



INTL TRANSFER PRICING ABUSE: Sizing the Problem

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Measuring International Transfer Pricing Abuse

- What Is It?
- Why Do We Care?
- What Do We Know?
- What's Next?




Summary

- Aggregate ITP metrics -- \$100b-\$150 b/yr "consensus" so far, but very rough
- Beyond aggregate estimates, detailed case studies produce striking new results
 - Examples: Mexico, Zambia, Switzerland, India, China
 - New forms of ITP abuse
 - Growing role of of secrecy jurisdictions in ITP abuse
 - Growing MNC abuses of traded services, intangibles
- **This needs to be a TJN research priority**

Why should we care?





If you cannot express it in numbers, your knowledge is of a meager and unsatisfactory kind.

-- Lord Kelvin, 1889

(...and #s can drive policy)

Growth Factors – TP Abuse

- Corporate globalization
 - Trade+investment
 - Traded services
 - Financial chicanery
- `‘Abuser`’ industry growth
 - Software
 - Big pharma
 - Extraction
 - Finance
- Rise of secrecy jurisdictions
 - “Offshore”
 - “Onshore”
- Rise of “enabling experts”
 - Accounting firms
 - Law firms
 - Major banks
- Official support for “corp-friendly” standards



- Limited developing country tax resources and skills
- Balkanized competing jurisdictions (vs. MNC solidarity on this issue)
- Global TJ resources
 - Policy analysis, design, redesign
 - Training, feedback

**EXAMPLE: PROFITABILITY OF FOREIGN AFFILIATES, US MNCS
(2007 \$Billions)**

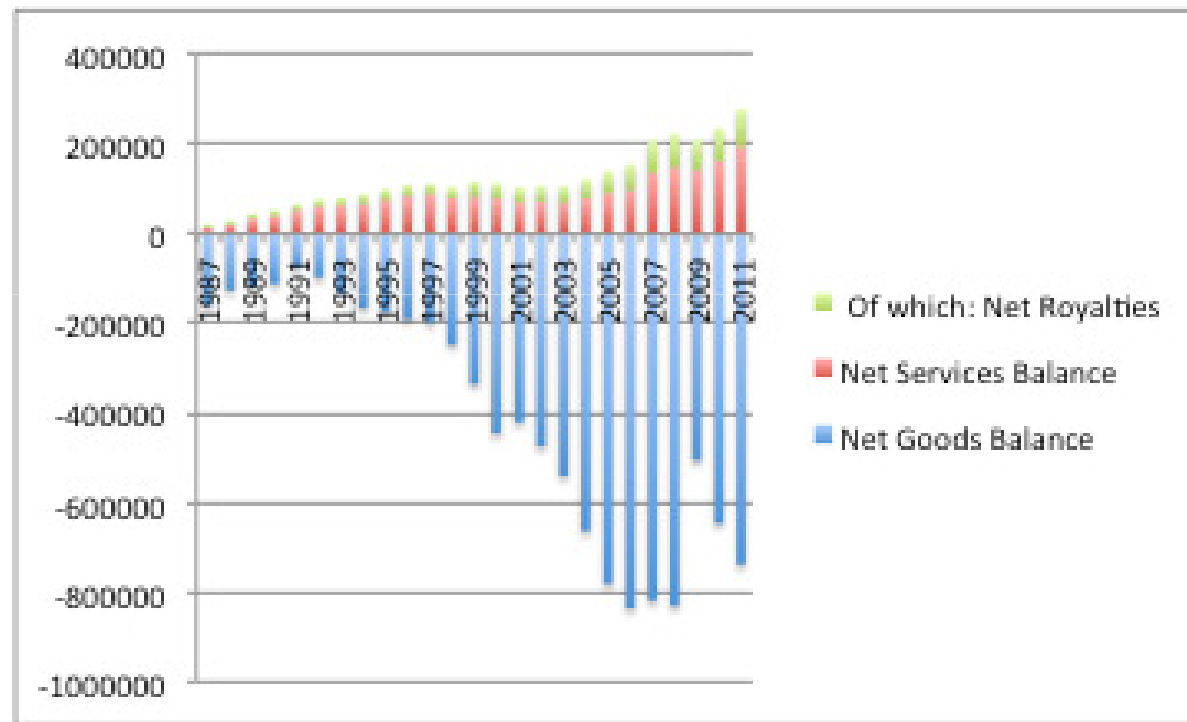
	Before-tax Profits	Effective Tax Rate	Profit per Employee (\$MM)
Bermuda	\$16.2	.026	\$5.4
Singapore	\$14.6	.074	\$.115
Ireland	\$45.4	.077	\$.488
Switzerland	\$18.2	.091	\$.219
Cayman Islands	\$7.4	.094	\$1.123
5 Haven Total	\$101.8	.072	\$.326
Global Total	\$430.2	.296	\$.043

Source: M. Sullivan, Tax Analysts, July 2010 testimony, US House +Ways Committee

Apple – China “value chain”

- 20 mm Ipad/yr @ \$500 retail = \$10 b.
- 65k US workers (35k in retail stores)
- 1.2 mm Chinese workers (Foxconn)
- \$40/Ipad = \$800 mm to China
- \$2.2 b royalties for IP, brand to offshore jurisdictions w 3% tax rate
- Total non-China gross margin = \$9.2 b – sales and marketing – royalties = \$6 b
- Total effective tax on non-COGS margin = <10%, mainly to US IRS

Growth of MNC Traded Services (US Example, 1986-2011)

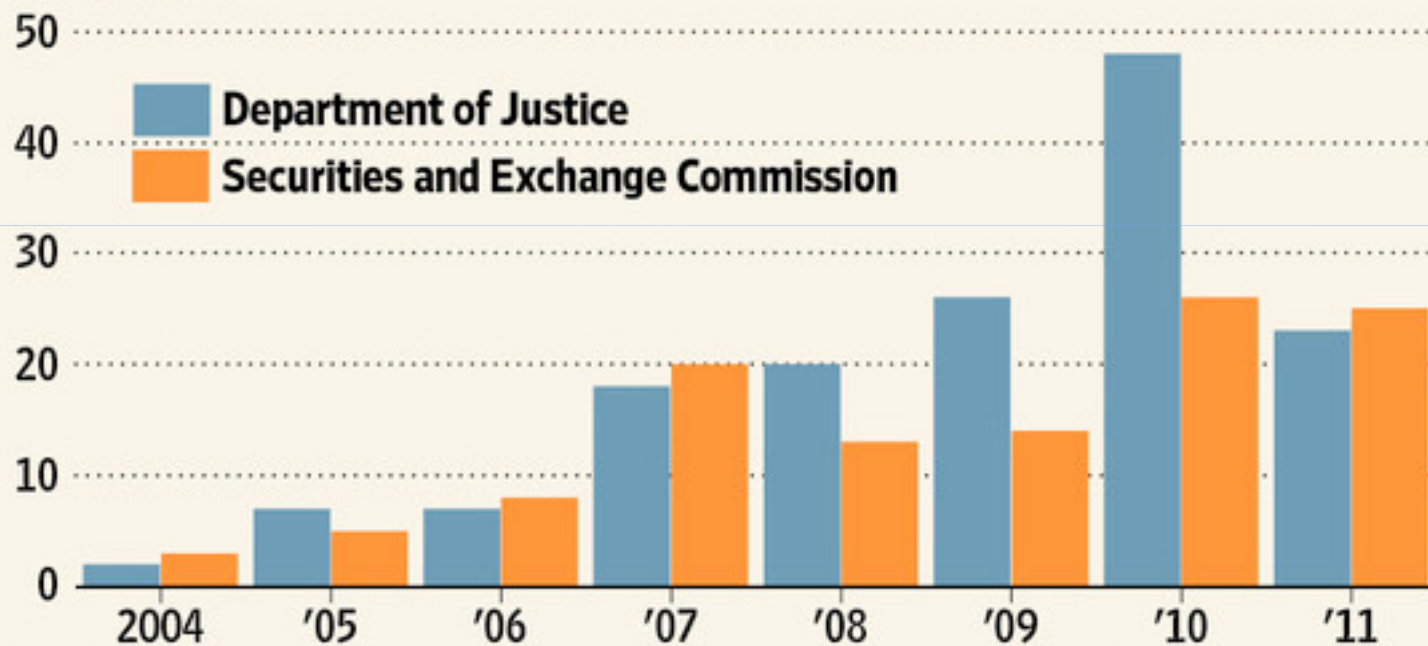


Many recent ITP abuses involving leading MNCs..

- Banana exporters cases (2006-)
- SABMiller (2008-): South Africa, 4 other countries
- Glencore (2011-): Zambia
- Grain exporters (2011-): Argentina
- Intellectual property abuses: Google, Pfizer, GE, Cisco, Forest Labs, etc. (2009-)
- Big bank tax evasion (soon...)

Growth Industry

Number of Foreign Corrupt Practices Act actions initiated by U.S. authorities



Note: SEC and Justice Department enforcement actions frequently involve the same cases.

Source: Gibson, Dunn & Crutcher LLP

The Wall Street Journal

Many leading TNCs also involved in FCPA cases

Top 10 US penalties (\$MM) as of 1/12

- Siemens (\$800->\$1700,'08)
- **Halliburton/KBR (\$579,'09)**
- BAE(\$400,'10)
- Technip (\$338,'10)
- Daimler (\$185,'10)
- Alcatel-Lucent (\$137,'10)
- Shell/Panalpina (\$82,'10)
- ABB (\$58,'10)
- **Pride (\$56,'10)**
- Baker Hughes ('07)
- Willbros ('08)
- Chevron ('07)
- Titan ('05)

Now in the works...(DOJ/SEC:+75)

- **Alcoa**
- **Allianz**
- **AstraZeneca**
- **Avon (grand jury re China)**
- **China NE Petrol Corp**
- **BHP Billiton**
- **Bridgestone Tire**
- **Deere & Co**
- **Glaxo**
- **HP (Europe)**
- **IBM**
- **Ingersoll**
- **Johnson & Johnson**
- **Lilly**
- **LV Sands/Adelson**
- **Merck**
- **Morgan Stanley**
- **Pfizer**
- **Raytheon**
- **Tyco, etc etc. etc.**

Illustrative

Global Distribution, Net Financial Assets

		Total Number	Ave. Net Financial Worth Per Capita (\$MM)	Total Liquid Net Worth (\$Tr.)	Of Which: "Offshore" (\$Tr.)	% of All Global Net Financial	% of All People
"Happy Few"	>\$30 MM	91,186	\$183.1	\$16.7	\$9.8	30.3%	0.001%
"Just Rich"	>\$5-\$30 MM	839,020	\$12.8	\$10.7	\$5.1	19.4%	0.01%
"Barely Rich"	>\$1-\$5 MM	8,419,794	\$2.1	\$17.4	\$4.7	31.6%	0.13%
GLOBAL ELITE	All >\$1 MM	9,350,000	\$4.4	\$44.8	\$19.6	81.3%	0.14%
EVERYONE ELSE		6,643,863,592	\$0.0016	\$10.3	\$1.0**		99.86%
TOTAL		6,653,213,592	\$0.01	\$55.1	\$20.6	100%	100%

** Foreign currency (mainly dollars and euros)

Source: ML/Cap Gemini (2001-09); World Bank data; UN Wider (07); US Treasury (09); our analysis

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Recent ITP Abuse Estimates

- Since 2000, flurry of aggregate ITP misinvoicing and "tax loss" estimates
- Most based on "trade partner comparison" methods
- Rough consensus on global revenue loss of \$100-\$150 billion/ yr., but much room for improvement
- No aggregate estimates for trade services, intellectual property transfer abuse
- Aggregate estimates have tended to obscure the role of havens and secrecy jurisdictions

Basic Concept -- Adjusted Partner Trade Measure

Total Misinvoicing = Export Misinvoicing + Import Misinvoicing

“Export Misinvoicing”: $\sum \sum ((X^*_{ijt} (1 + CIF_{ijt}) - \sum \sum M^w_{ijt}))$

“Import Misinvoicing”: $\sum \sum (M^*_{ijt} - \sum \sum (X^w_{ijt} (1 + CIF_{ijt})))$

Where: X^* = Country X's Reported FOB goods exports per commodity per trading partner at time t, in a common currency\

M^* = Country X's Reported CIF goods imports per commodity per trading partner at time t, in a common currency

X^w = Sum of world's reported FOB goods exports per commodity per trading partner at time t, in a common currency

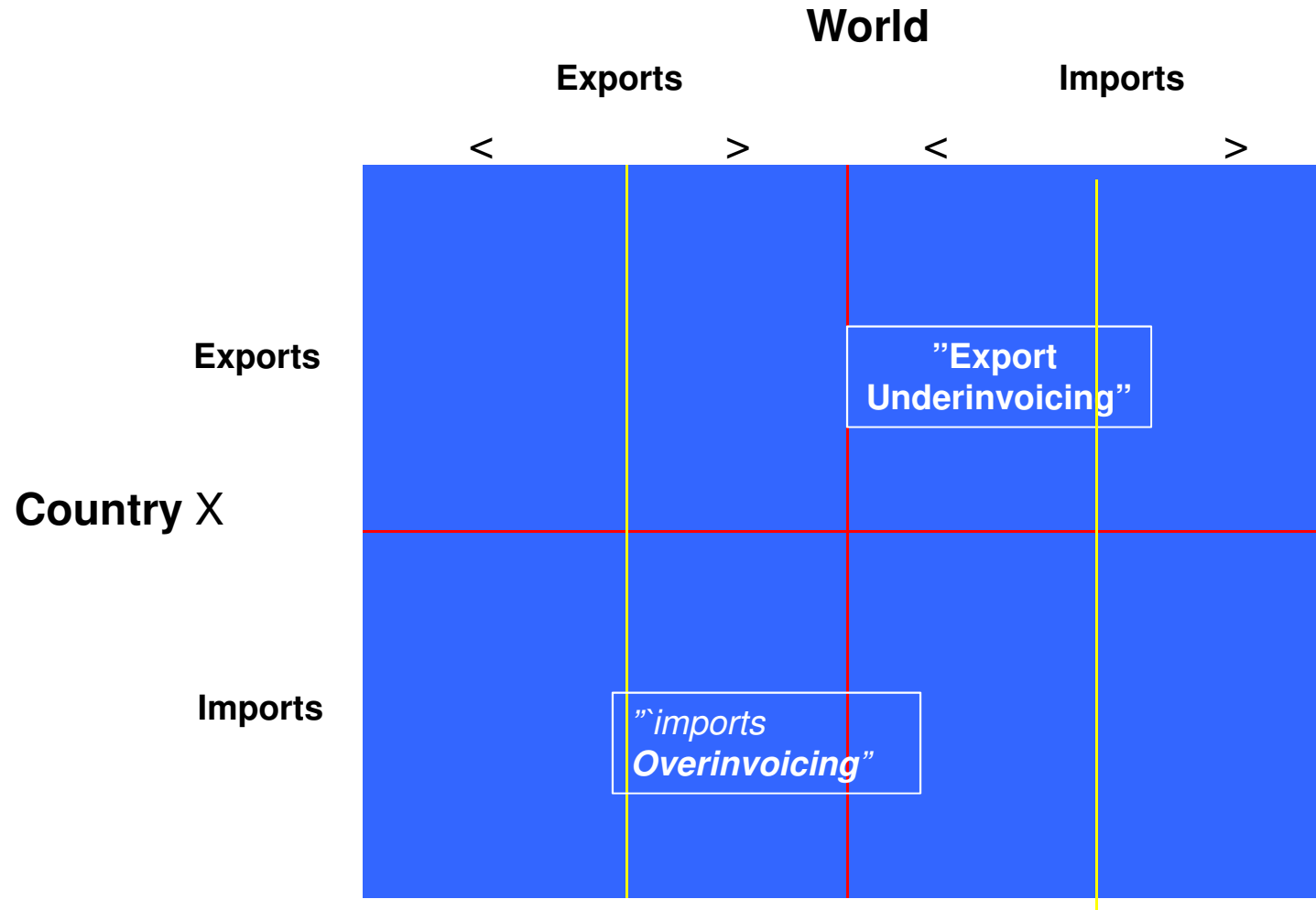
M^w = Country X's Reported CIF goods imports per commodity per trading partner at time t, in a common currency

CIF_{ijt} = “normal trade costs,” including customs, insurance and freight, for commodity j and trading partners j at time t

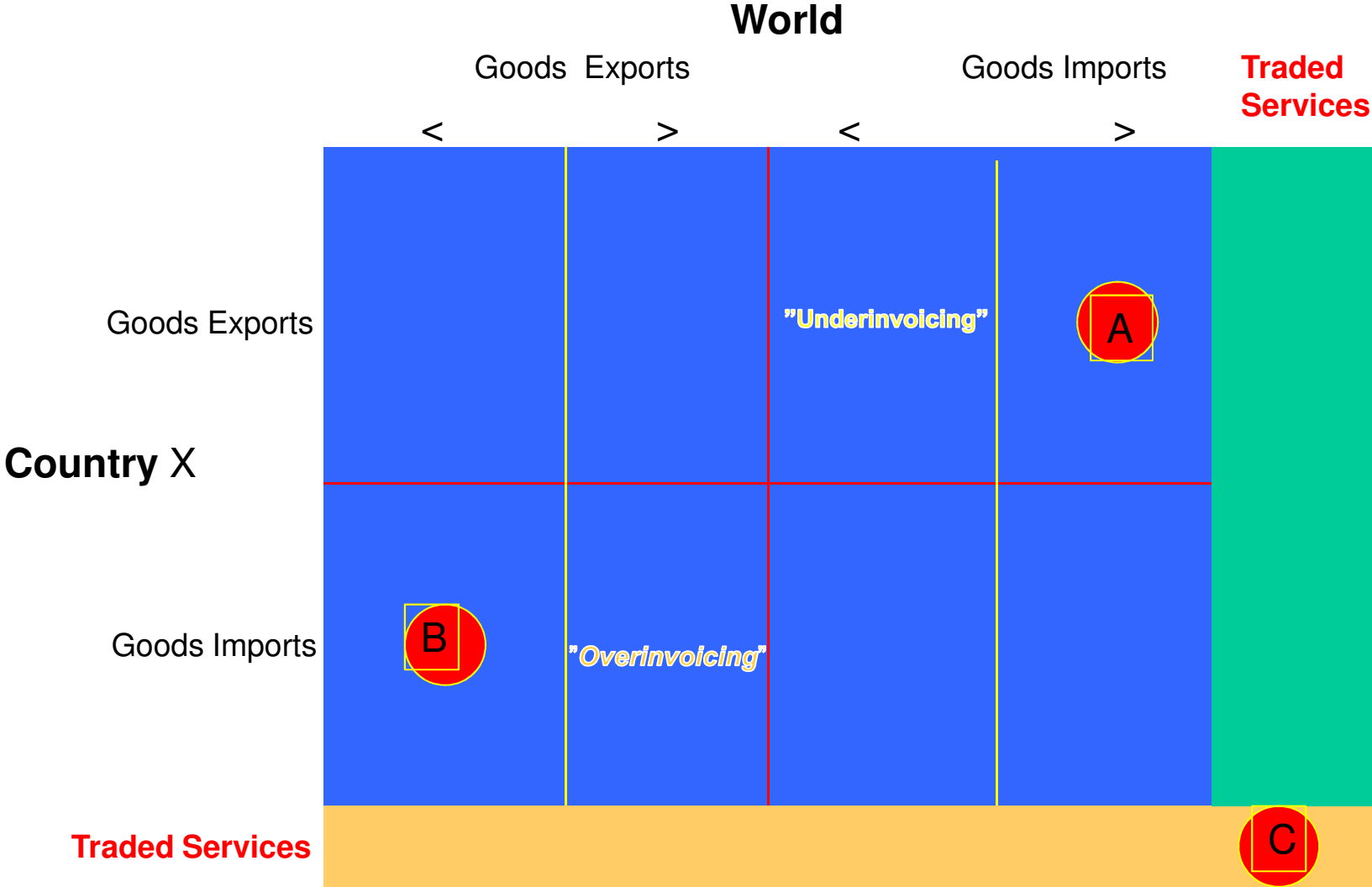
WORLD EMPLOYMENT 2010		MEXICAN EMPLOYMENT 2010		"UNDEREMPLOYED" 2010		WORLD EMPLOYMENT 2010		MEXICAN EMPLOYMENT 2010		"UNDEREMPLOYED" 2010		WORLD EMPLOYMENT 2010		MEXICAN EMPLOYMENT 2010		"UNDEREMPLOYED" 2010	
Afghanistan	10	10	10	10	10	Afghanistan	10	10	10	10	10	Afghanistan	10	10	10	10	10
Algeria	10	10	10	10	10	Algeria	10	10	10	10	10	Algeria	10	10	10	10	10
...
USA	130	130	130	130	130	USA	130	130	130	130	130	USA	130	130	130	130	130
...
World Total	1000	1000	1000	1000	1000	World Total	1000	1000	1000	1000	1000	World Total	1000	1000	1000	1000	1000

IN PRACTICE...NOT MUCH FUN...!!!

CONVENTIONAL MISINVOICING



EXPANDED MISINVOICING FRAMEWORK



Recent Aggregate ITP Cost Estimates

Study	Approach	Estimated Lost Tax Rev
Simon Pak (2003-6)	<ul style="list-style-type: none"> • Goods trade misinvoicing - Bilateral Customs data 	“+\$200 billion/ yr.”
GFI (2011-12)	<ul style="list-style-type: none"> • Goods trade misinvoicing 	“\$98-\$106 b./ yr., 2002-06 “
Christian Aid (2009)	<ul style="list-style-type: none"> • Goods trade misinvoicing – partner discrepancies 	“+\$160 billion/yr.”
TJN (2012)	<ul style="list-style-type: none"> • Country studies • `intangibles` abuse 	<ul style="list-style-type: none"> • Case studies of Mx, Zambia, Swiss, India, China

GFI'S ESTIMATES OF "ILLICIT FINANCIAL FLOWS" FROM DEVELOPING COUNTRIES

(Current US \$Billions Aggregated Across Years)

Study	Focus	Period	Trade Misinvoicing		+	Capital Flight		=	Total "Illicit Flows"		Yearly Average	
			1990-2008	2000-08		1990-2008	2000-08		1990-2008	2000-08	1990-2008	2000-08
GFI (6/2011)	LDCs (n=44)	1990-2008	\$126.3	\$33.6		\$160	\$52		\$286	\$86	\$15.1	↔ \$9.5
						15.9*	na		15.9*	na	‡	
						\$176	na		\$302	na	\$15.9	na
GFI (1/2011)	All Dev Countries (n=217)	2000-2008	na	\$3,477		na	\$3,053		na	\$6,530	na	\$726

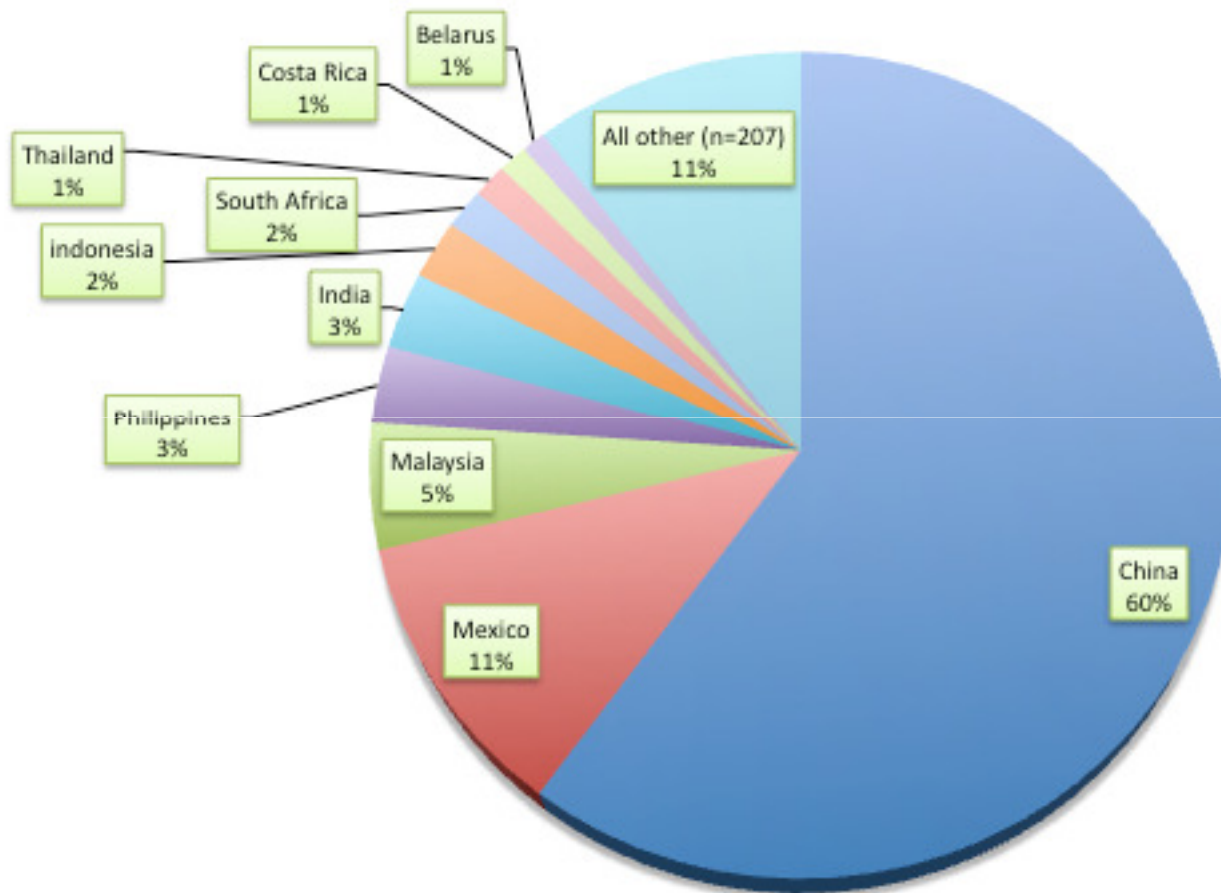
* Estimated for 15 countries with missing data

Source: GFI studies, JSH analysis

Key Issues – GFI approach

	Trade Misinvoicing	Capital Flight	Bias
• Country concentration	✓✓		++
• All negative flows omitted	✓✓	✓✓	++
• Data quality (timing, cif costs, aggregation, etc.)	✓✓	✓	?
• Stocks vs. flows	✓✓	✓✓	-
• Income on offshore stocks	✓✓	✓✓	-
• Post-2000 focus	✓✓	✓✓	-
• Missing data	✓ 53 zeroes +72 missing /217	✓ 69 zeroes + 72 missing/217	-
• Imputed values		✓LDCs	+
• Mispricing in traded services omitted	✓		- ?

GFI "Trade Misinvoicing" By Country, 2000-2008
(Σ = \$3.48 trillion)



Revised Discrepancies, US- China Trade 2000-2009**

Chinese-U.S. Bilateral Merchandise Trade Statistics 2000, 2004, 2006 (Values in Billions of U.S. Dollars)								
	Eastbound (Bound for United States)				Westbound (Bound for China)			
Year	Chinese Exports	U.S. Imports	<i>initial</i> Difference Revised	Difference as a % of Imports	Chinese Imports	U.S. Exports	Difference	Difference as % of Imports
2000	52.1	100.0	48.0 \$7.5	47.9	22.4	16.3	6.1	27.3
2004	125.0	196.7	71.8 \$23.5	36.5	44.7	34.7	9.9	22.3
2006	203.5	287.8	84.3 \$24.2	29.3	59.2	55.2	4.0	6.7

**Source: "Report on the Statistical Discrepancy (10/2009 MOC/PRC, USTR/DOC)

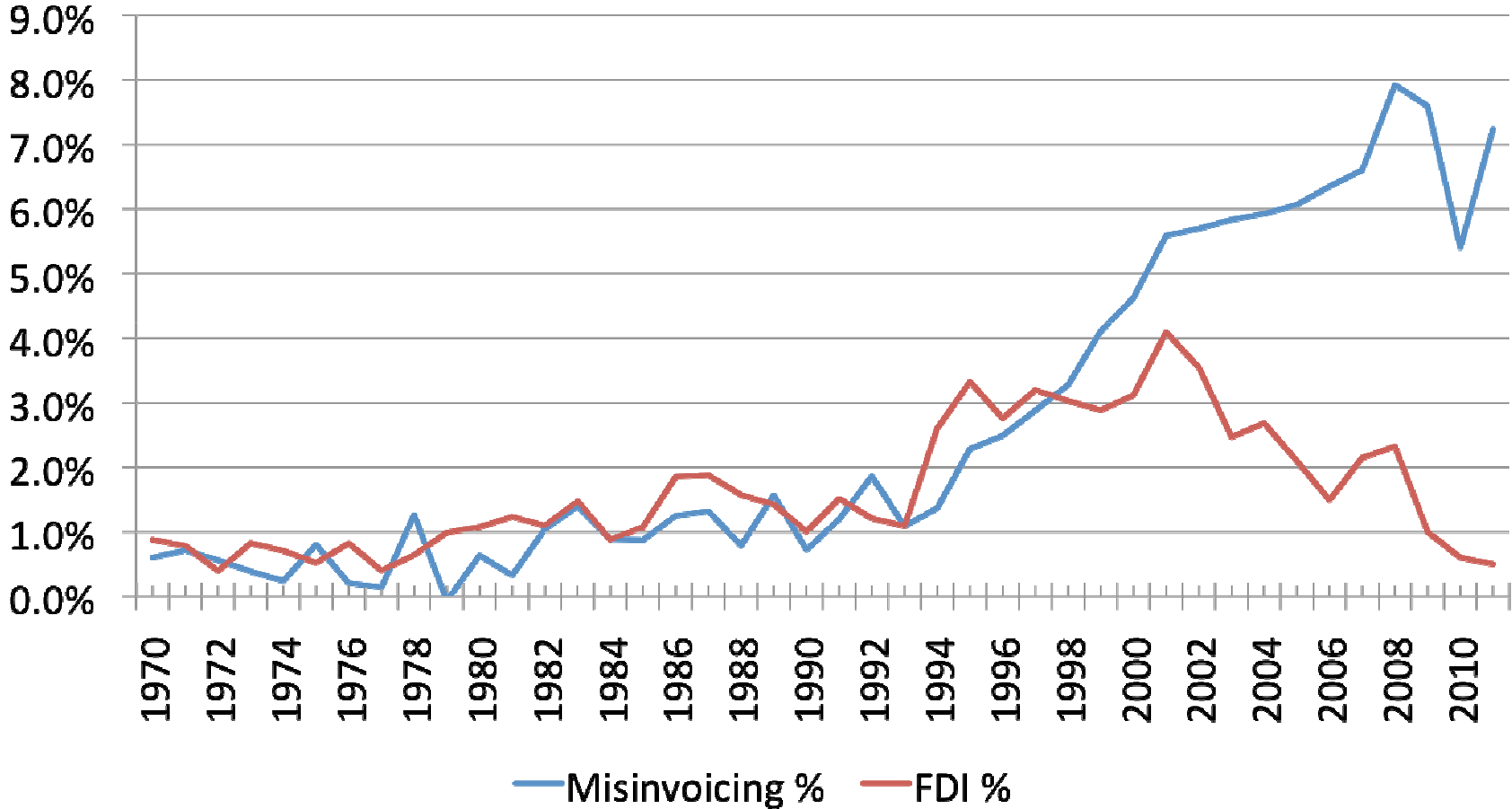
Case Studies

- Traded Goods
 - Mexico
 - Zambia
 - Switzerland
- Traded Services
- Abusive Structured Finance

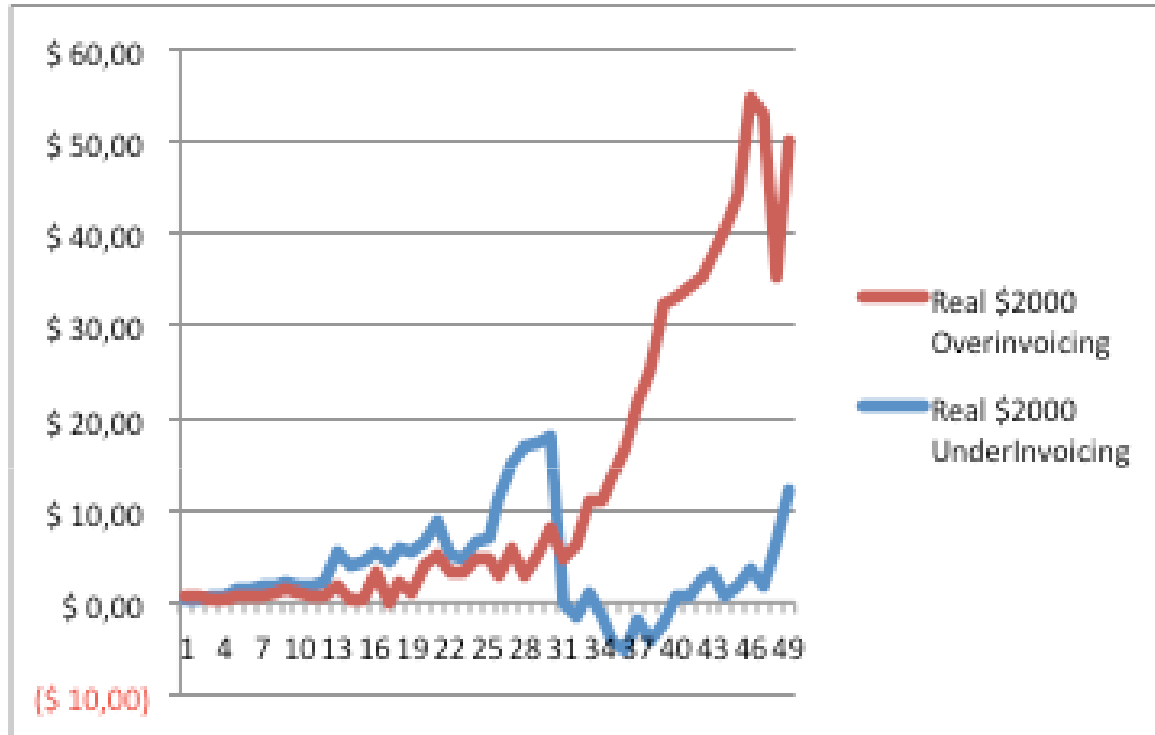
1. MEXICO CASE

Mexico

Misinvoicing Vs. Net FDI as a % of GDP, 1970-2011



Mexico – Trend in "Real" Mispricing (Real\$2000 \$Billions, 1962-2011)

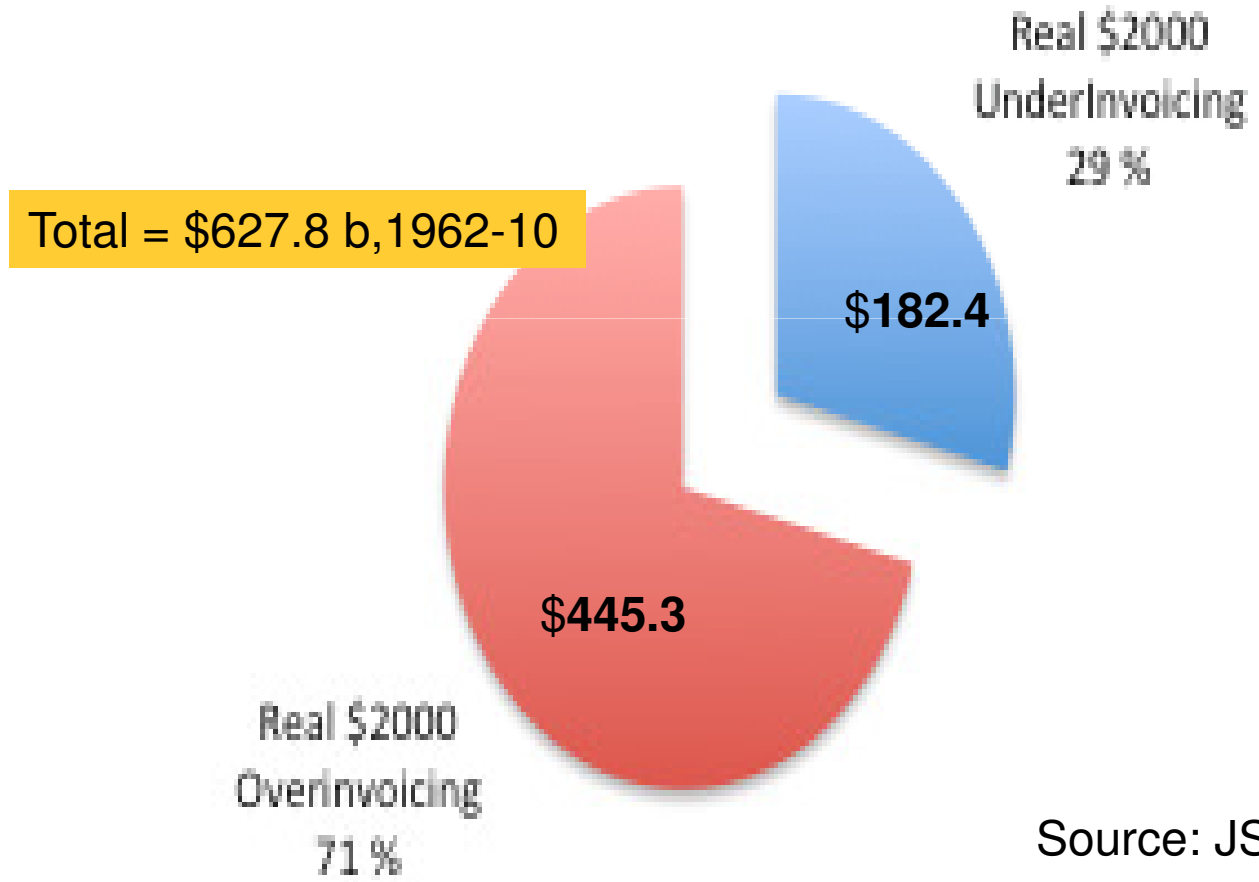


Source: UN Comtrade raw data (2012), JSH analysis

Apparent

Mexico: Real Misinvoicing

(Cumulative Total, 1962-2010; Real \$2000 Billions)



Source: JSH 2012

Technical factors – inflated Mexico estimates

- US (largest Mx trading partner) includes reexports in its exports to Mexico, but breaks them out
- Mexico doesn't report "reexports" or "reimports" wrt to US -- inflates reported "imports"
- While US exports are FOB-border, Mx imports are CIF point of origin, which adds internal US shipping costs

MEXICO

Real Misinvoicing, 1962-2010, By Trading Partner

Σ Net = \$627.7 Billion

	Σ			Σ
Canada	\$139,3		China - HK	(\$10,5)
China - Mainland	\$132,3		Israel	(\$9,7)
Japan	\$68,7		Neth Antilles	(\$9,0)
Other Asia Nes	\$45,8		DRKorea	(\$5,6)
Korea	\$37,7		Zimbabwe	(\$4,9)
Malaysia	\$27,3		Cocos Islands (Aust)	(\$4,9)
US	\$25,9		Dom Repub	(\$4,2)
Germany	\$24,6		Palestine	(\$2,0)
Italy	\$12,6		Cuba	(\$1,9)
Thailand	\$12,3		Cayman Islands	(\$1,5)
Brazil	\$9,7		Switzerland	(\$1,5)
France	\$9,6		Panama	(\$1,3)
Philippines	\$9,6		Gambia	(\$1,3)
Singapore	\$8,9		Tajikstan	(\$1,0)
Spain	\$8,7		Bermuda	(\$1,0)
Colombia	\$8,1		Not specified	(\$0,8)
UK	\$7,2		Seychelles	(\$0,5)
Costa Rica	\$6,4		Belize	(\$0,5)
Bahamas	\$6,1		Jamaica	(\$0,4)
Australia	\$5,6		Greenland	(\$0,4)
India	\$5,2		Uzbekistan	(\$0,3)
Chile	\$4,6		Haiti	(\$0,2)
Saudi Arabia	\$4,4		Guinea - Bissau	(\$0,2)
Indonesia	\$4,3		Fiji	(\$0,2)
Russia	\$3,8		Kazakhstan	(\$0,2)
$\Sigma\Sigma$ TOP 20	\$628,6	91 %	TOP 20	(\$63,9)
$\Sigma\Sigma$ TOTAL POSITIVE	693.5			

Source: UN Comtrade data (2012), JSH analysis

MEXICO

Real MX Export Mis-invoicing, 1962-2010, By Trading Partner

Σ Net = \$182.4 Billion							
% of			% of				
Σ misinvoicing			Σ misinvoicing				
Canada	\$	104,07	75 %	China - HK	\$	0,18	-2 %
China - Mainland	\$	9,79	7 %	Israel	\$	-8,91	92 %
Japan	\$	26,95	39 %	Neth Antilles	\$	-10,98	122 %
Other Asia Nes	\$	-3,00	-7 %	DRKorea	\$	-0,68	12 %
Korea	\$	5,29	14 %	Zimbabwe	\$	-2,05	42 %
Malaysia	\$	1,19	4 %	Cocos Islands (Aust)	\$	-4,91	100 %
US	\$	17,72	68 %	Dom Repub	\$	-4,92	117 %
Germany	\$	9,92	40 %	Palestine	\$	-2,02	100 %
Italy	\$	5,75	46 %	Cuba	\$	-3,26	171 %
Thailand	\$	2,01	16 %	Cayman Islands	\$	-1,65	107 %
Brazil	\$	3,36	35 %	Switzerland	\$	-4,82	330 %
France	\$	5,38	56 %	Panama	\$	-3,82	296 %
Philippines	\$	0,36	4 %	Gambia	\$	-0,00	0 %
Singapore	\$	2,55	29 %	Tajikstan	\$	-0,06	6 %
Spain	\$	7,31	84 %	Bermuda	\$	-1,17	123 %
Colombia	\$	6,69	83 %	Not specified	\$	-10,31	1214 %
UK	\$	1,36	19 %	Seychelles	\$	-0,00	0 %
Costa Rica	\$	0,82	13 %	Belize	\$	-0,22	48 %
Bahamas	\$	5,61	91 %	Jamaica	\$	-0,42	108 %
Australia	\$	3,68	65 %	Greenland	\$	-0,00	0 %
India	\$	-1,19	-23 %	Uzbekistan	\$	-0,01	4 %
Chile	\$	2,39	52 %	Haiti	\$	-0,29	132 %
Saudi Arabia	\$	1,98	45 %	Guinea - Bissau	\$	-0,19	101 %
Indonesia	\$	0,78	18 %	Fiji	\$	0,00	-2 %
Russia	\$	0,60	16 %	Kazakhstan	\$	0,07	-41 %

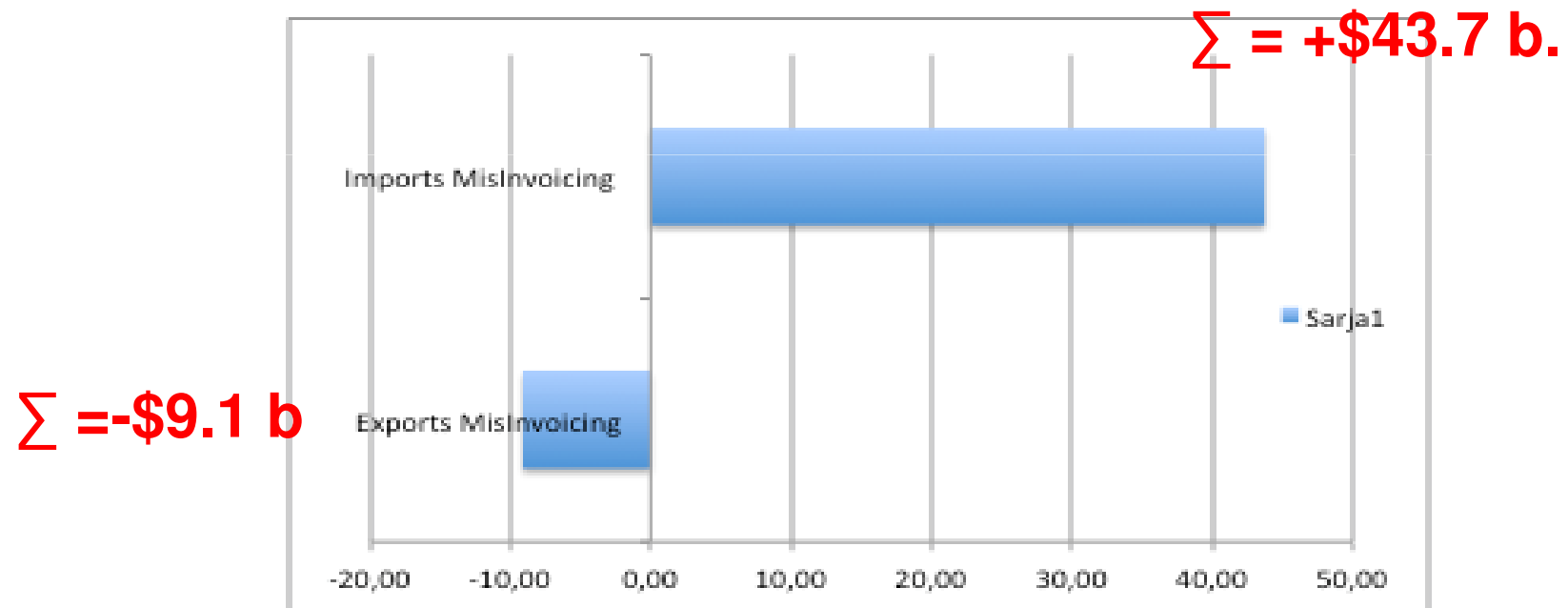
Source: UN Comtrade data (2012), JSH analysis

(c)JSH/TJN 2012

2. ZAMBIA

ZAMBIA – REAL MISINVOICING, 1966-2010 (Real \$2000, \$B.)

Net $\Sigma\Sigma = \$34.6$ b.



ZAMBIA - REAL TOTAL MISINVOICING, 1966-2010

(Real\$2000; Net total = \$34.6 billion)

US	\$	7,22	Switzerland	\$	-10,53
Canada	\$	7,11	Iran	\$	-2,02
Not specified	\$	5,13	UK	\$	-1,52
China - Mainland	\$	3,46	Singapore	\$	-0,90
Korea	\$	3,21	Neth Antilles	\$	-0,82
Saudi Arabia	\$	2,90	China HK	\$	-0,71
Japan	\$	2,88	Dom Repub	\$	-0,41
Other Asia Nes	\$	1,75	Panama	\$	-0,35
UAE	\$	1,35	Tanzania	\$	-0,31
Kuwait	\$	1,30	El Salvador	\$	-0,29
Top 10	\$	36,32	Top 10	\$	-17,86
All Other Pos	\$	18,15	All Other Neg	\$	-1,94
TOTAL GROSS	\$	54,47	TOTAL GROSS	\$	-19,80

TOTAL NET \$34.6 billion

Source: UN Comtrade data (2012), JSH analysis

3. SWITZERLAND CASE

SWITZERLAND -- REAL GOODS MISINVOICING BY TRADING PARTNER

(1962-2011, Real \$Billions)

India	\$69,5	Romania	(\$3,1)
China	\$68,9	Bolivia	(\$3,1)
Israel	\$31,0	Ghana	(\$3,6)
Germany	\$19,4	Denmark	(\$3,7)
Palestine	\$18,3	Greece	(\$3,8)
Libya	\$13,4	Canada	(\$4,4)
Netherlands	\$12,8	Portugal	(\$4,4)
Malaysia	\$11,1	Iraq	(\$4,7)
Japan	\$10,8	Poland	(\$4,9)
Italy	\$9,9	Austria	(\$8,7)
Ireland	\$7,6	Zambia	(\$10,5)
Saudi Arabia	\$7,3	Mexico	(\$11,6)
Turkey	\$6,7	"Not Specified"	(\$13,1)
Nigeria	\$6,6	Spain	(\$14,1)
Singapore	\$5,9	South Africa	(\$21,1)
Vietnam	\$5,5	Peru	(\$21,2)
Finland	\$5,4	Kazakhstan	(\$32,0)
Thailand	\$5,4	USA	(\$52,8)
Czech	\$4,9	France	(\$53,1)
Algeria	\$4,9	Russia	(\$81,3)
TOTAL -- TOP 20	\$325,1	TOTAL - TOP 20	(\$355,2)
ALL OTHER POSITIVES	\$56,3	ALL OTHER NEGATIVES	(\$48,7)
TOTAL GROSS	\$381,5		(\$403,9)
	TOTAL NET		(\$22,45)

Source: UN Comtrade data (2012), JSH analysis

(c)JSH/TJN 2012

4. "TRADE" IN INTELLECTUAL PROPERTY

"The invisible hand
is nowhere to be seen."

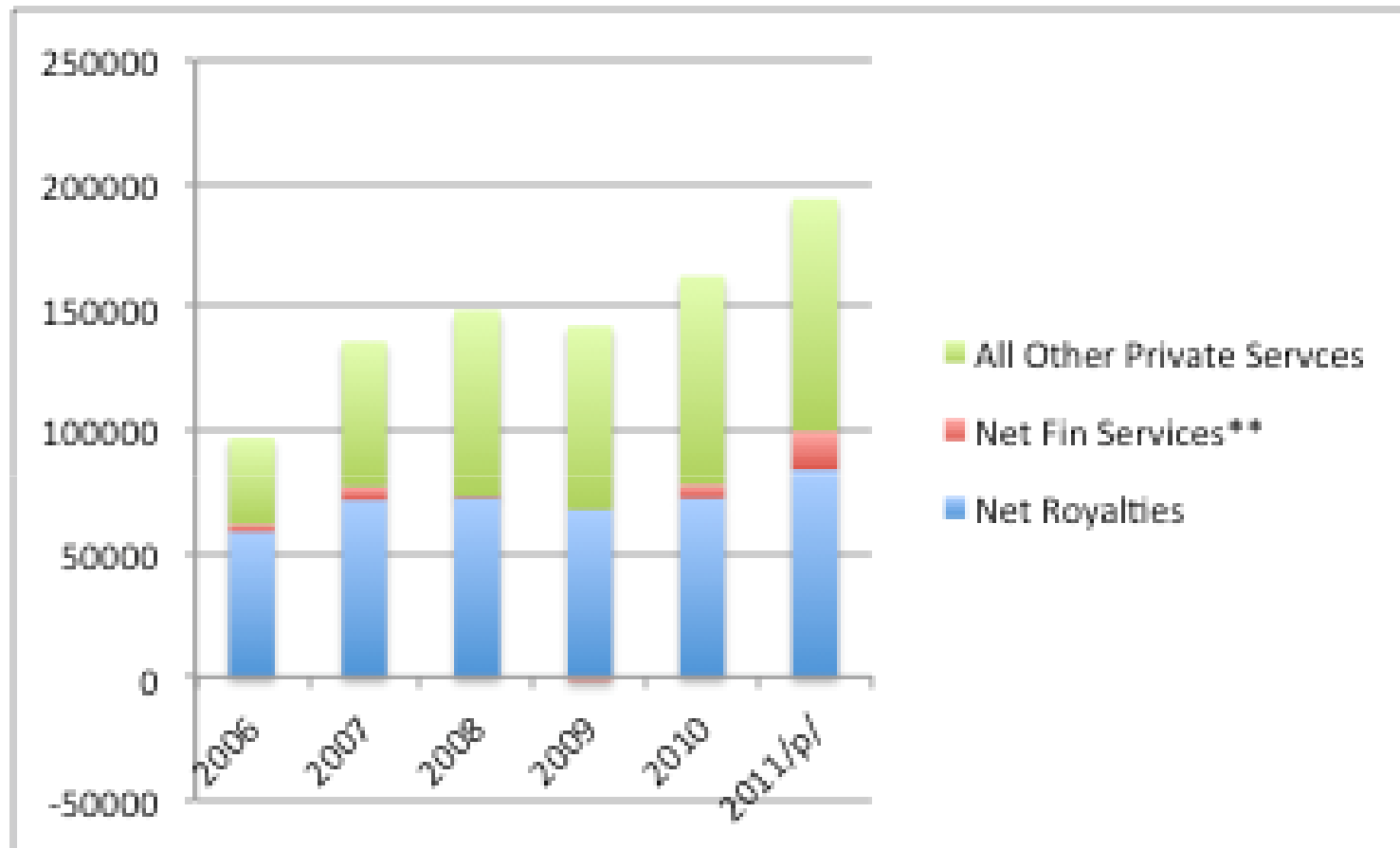
-- Indian economist



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COMPOSITION – US NET SERVICE EXPORTS (2006-11, \$mm)



Measuring International Transfer Pricing Abuse

- What Is It?
- Why Do We Care?
- What Do We Know?
- What's Next?



Summary

- **Measuring ITP abuse: a critical part of ‘The Price of Offshore’ policy agenda**
- **We can’t rely only on existing (aggregate) estimates**
- **Examples – Mexico, Zambia, Switzerland, etc. – show that disaggregating has many advantages**
 - Reveals new forms of ITP abuse
 - Highlights growing role of of secrecy jurisdictions in ITP abuse
 - Highlights MNC abuse of traded service
- **This needs to be a TJN research priority**

Tax justice impact

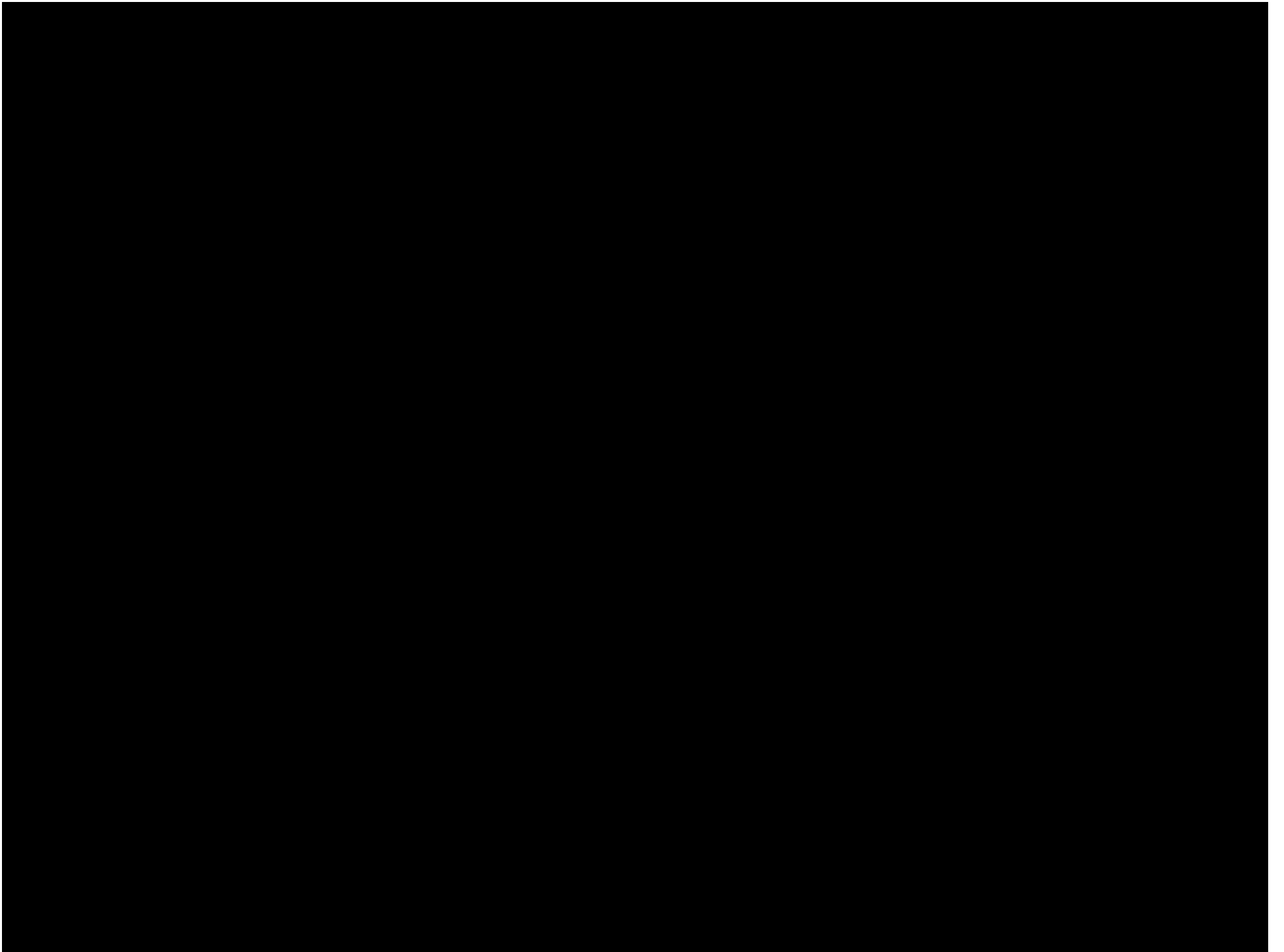
**Government revenue + taxes
by country/ group
(Median % of official GDP, 2000-09)**

Country Group	Population (2009) (Billions)	Per Capita Income (PPP-Adjusted '09)	Gov Revenue X Grants	Income Taxes	Sales Taxes	Payroll Taxes	Taxes on Intl Trade	Other Taxes	Other Gov Revenue	Grants
OECD	1.22	\$33153	26.1%	6.6%	7.3%	8.9%	.1%	1.0%	2.2%	0%
EU	.500	\$31384	35.2%	7.4%	11.3%	12.2%	.02%	1.2%	3.1%	0%
US	.310	\$45989	17.9%	9.5%	.6%	6.8%	.2%	.3%	.5%	0%
China	1.331	\$6828	9.5%	2.1%	6.2%	0%	.3%	.1%	.8%	.1%
Other Middle Income	3.481	\$6245	21.3%	4.6%	6.1%	4.5%	1.3%	.4%	3.2%	.8%
Low Income	.846	\$1205	11.5%	.1%	2.3%	0%	7.0%	1.5%	.6%	9.6%
World	6.775	\$10686	25.0%	5.1%	8.1%	7.1%	1.31%	.59%	2.57%	.23%

Source: World Bank data (2011) , JSH analysis

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“It is capitalism that is truly radical.”
-- Brecht



Investigative Economics

- “Just look at the f’n data ”
(John Tukey)
- Puzzles tell us where to look
- Pragmatic, case-based and inferential

Neoclassical Economics

- Mathematical virtuosity
- Models tell us where to look
- “Methodological individualism,”
early 20th c. positivism
- 60s behaviorism: “You look
pretty good today; how am I?”

Estimated US Corporate Tax Losses
Due to Trade Misinvoicing

<u>Year</u>	<u>\$ Shift</u>	<u>Tax Loss</u>
2000*	\$131 BN	\$44.5 BN
2001*	\$156 BN	\$53.1 BN
2002	\$251 BN	\$85.2 BN
2003	\$143 BN	\$48.7 BN
2004	\$267 BN	\$90.9 BN
2005	\$252 BN	\$85.6 BN

◆ Pak and Zdanowicz (2006): estimates based on authors' special Access to US Customs data on product values reported for imports and exports.