentioned in note 13, see also the article by Stephen Hymer, "The Multinational Corporation and the Law of Uneven Development" in: Charles Kindleberger (ed) "The International Corporation", MIT, 1970.

17. See the important work of Gerry Helleiner, The UNCTAD Manufacturing Division, and Constantine Vaitsos in his paper, "The Integration of Latin America with the Rest of the World in view of the Operations of Subsidiaries of TNEs", all of them presented to the UNCTAD/IDS conference on Intra-firm Trade.

18. On the changing character of the social nexus under capitalism, see the work of Alfred Sohn-Rethal, notably: "The Dual Economics of Transition" in the Bulletin of the Conference of Socialist Economists, No 2.2 1972, reprinted in the Conference of Socialist Economists collection, "The Capitalist Labour Process", CSE/Stage 1, 1976, as well as his longer book, "Intellectual and Manual Labour", Macmillan, 1978. On the connection of the socialisation of labour to international firms, see my paper, "Underdevelopment, International Firms and the International Division of Labour", in: "Towards a New World Economy", Rotterdam University Press, 1972, pp 161-247.

31. See Maurice Collins' paper "Suggested Guidelines - payment for goods - technology - services", originally submitted to the UN Expert Group on Tax Treaties between Developed and Developing Countries, Geneva, October-November 1977.

32. Ibid, pp 5, 7 and 13.

33. Verlage, op cit, pp 110, 115, 116 and 117.

34. United States Internal Revenue Service, "Multinational Companies, Tax Avoidance and/or Evasion Schemes and Available Methods to Curb Abuse", paper presented to 18th Technical Conference of CIAT, Montevideo, March 1977, p 2.

35. Arpan, op cit, p 79.

36. US Treasury Department, "Summary Study of International Cases involving Section 482 of the Internal Revenue Code", Washington, January 1973, Tables 2 and 8.

37. Edwardes-Ker, op cit, Chapter 5, Section 7, p 16.

38. On the debate in Britain, see the interesting paper by Grahame Thompson, "Capitalist Profit Calculation and Inflation Accounting", Open University, October 1977.

39. The Monopolies Commission, "Chlordiazepoxide and Diazepam", HMSO, 1973, para 223, pp 65-6.

40. Ibid, para 192, p 56. See pages 53-6 for a summary of the whole Roche argument.

41. Frank Ellis, "Transfer Pricing in Bananas", paper to this conference.

42. Norman Girvan, op cit.

43. I have discussed the principles of pricing and the issues of risk, discounting, and sunk costs in relation to the debate in the UK on the pricing of North Sea Natural Gas. See: "Pricing North Sea Gas: Case Study and Commentary", London Business School, 1969.

44. See the paper to UNCTAD/IDS November conference, op cit, and that to the current conference.

45. UNCTAD Manufactures Division, op cit, Chapter III, pp 21-35.

46. International Grain Companies hearings, op cit, p 7 for table.

47. Robin Murray, "The Internationalisation of Capital and

the British Economy" in: J Samuels (ed) "Readings in Mergers and Takeovers", Elek Books, 1971, Table 5, p 284.

48. International Grain Companies hearings, op cit, p 234.

49. Edwardes-Ker, op cit, Chapter 5, pp 10-11.

50. Ibid, Chapter 5, p 17.

51. US IRS, op cit, p 2.

52. Vaitsos, op cit, pp 99-107.

53. The evidence for this paragraph comes from the following: "US Treasury Summary Study of Cases Involving Section 482", Table 4; Oscar Hernandez Sierra, "Control of Transfer Pricing by Multinational Companies: Case Study of INCOMEX in Colombia", in: "Report of UNCTAD/IDS Conference on Intra-firm Transactions, op cit, p 29; P V Roumeliotis and C P Golemis, "Transfer Pricing and the Power of Multinational Enterprises in Greece", paper submitted to the UNCTAD/IDS conference on Intra-firm Trade, November 1977; Norman Girvan, op cit, and Frank Ellis' paper to the current conference.