

Politics of Intra-Firm Trade: Corporate Price Planning and the Double Role of the Arm's Length Principle

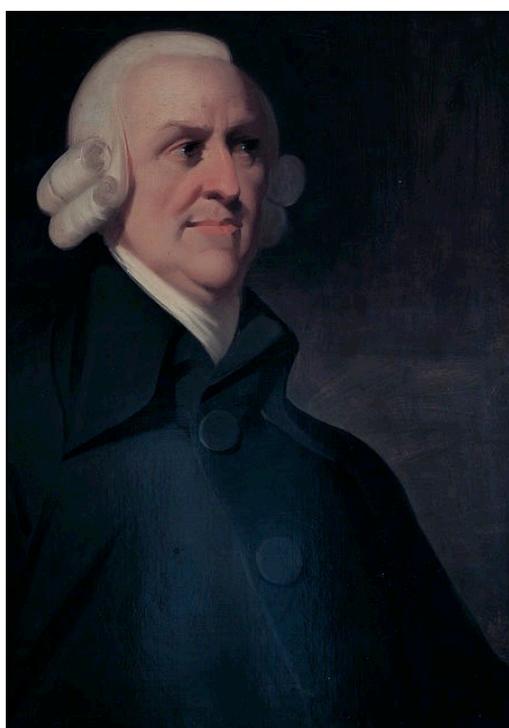
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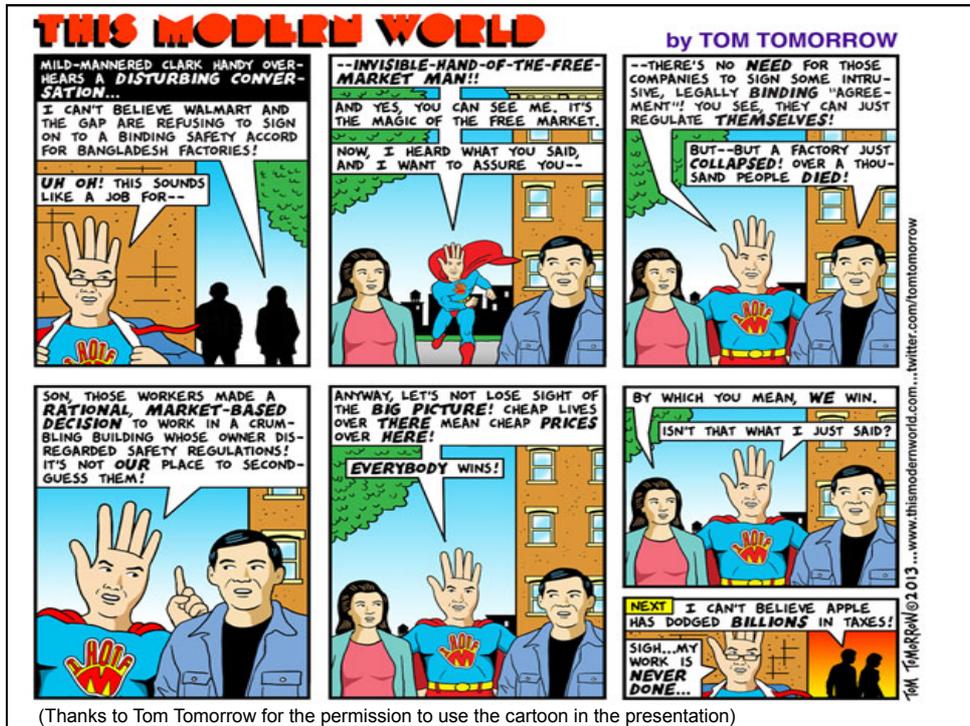
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"...he intends only his own gain, and he is in this, as in many other cases, led by an **invisible hand** to promote an end which was no part of his intention. ... By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it."

— Adam Smith,
Wealth of Nations, 1776





Separate entities or part of the same structure?

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Transfer pricing: Keeping it at arm's length

Transfer pricing can deprive governments of their fair share of taxes from global corporations and expose multinationals to possible double taxation. No country – poor, emerging or wealthy – wants its tax base to suffer because of transfer pricing. The arm's length principle can help.

John Neighbour
OECD Centre for Tax Policy and Administration



Not long ago, transfer pricing was a subject for tax administrators and one or two other specialists. But recently, politicians, economists and businesspeople, as well as NGOs, have been waking up to the importance of who pays tax on what in international business transactions between different arms of the same corporation. Globalisation

Arm's length

In a bid to avoid such problems, current OECD international guidelines are based on the arm's length principle – that a transfer price should be the same as if the two companies involved were indeed two independents, not part of the same corporate structure. The arm's length principle (ALP), despite its informal sounding name, is found in Article 9 of the OECD Model Tax Convention and is the framework for bilateral treaties between OECD countries, and many non-OECD governments, too.

...parts will be disappointed not to have much as the profit will be on their side of the operation. This problem only arises inside corporations with subsidiaries in more than one country; if the UK company bought its microchips from an independent company in Korea it would pay the market price, and the supplier would pay taxes on its own profits in the normal way. It is the fact that the various parts of the organisation are under some form of common control that is important for the tax authority as this may mean that transfers are not subject to the full play of market forces.

Transfer prices are useful in several ways. They can help an MNE identify those parts of the enterprise that are performing well and not so well. And an MNE could suffer double taxation on the same profits without proper transfer pricing. Take the example of a French bicycle manufacturer that distributes its bikes through a subsidiary in the Netherlands. The bicycle costs €90 to make and it costs the Dutch company €100 to distribute it. The company

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How to define “markets”?



Markets are
“constituted by two
roles, buyer and
seller, each
standing on one
side of the market,
facing the other.”

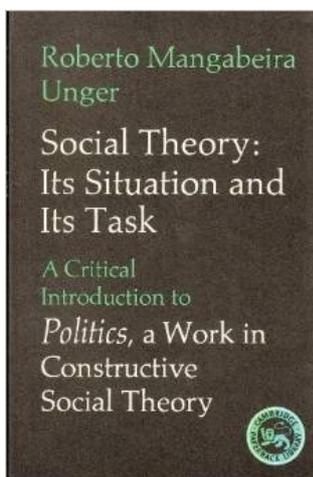
**BUSINESS
ORGANIZATION**

“Definitional social
characteristic of a
market is the
impersonal relation
between buyer and
seller.”

**and the MYTH of the
MARKET ECONOMY**

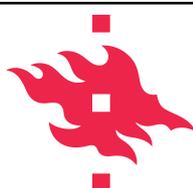
William Lazonick

If not markets, then what?



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- Narrow meaning of **politics**: “conflict over the mastery and uses of governmental power”
- Broader meaning: **“struggle over the resources and arrangements that set the basic terms of our practical and passionate relations”**



In other words...

- Both states and corporations engage in planning their markets and marketing their plans
- Under certain conditions, there may be grounds to address also corporations as political agents, as they can alter the “resources and arrangements that set the basic terms of our practical and passionate relations”
- This can be seen in a level of individual firm with tax policies that have significant impact of a national economy
- Or it can be analysed on an aggregate level

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Double role of the Arm's Length Principle

- “Definitional social characteristic of a market is the impersonal relation between buyer and seller” (Lazonick 1991)
- **ALP has been failure** as an instrument to establish markets inside hierarchic corporate structures
- **However, ALP has been success** in maintaining non-market planning operations inside corporations
- ALP offers basis for assuming markets in places where their existence is ideologically important even though in practice these markets do not work

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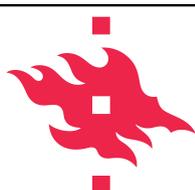


Normative implications

- **Policy:** Intra-firm prices already contain a significant element of planning > hence, support for formulary apportionment
- **Discourse:** New interpretations and framings of concepts such as:
 - Intra-firm trade
 - Illicit financial flows
 - Corporate responsibility...
- **Alternative vocabulary:** Corporate planning, cross-subsidization...

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Thank you

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