RESEARCHING TRANSNATIONAL CORPORATIONS:

A PERSONAL PERSPECTIVE

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From the time I joined the Foreign Participation section of the Australian Bureau of Statistics in Canberra, after graduating from the University of Sydney, I was able to pursue my interest in the operations of multinational companies. My interest was developed following my experience studying economics at the University of Sydney which I, and many others, considered did not really help you understand the 'real' economy and how businesses and industries work.

There is certainly nothing more 'real world' than studying and researching the activities of multinational companies. I became very interested in the industries these companies were active in and whether they operated differently from domestically based companies. Did it matter that there were high levels of foreign ownership in some of Australia's key industries? Did government policies that regulated and constrained their activities benefit Australia, and if so, how?

Researching TNCs at the University of Sydney

The public service bureaucracy was not really to my liking so, after a short time, I applied for a research assistant position with Ted Wheelwright. He had received funds from an Australian businessman and grant money from the federal Labor government to set up a research unit at the University of Sydney to study multinationals. In 1976, we established the Transnational Corporations Research Project (TCRP) in the Department of Economics.

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We preferred the less common term 'transnational' because we felt it was a better description of how these companies operated, rather than the more common term 'multinational' which implied the companies had owners from multiple countries. Obviously, as the global reach of these companies has grown over the decades, both terms have become accurate and interchangeable: these companies obviously operate across multiple country borders and many also have complex ownership structures spanning different countries and investors.

Although the TCRP was small, employing only two staff, we were able to undertake our own research and establish linkages with researchers in Australia and around the world who were working on similar issues. We produced numerous papers, books and reports that, in their own small way, contributed to the debate about foreign ownership in Australia. Ted and I also wrote a popular book on how Australia had become a 'client state' under the influence of international capital (Crough and Wheelwright 1982).

In the context of the already multi-year struggle for the establishment of a Political Economy department at the University, one clear issue arose. Most mainstream economic models did not really enable you to understand the dynamics of these corporate entities. When much of international trade and investment is internalised by these companies – as has increasingly become the case – models of 'normal' or romanticised notions of market mechanisms are not very helpful in understanding how these companies operate and why. Clearly these companies face market mechanisms when they deal with their customers, but how they arrange their affairs to manage these mechanisms and take advantage of them is an important and extremely complex area of study.

As with a lot of things in life, you can expect something unexpected to happen sooner or later. One such moment for me was when I was approached by a researcher, Stuart McGill, who had been engaged by the Australian Minister of Aboriginal Affairs to do some work on the activities of multinational companies that were impacting Australian Indigenous communities and how this compared to the experience in North America. The research was specifically focused on the impacts of mining and exploration companies operating, or seeking to operate, in areas close to Indigenous communities (McGill and Crough 1986). Following this introduction to indigenous issues, I spent a few years, mainly in the Northern Territory and the Kimberley region, working with Indigenous communities and organisations on their economic issues (Crough *et al.* 1989). Needless to say, it was not an area of research crowded out by mainstream economists. Marginal costing, perfect markets and concepts of economic optimisation did not easily translate into explaining how the local economy of these communities, much less the broader economy, worked and where indigenous people fitted in. I found that geographers, because of their emphasis on field work and their broader social and physical sciences approaches, had a lot more to contribute.

Ultimately, Ted Wheelwright decided to relocate the TCRP at Sydney University from the Economics department to the Geography department. Instead of battling with unsympathetic - and even hostile - economics professors who could not see why research on multinational companies was important, we found a much more welcoming home there.

Transfer pricing

Some of the research I undertook while working in the TCRP at the University of Sydney focused on transfer pricing. That is, analysis of the impacts of the internal pricing decisions of transferring products, services and intellectual property, between entities within multinational corporations. The pricing of their trade in products, services, intellectual property and financial transactions not only enables the corporations to better control resource allocation and profitability between their constituent entities, but also to manage their taxation position *vis a vis* different country jurisdictional tax systems. Multinational corporations are in a very strong position to take advantage of different tax rates (of all types of taxation), tax incentives, tax holidays and weak regulatory regimes in many countries.

The bauxite mining and alumina and aluminium processing industry was a focus of my early transfer pricing work. One paper focused on a large company, Comalco Australia Ltd., whose transfer pricing issues ultimately ended up in the Australian High Court. I remember meeting High Court Justice Lionel Murphy, a personal friend of Ted Wheelwright, who said there was important evidence presented to the Court that he thought someone should write about. Justice Murphy provided us with copies of the so-called *Appeal Books* that included detailed information that had been presented to the Court. These books provided details of what would normally be confidential information of the company's internal pricing activities (Crough 1981). While the Commissioner of Taxation ultimately ended up losing the case on a number of legal technicalities, it did expose weaknesses in Australia's legislation for dealing with transfer pricing and tax avoidance. New legislation was ultimately introduced to remedy the technical inadequacies of the previous legislation and expand the scope of the Commissioner's power to adjust the income and expenses relating to non-arm's length transactions.

The second piece of work came from one of the unlikeliest of places: Iceland. A group of Icelandic researchers visited us in Australia seeking details of the pricing of alumina processed in Australia for shipment to Iceland for smelting into aluminium. The researchers noticed some irregularities in the trade statistics between exports from Australia and imports to Iceland that suggested the price of alumina was somehow being inflated, effectively while it was on board ships travelling to Iceland. Iceland, with its abundant natural resources for producing electricity, was an excellent location for aluminium smelters which use large amounts of electricity. The researchers were concerned that Swiss Aluminium was manipulating the transfer prices of alumina sold to its related entity in Iceland to artificially shift profits out of their country. Trade statistics do not normally disclose confidential details but, possibly due to an oversight in the Australian Bureau of Statistics, it was feasible to roughly estimate the prices of alumina being exported from Australia by Swiss Aluminium and compare these to the import prices (Crough 1985).

Another unexpected path to working on transfer pricing issues was when I was approached by a researcher, David Doulman, from the Food and Agriculture Organisation (FAO), who was working on the global tuna industry with the Pacific Islands Forum. I was not aware of it at the time but, during the research, I found out that one of Australia's largest tuna and marine fishing companies today, the South Australian Fishing Cooperative Ltd (SAFCOL), originally established in the South Australian town of Port Lincoln in 1945, was one of the first companies to internationalise its operations when it established tuna canneries in Thailand to take advantage of low labour costs and access to fish resources from the Asia Pacific region. Heinz, a global multinational food company, had set up a tuna cannery in the NSW town of Eden to process its *Greenseas* brand of products after having established food processing and distribution operations in Australia in the mid-1930s.

The tuna industry is of vital interest to various countries, including Pacific Island nations, as the fish resources are within their maritime economic zones, but the exploitation of their resources is typically undertaken by large international companies in other countries (Doulman 1987). The canning and processing of tuna is a major employer in other countries, such as Thailand and Vietnam, and the companies that undertake the processing benefit from low wage costs. One issue being examined by the FAO was whether the ability of the large companies in the supply chain to determine or significantly influence the pricing for fish, canned fish, and other fish-derived products sold around the world was shifting value and profits away from the lower income countries and not properly rewarding them for their contributions to the global industry (Crough 1987, 1991).

Next time you buy a humble can of tuna or sardines, think about where the fish came from and who caught them (was it a locally owned fishing business or a large international company with industrial-sized fishing and freezing ships?); where were the fish processed and canned and by whom? (look on the bottom of the can to see the names of countries where the processing occurs); who owns the brand and is it part of a vast stable of brands owned by a multinational food company? When the price is broken up into its constituent parts, what share do each of the multiple entities involved in the supply and marketing chain get? This continues to be an interesting area for research.

Economic consulting

Ultimately, my studies of transfer pricing and multinational corporations led the Australian Taxation Office to offer me work as an economic consultant. This was when the ATO's compliance approaches to the taxation of international corporations were being developed. The ATO was one of the leaders, following the developments in the US regulatory and compliance regime, in focusing on transfer pricing as a tax avoidance problem. I was later employed by the ATO as an economist to specifically focus on transfer pricing compliance.

At the same time as tax authorities around the world began to develop their own approaches to transfer pricing through the implementation of new laws, regulations and compliance programs, the accounting, law and tax advisory firms began to develop their own approaches to advise their clients on how to comply with these laws and the new audit programs.

Ernst & Young (EY) in Australia started to employ economists to focus on transfer pricing and international tax issues; and I was offered a position to join those efforts.

After working for EY for a number of years in Sydney, I was offered a position in the New York EY office. The initial offer was for a 3-year secondment but, like a lot of people who come from other countries to live and work in New York, the opportunities to work in teams with other professionals and with large companies as clients – as well as living in a city as dynamic as New York – there is a strong inclination to stay. In my case, the 3 years turned into 18 years.

Working as an academic researcher on multinational corporations is rewarding, but you are always limited in the information you have available for your research. While transfer pricing is a global issue, it is subject to an extensive network of laws and regulations in virtually every country in the world and it is a critical program focus of the Organisation for Economic Cooperation and Development and its member countries. The OECD's work is known as the Base Erosion and Project Shifting (BEPS) project which has resulted in legislative and regulatory changes in many countries in recent years. Information on how companies make internal pricing decisions is very difficult to obtain as an outsider. Working in a global accounting firm such as EY gives you access to financial information of even the largest companies in the world. It also provides an opportunity to better understand what drives these entities. What do they do, why do they do it, how do they adapt to economic and regulatory changes, what drives the value created in the business, how is their intellectual property developed, exploited, maintained and protected?

While transfer pricing might seem to be an issue that economists would have an advantage in researching and analysing, the internalisation of market mechanisms within a global enterprise is affected by a wide range of complex economic, legal, regulatory, financial issues. Even the most complex of mainstream economic models struggle to understand these multiple dimensions and produce reliable outcomes. Lack of real-world data to input into these models further reduces their usefulness.

Arm's-length behaviour

One of the important foundational elements of transfer pricing work is the concept of arm's length behaviour. That is, most regulatory regimes are based on the principle that transfer prices within a multinational corporation should be similar to, or comparable to, the pricing behaviour of parties dealing at arm's length. Put simply, the pricing should be based, to the extent possible, on the pricing outcomes of parties that are unrelated to each other, with each following their own commercial and financial interests. While the concept sounds relatively straightforward – find arm's length prices and compare them to the transfer prices of a product or service – in practice, except for a few products such as basic commodities like minerals and agricultural products, there are no publicly available prices that are comparable to the prices set within a multinational corporation.

An extraordinary range of products and services incorporate some form of intellectual property and are effectively unique to that company, and the intellectual property in these products is a closely guarded secret. In fact, this is how many companies differentiate themselves from their competitors and drive value. Some of them, like pharmaceutical companies, spend billions of dollars developing their products and want them protected through regulatory regimes such as patent protection. Once generic products come into the market, new prices appear in those markets but the value attributable to the marketing and branding of these products is still difficult to incorporate into a transfer framework.

These concerns lead to the question of what exactly is the business that is being analysed? Is Telsa more correctly characterised as a car company or as a software company? How much of Apple's success is driven by its products or by its marketing prowess? Are Facebook and Google similar to a broadcasting/media businesses or are they really in the advertising business? These answers to these questions have real world implications. For example, when the CEOs of Facebook and TikTok recently appeared before US Congress it was revealing that most of the questioning demonstrated the complete ignorance of many members of exactly how these companies operate and how they make money. If the Congress, and indeed any legislative body in the rest of the world, thinks of regulating the activities of these types of companies, if they do not understand their business models it is almost inevitable that the legislative responses will be completely inadequate and lead to all sorts of unintended consequences. Many people who use these apps would also probably wonder how these companies can be so profitable when it is 'free' to use them.

To properly understand concepts like comparability, the underlying principle of arm's length pricing, you need to focus on these questions. Is there a market, or arm's length price, for a Tesla car, let alone all of its component parts, including the software? Can you compare transfer prices of Apple phones with those of Samsung? What is the correct arm's length price for unique software like that of Microsoft? How does a global consulting business with thousands of employees in India or the Philippines price the internal services provided to the parent entity. With technology often owned in one country, manufacturing in others, marketing in others, is value – and ultimately taxing rights – being properly allocated to the countries where these various activities are located? While there is an external market price for all of these products, transfer pricing is concerned with how these companies sell their own products, services and intellectual property internally between their own entities located in different nations.

Conclusion

It has been five decades since I started working in the Australian Bureau of Statistics measuring foreign ownership of Australian industries and resources and then worked with political economist Ted Wheelwright to develop TNC-focused research at the University of Sydney. The world of international business is immensely more complicated now than it was then. I have been fortunate in having the opportunity to work with researchers from all over the world and with highly professional people in a global organisation for companies and governments that are dealing with more complexity than ever.

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