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Folder Title:
PSE [Public Safety Equipment]--St. Louis, Missouri 8/27/92 [OA 7579] [1]

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G	26	22	7	4

(Ferguson/Walters)
August 26, 1992
2:45 p.m.
STLOUIS

PRESIDENTIAL REMARKS: PUBLIC SAFETY EQUIPMENT, INC.
ST. LOUIS, MISSOURI
AUGUST 27, 1992
9:00 A.M. (??)

Thank you and good morning.

(Acknowledgments)

((This is great. Look at the equipment you have here -- light bars, beacons -- you've given a whole new meaning to a thousand points of light.))

((I may take some of your sirens back to Washington. They're the only thing that makes more noise than the White House press corps.))

You know, the press specializes in the business of bad news. But today I'd like to open with some good news.

Together we have seen a world transformed these past three and a half years -- a world made new by American strength and resolve. And now that the Cold War is over, the defining challenge of the '90s is to win the economic competition of the new global economy -- to win the peace.

Our goal is simple and profound: We must be a military superpower, an economic superpower and an export superpower.

In this election, you'll hear two versions of how to do this. My opponents' answer is to look inward, and protect what we already have from the challenges of this new world. My approach is to look forward -- to open new markets, prepare our people to compete, to restore our social fabric -- to save and invest, so that we can win.

I wanted to come here today to St. Louis to lay out the sharp difference between Governor Clinton and me on the crucial issue of investment and open trade. My policies encourage both -- because my experience in business and foreign affairs has shown me that trade and investment create jobs.

In contrast, my opponent and the Democratic Congress want to tax both trade and investment. But taxes stifle things -- and in this case, their taxes would chase away business and destroy jobs.

I know my opponent has lots of slogans and policy buzzwords that sound appealing when you first hear them -- but America can't afford them.

PSE is an example of where we're going -- and how we're going to get there. Not so long ago companies like PSE could be satisfied with a national market -- sell your goods in the fifty states and leave it at that.

That's no longer good enough. So five years ago, you took on the world. I'm told that now 35 percent of what you build is sold outside our borders, in ~~66~~ 48 different countries. Today your light bars and sirens help save lives not only on the streets of Detroit and Peoria, but in Israel, Hong Kong and Spain.

PSE's story is a parable for our entire country's economic future -- never settling for less, always pushing ahead, embracing the challenges of foreign competition and reshaping them as opportunities.

Let me offer a personal note -- tell you how I first learned about competing in the world.

I spent a good part of my life out in West Texas, in the oil business. I painted rigs for a while, even lived out of a suitcase as a salesman. And all around me in those days I saw towns and businesses rise up from nothing, for a simple reason: The world wanted what Texas had to offer -- cotton and cattle and crude.

LOOKING FORWARD

We understood that the more goods we sold outside our borders, the more jobs we could create within them.

Later on, when I started my own business, I learned again: we had to take a global view to compete. I shopped for investors on the west coast, on the east coast, but I couldn't stop there. I traveled the world -- to Europe and the Far East. Every dollar we could bring into this country was a dollar that went to expand our company, create jobs in our community.

Then when I started to get involved in foreign relations, I built on that business experience. I saw again how important America is to the world, and how important the world is to America -- not just for national security in the traditional sense, but for our economic security, for creating jobs, right here at home.

We've held steady to this vision for three years now, and we've made solid progress. As we knock down trade barriers, American companies are rushing to meet the demand. Since I took office, exports have increased by one-third. America is the

David Watkins

greatest exporter the world has ever seen -- $422 billion dollars of exports last year alone.

Let me bring it close to home. In Missouri, exports are up 37 percent over the last three years -- $4.5 billion worth of goods shipped to 166 countries around the world.

Impressive numbers, but when you dig behind the trade statistics, you find the real benefit of the new world economy -- in a word, it's jobs. Here in Missouri, 100,000 jobs are supported by foreign trade. Across the country, more than 7 million Americans owe their jobs to trade.

Everyone recognizes that the world is moving at a faster pace, but I see something more: it's moving our way. Right now we're building on the export success of the last three years. Two weeks ago we entered a new era of open trade. Along with Mexico and Canada, we initialed the North American Free Trade Agreement, with the goal of knocking down tariffs and creating one of the largest free-trade areas in the world -- an integrated economy worth more than $6 trillion dollars.

Here in Missouri, you already export $2 billion worth of goods to Mexico and Canada. That's a lot of paychecks, but our new agreement will create still more jobs, and make us even stronger in the race with our European and Asian competitors.

NAFTA is a solid agreement -- when you've been in as many tough negotiations as I have, you learn to tell the difference. We're going to take this case to the protectionists on Capitol Hill, because they need to hear it. Right now, before our

initials are even dry on the agreement, ~~the Democratic leadership~~ in Congress is calling for us to slap a tarriff on any ~~new~~ trade that comes from NAFTA.

Think about that for a minute -- ((that's a minute longer than they've thought about it)). After long, tough negotiations with our two closest trading partners, we've agreed to end tariffs. The congressional Democrats say: Okay, fine. But first you have to put on a new tariff.

In other words, they think the way to eliminate trade barriers is to build a new trade barrier.

That's like telling us they want us to hit a homerun, but please only if we run around the bases backward.

This "transaction tax," as they call it, will make it more expensive for our businesses to compete with the European and Asians -- and it will discourage the creation of new jobs for you and your neighbors. It turns the agreement on its head -- defeats the whole purpose.

What about Governor Clinton? Where does he stand? Well, just last week, when asked about ~~our new trade agreement,~~ NAFTA he hemmed and hawed, and at last he said: "When I have a definitive opinion, I'll say so."

No matter how much Governor Clinton would like to fudge the issue, the difference couldn't be clearer -- and the difference is based on two very different views of America's future. My opponents see us knocking down trade barriers and they say: Hold everything. They see us open new markets for American goods and

they say: Wait a minute. Maybe we can't compete. The American worker can't cut it. So let's pull down the blinds, lock the doors and hope the world goes away.

Well, let me tell them something you already know. The American worker doesn't have to hide from anybody. Americans can outwork, out-think, out-compete anybody, anywhere, anytime.

That's something everyone in the world seems to understand -- everyone but the protectionist Democrats. Over the last decade, we've seen a flood of foreign investment in the United States -- businesses from all over the world setting up shop from Portland, Oregon to Portland, Maine. These investors follow a simple logic: if you want the best science and universities in the world, if you want the best workers in the world, you have to come to the U.S.A.

The result has been jobs: One out of every ten manufacturing workers in the United States works for a company supported by foreign investment. And that's the bottom line: jobs for Americans, a growing economic pie for everyone.

Sue Maguire COMM.

Now, here's one issue where Governor Clinton doesn't waffle. He's surveyed the issue of foreign investment and come out foresquare for -- you guessed it -- a tax increase.

He's proposed to increase taxes on foreign investment in the United States, even though those companies employ a total of 4 and one-half million Americans.

Sue Maguire COMM

[[Governor Clinton says his new tax will raise $45 billion. He might want to talk to his own Democrats on Capitol Hill. The

Joint Committee on Taxation says that estimate is about 45 times too high.]]

JCT MEMO

Governor Clinton says his tax increase will "crack down" on foreign companies, but all it will really do is drive them out. And if they go, they'll take those jobs with them.

Travel around this state. Go to New Madrid (MA-drid), talk to the 1200 employees at Noranda Aluminum -- or to Joplin, talk to the 425 employees of Atlas Powder. Go to any of the 244 foreign-owned companies that employ 60,000 workers right here in Missouri. I don't think you're going to find any of those Missourians railing against the evils of foreign investment.

MO Advantage Fact Sheet

16

If Governor Clinton's tax hike had been in effect these past few years, those companies wouldn't be here -- and those jobs wouldn't have been created for Missourians.

And it's not just Missouri. Whether it's the Nissan plant in Tennessee -- or the proposed BMW plant in South Carolina -- Governor Clinton's tax increase would be felt in every region of every state of this country.

NEXIS

17

Governor Clinton needs to learn something about international relations. If he raises this tax, our foreign competitors are going to say: "What's good for the goose is good for the gander." His tax is like a gilded invitation sent to foreign governments where U.S. companies also do business. And the invititation reads: "Please retaliate."

The result would be not just a reduction in investment here, but a contraction worldwide. There was another occasion when

that happened. It was in 1930. Right before the great depression.

[[No other major industrial nation favors the kind of tax increase Governor Clinton proposes -- not Germany, not Japan. But I can tell you one nation that does tax foreign investment as he would like: India.

Well, here's a promise I am proud to make: As long as I am president, India will not be a model for how to conduct economic policy in the United States of America.]]

Let's review the facts about Governor Clinton's tax: It won't raise revenue. It won't create a single job. It will discourage investment. And it threatens to start a trade war at the very moment when markets the world over are opening up to American products.

We should ask why, given all this, Governor Clinton would ever propose such a tax in the first place. I can tell you why. Today change is accelerating, and change breeds uneasiness, skepticism, even fear. And by disparaging foreign investment, Governor Clinton hopes to exploit the darker fears of this uncertain age -- fear of the future, fear of the unknown, fear of foreigners.

Well, let me tell Governor Clinton something: Play politics all you want, but those are American jobs you're playing politics with. Those are American workers you're putting at risk.

The American people won't buy it. The proudest people on earth have never stooped to fearmongers before, and we're not going to start now.

In talking about America's future in the global economy, I mentioned my own experience, because I want you to understand why I believe what I do about America's ability to compete. I've built a business; I've dealt with foreign nations; I know what it takes to make America secure and strong at home and abroad.

Governor Clinton takes a different view, and it is borne of his life experience -- a life spent in Arkansas government.

So the American people have a clear choice this year. It's a choice between the patrons of the past and the architects of the future. I believe we can shape what lies ahead -- not by turning away from challenges but by doing what you here at PSE have done -- meeting the competition head on, making foreign markets your own.

I have faith in America's future -- because I have faith in the American people. It's the same faith that brought me out to Texas more than 40 years ago -- the same faith that brought me into public life -- the same faith that has led me to fight for open markets -- because I know that no challenge is too great for the American heart.

Thank you and God bless you.

# #

Organization For
International Investment

MYTHS ABOUT FOREIGN INVESTMENT IN THE UNITED STATES

Myth #1: Foreign investment hurts domestic business.

FACT: ***Foreign-owned U.S. companies contribute substantially to the productivity of the U.S. economy.*** These companies generally have a good history of investing in capital resources and increasing productivity. The latest Commerce Department statistics show that in 1988 foreign-owned U.S. companies in manufacturing spent almost 50 percent more on investment in plant and equipment per worker than the average for all U.S. manufacturing.

Productivity also grew more rapidly in foreign-owned U.S. manufacturing companies than in the manufacturing sector as a whole between 1980 and 1988. In real terms, the gross product (i.e., value added) of foreign-owned U.S. companies in manufacturing rose nearly four times as fast as all manufacturing establishments in the U.S. between 1980 and 1987.

Foreign investment can also bring new technologies into an economy, potentially increasing the competitiveness of U.S.-owned companies. According to an August 1991 Commerce Department study on foreign direct investment, "U.S. affiliates have been contributors to the advance of technology in U.S. industry."

Notably, "[i]n the automobile industry, anecdotal evidence suggests that U.S. affiliates of foreign firms appear to have encouraged the diffusion of new technologies, including speeding the adoption of robotics to improve the efficiency of the manufacturing process," according to the Commerce Department report.

Myth #2: Foreigners are buying up America.

FACT: ***As of 1990, foreign direct investment in the United States amounted to approximately $466 billion, based on current or replacement cost measures.*** This is about three percent of total U.S. domestic net worth.

Source: U.S. Commerce Department

Myth #3: Foreign investment in the U.S. only benefits the investor.

FACT: ***Productive investment of any kind benefits an economy, regardless of the nationality of the investor.*** Employment of American workers, increased exports and taxes paid are just some of the benefits foreign-owned companies bring to the United States.

Employment at U.S. subsidiaries of foreign-owned companies totaled 4.7 million in 1990, or about five percent of all U.S. nonbank employment. Employment at foreign-owned U.S. manufacturing companies came to more than 2.0 million workers -- about 10.8 percent of the total U.S. manufacturing workforce. In 1990, foreign-owned companies exported $91 billion of merchandise from the U.S. Foreign-owned companies paid $24.4 billion in direct taxes (e.g. sales, property) in addition to income and payroll taxes in 1989.

Source: U.S. Commerce Department

Myth #4: Japan is the biggest investor in the U.S. economy.

FACT: ***As of the end of 1991, the United Kingdom was the largest investor in the United States, accounting for 27.4 percent of total foreign direct investment.*** Japanese (20.6 percent) and Dutch (14.9 percent) investors ranked second and third respectively.

Myth #5: The success of U.S.-owned corporations is more important to the U.S. economy than that of foreign-owned U.S. corporations.

FACT: ***Harvard's Robert Reich, building on the work of many economists, has pointed out that the ownership of a corporation is less important than the corporation's willingness and ability to create and maintain high wage jobs in the United States.***

According to Reich, " . . . ownership of the corporation is profoundly less relevant to America's economic future than the skills, training, and knowledge commanded

by American workers -- workers who are increasingly employed within the United States by foreign-owned corporations."

Myth #6: Foreign investment plays a larger role in the U.S. economy than it does in all other major industrial nations.

FACT: ***Foreign investment from all sources plays a proportionally larger role in the economies of all other major industrial nations (except Japan) than it does in the United States.***

For example, in 1986 (the most recently available data from all countries), in terms of manufacturing employment, foreign-owned firms in the United States accounted for seven percent of all manufacturing employment in the U.S. economy. By contrast, foreign-owned firms accounted for two to almost five times as much in the United Kingdom, France, Germany and Canada than that amount. In terms of total assets, the foreign-owned company share for these four countries was one and a half to almost three times as large as in the United States. This information is summarized below.

SHARE OF FOREIGN-OWNED FIRMS		
	Percentage of Manufacturing Employment	**Percentage of Total Assets**
Canada	34	25*
France	21	26*
United Kingdom	14	14
Germany	13	17
United States	7	9
Japan	1	1

*1987

Source: D. Julius & S. Thomsen, "Foreign-owned Firms, Trade, and Economic Integration," *Tokyo Club Papers 2*, Royal Institute of International Affairs, 1988 and Commerce Department.

Myth #7: Foreign businesses play a larger role in the U.S. economy than U.S. businesses play in the home economies of these foreign businesses.

FACT: U.S.-owned businesses are generally more active in the economies of other major industrial countries than are foreign-owned businesses from these countries in the U.S. economy.

For example in 1989, as a percentage of the host-country's gross domestic product, the value of U.S.-owned businesses in the United Kingdom was three times that of British businesses in the United States, 7.5 percent as compared with 2.3 percent. Similar and even larger disparities hold for the other major industrial countries other than Japan. This information is summarized below.

FOREIGN DIRECT INVESTMENT AS A PERCENT OF HOST-COUNTRY GROSS DOMESTIC PRODUCT		
	Percentage of Foreign Holdings in the United States	**Percentage of U.S. Holdings in the Foreign Country**
United Kingdom	2.3	7.5
Netherlands	1.2	6.9
Japan	1.3	0.7*
Canada	0.6	11.9
Germany	0.5	1.8
Switzerland	0.4	10.8
France	0.3	1.4

* 1988

Source: Commerce Department

Myth #8: U.S. businesses are no longer an important source of foreign direct investment to the world economy.

FACT: ***The U.S. remains, by far, the largest source of foreign direct investment in the world.*** At the end of 1989, the overall value of the stock of all foreign direct investment from all sources around the world came to almost $1.4 trillion, on a historic cost basis. Of this total, U.S. businesses held $380 billion, or 28.3 percent. The next largest national source for direct investment was the United Kingdom. British businesses had $224 billion, or 16.7 percent. Japanese businesses were in third place, with $154 billion in direct investment, or 11.5 percent of the overall total.

Source: Commerce Department

① strongly endorsed in the past

"imperative." last year

April 14, 1992 Wash Post

Org labor breathing easier

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Gephardt:

July 29 edit WSJ | We must reject the outdated applauding Gephardt's efforts.

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"I'm When I have definitive opinion

I'll say so."

details of the agreement

THE WHITE HOUSE
WASHINGTON

Findley - in a free trade zone
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trying to export
call Gary Foster

Theme: general strong economy
mailing down whether
jobs - strong economy.
tie in jobs training
draw linkages

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Director, Washington

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Suite 704
Washington, DC 20006
(202) 659-1903
Fax (202) 659-2293

Organization for
International Investment

DO FOREIGN-OWNED U.S. CORPORATIONS PAY THEIR FAIR SHARE OF U.S. CORPORATE INCOME TAX?

There has been much discussion recently about whether foreign-owned U.S. corporations ("FO-USCs") are paying their fair share of U.S. corporate income tax ("tax"). Those arguing that FO-USCs do not pay their fair share of taxes have referred to Statistics Of Income ("SOI") data taken from federal corporate income tax returns, particularly those from the 1986 tax year.

Although FO-USCs paid less tax in 1986 than in earlier or later years, ***THE SOI FIGURES CLEARLY DEMONSTRATE THAT FO-USCS HAVE PAID THEIR FAIR SHARE OF U.S. INCOME TAX.***

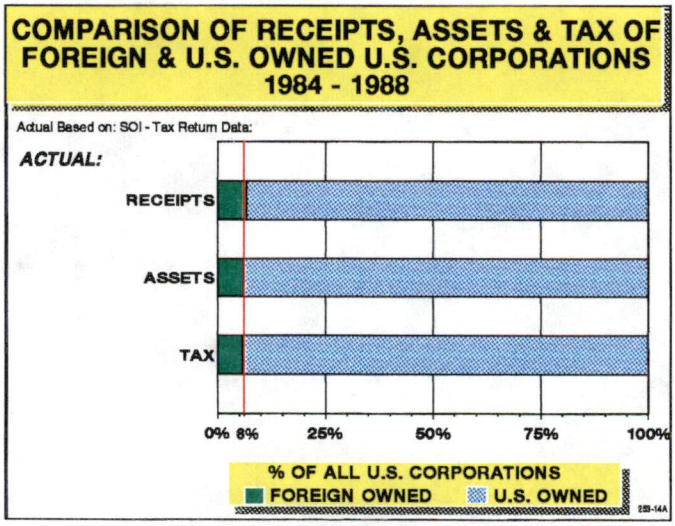
FO-USCs should be expected to pay U.S. tax in proportion to their share of U.S. business. Corporate assets and receipts may be the most indicative measures of U.S. business activity. If FO-USCs over a period of time, own on average 6% of all U.S. corporate assets and generate 6% of all U.S. receipts, FO-USCs should pay about 6% of all U.S. corporate income tax. One would not expect FO-USCs to pay significantly more or less than this amount.

The SOI data for the years 1984 through 1988 (the most recent years for which SOI data is available) yield some consistent patterns (see Attachment):

- FO-USC assets on average represent approximately 6% (actual 5.91%) of all U.S. corporation assets.

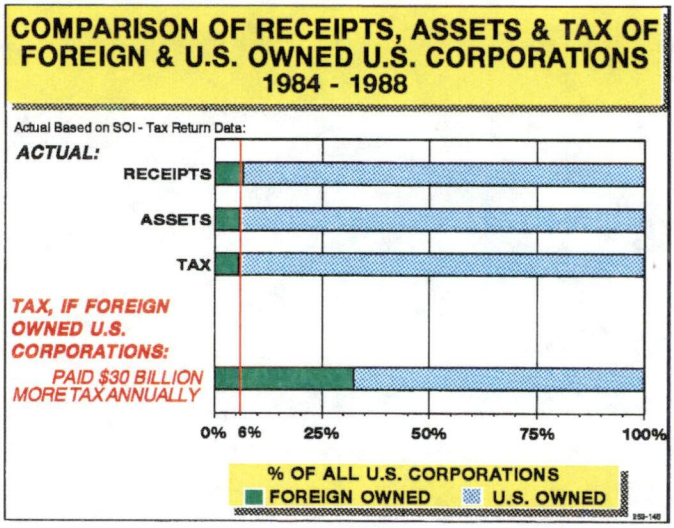
- FO-USC receipts on average represent approximately 6% (actual 6.69%) of all U.S. corporation receipts.

One would therefore expect FO-USCs over this time period to pay approximately 6% of the income taxes paid by all U.S. corporations, and this was in fact the case. FO-USCs paid approximately 6% (actual 5.61%) of the tax, an amount not "out of line" with all U.S. corporations.



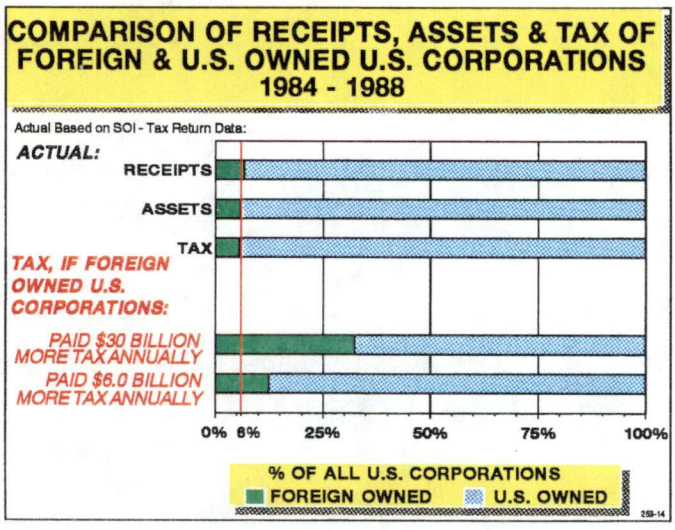
During hearings of the House Ways and Means Oversight Subcommittee in August, 1990 and March, 1992, statements were made charging that FO-USCs should be paying an additional $30 billion in U.S. tax per year. But the SOI data for 1984 through 1988 clearly show these charges are off the mark. If $30 billion were added to the tax liabilities of FO-USCs, the following distortions would occur.

- If FO-USCs had paid $30 billion more corporate income tax in each of the five years, their share would have been 32% (actual 32.49%) of all U.S. corporate income tax paid in the period, more than five times their 6% average of assets or receipts.



- If $30 billion were added to the tax that FO-USCs paid in just one year, say in 1986, FO-USCs would have paid nearly 32% (actual 31.81%) of all U.S. corporate income tax for that year.

- Even if $30 billion of additional tax had been paid by FO-USCs over the entire 5 year period of the years from 1984 to 1988 (i.e., equivalent to $6.0 billion per year), FO-USCs would have paid 12% (actual 12.43%) of all U.S. corporate income tax paid during the five-year period; twice their 6% average of assets or receipts.



CLEARLY, THE ASSERTION THAT FO-USCS UNDERPAY BILLIONS IN CORPORATE INCOME TAXES ANNUALLY IS UNFOUNDED AND UNREALISTIC.

Moreover, any exercise to break down the SOI data by industry or products to determine whether a particular corporation or a particular industry is contributing its fair share of income tax would be pointless. Even if it could be demonstrated that the earnings of a particular company or sector were lower than some statistical "norm," one could not conclude that the company or sector was not paying its proper taxes or that a "transfer pricing problem" existed. Unfortunately, the issue is not that simple.

Except for regulated industries, one would not expect all companies within an industry to have the same level of profitability. There are too many variables. Each individual company has efficiencies or inefficiencies in any number of areas, e.g., marketing, manufacturing, foreign currency exchange, raw material sources, supply agreements, market share, market acceptance, labor, quality of facilities and equipment, financing, technologies. Simply stated it does not follow that because Ford is profitable, Chrysler must also be profitable.

This emphasizes the danger in using statistical extrapolation to justify changes in the law -- particularly, if those changes could jeopardize the benefits the U.S. realizes from foreign investment. The SOI data clearly show that FO-USCs on the whole pay their fair share of U.S. corporate income tax -- a share proportionate to their share of U.S. business. Should individual U.S. corporations, whether foreign-owned or U.S.-owned, manipulate their U.S. tax liabilities, the problem is best addressed, as Treasury officials have repeatedly stated, through the audit process on an individual company basis -- not through broad based, discriminatory law changes.

TAH:dmb (wp362:2)
Attachment
July 15, 1992

TREASURY (SOI) DATA

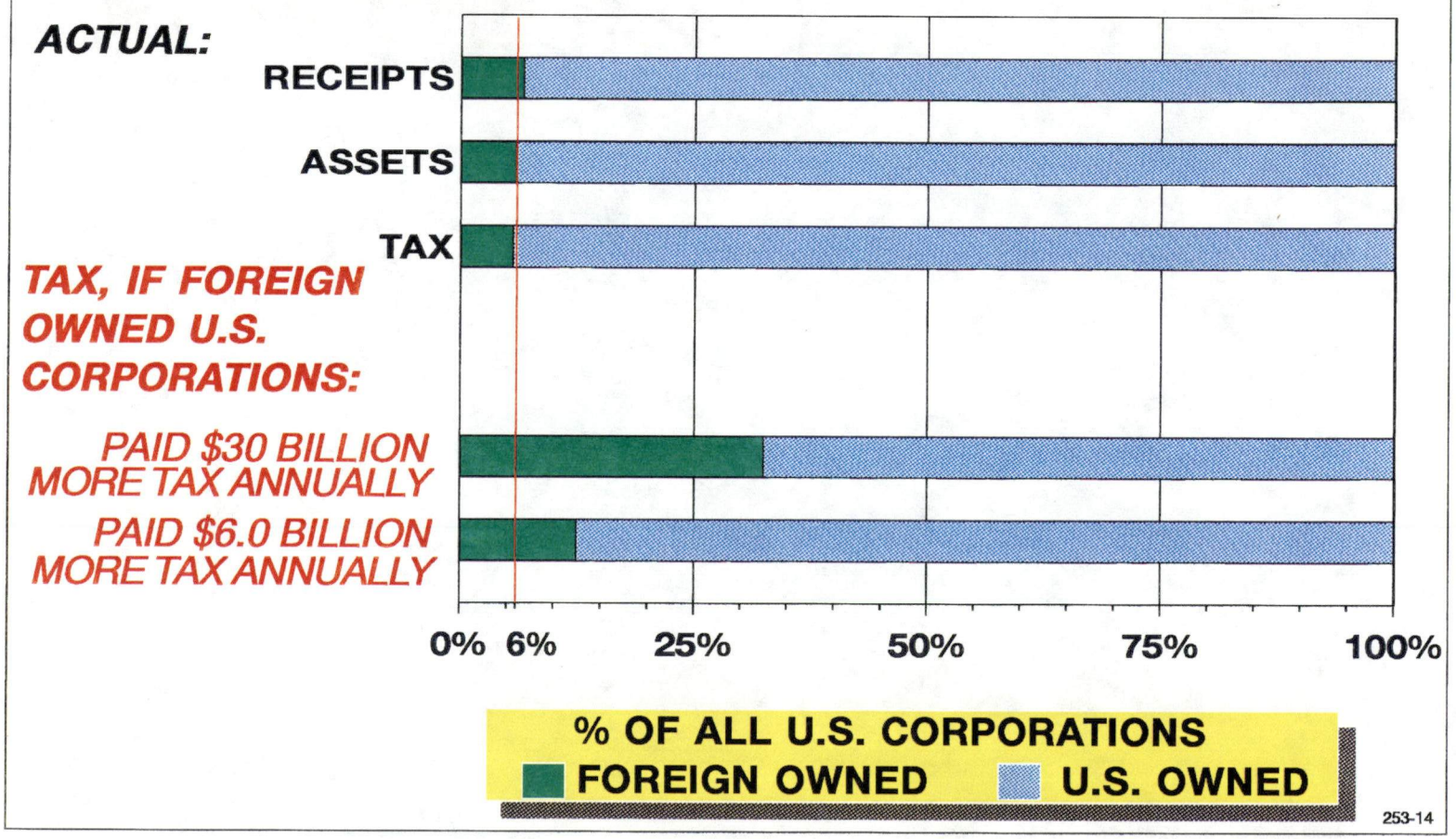
	1984	1985	1986	1987	1988
Total Assets:					
FO-USCs	552.6	655.7	840.9	959.4	1,199.3
All U.S. Corp.	11,106.7	12,773.1	14,163.2	15,310.6	16,568.5
Total Receipts:					
FO-USCs	459.2	513.8	542.7	686.8	825.6
All U.S. Corp.	7,860.7	3,398.3	8,669.4	9,580.7	10,264.9
Federal Income Tax Liability:					
FO-USCs	4.5	3.6	3.0	4.6	5.8
All U.S. Corp.	64.0	63.3	73.9	87.0	95.9

MONEY AMOUNTS IN BILLIONS

253-15

COMPARISON OF RECEIPTS, ASSETS & TAX OF FOREIGN & U.S. OWNED U.S. CORPORATIONS 1984 - 1988

Actual Based on SOI - Tax Return Data:



253-14

1ST STORY of Level 1 printed in FULL format.

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August 13, 1992, Thursday, Final Edition

SECTION: FIRST SECTION; PAGE A1

LENGTH: 1151 words

HEADLINE: U.S., Canada and Mexico Agree to Form Trade Bloc;
Pact Would Create World's Largest Commercial Zone

SERIES: Occasional

BYLINE: Stuart Auerbach, Washington Post Staff Writer

BODY:

The United States, Canada and Mexico concluded a hemispheric free-trade agreement yesterday that would create the world's largest trade bloc, one designed to make North American companies more competitive against their Asian and European rivals.

The agreement covers a territory stretching from the Yukon to the Yucatan with some 360 million people and an economy of $ 6 trillion.

Under the pact, known as the North American Free Trade Agreement, tariffs and other barriers to the movement of goods, services and money between the United States and its neighbors to the north and south will be erased over the next 15 years.

Just hours after the agreement was reached, President Bush stepped out into the morning sun of the White House Rose Garden to announce the pact and call it "the beginning of a new era" for North American economic cooperation that will "create jobs and generate growth in all three countries."

While U.S. business cheered the announcement, Democrats, organized labor and others immediately raised questions about its impact, signaling a difficult ratification battle in Congress next year.

Democratic presidential nominee Bill Clinton said he supports a free-trade pact if it "provides adequate protection for workers, farmers and the environment on both sides of the border."

Two influential Democratic lawmakers -- House Majority Leader Richard A. Gephardt (Mo.) and Sen. Max Baucus (Mont.), chairman of the Senate Finance Committee's trade panel -- said the trade pact negotiated by the Bush administration failed those tests. They called for a renegotiation of the agreement to strengthen its provisions on protecting the environment and helping workers who lose their jobs because of the accord.

Under the agreement, which is to take effect on Jan. 1, 1994, patterns of trade are expected to change in all of North America, just as they changed between the United States and Canada under a similar accord between those two countries 3 1/2 years ago. The concept behind these agreements is that the economy of the entire region will grow more vigorously and be more competitive

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with foreign rivals as a whole than as separate national economies.

With Mexican tariffs now averaging 250 percent higher than U.S. tariffs, American makers of cars, auto parts, telecommunications equipment, computers and other products expect the lowering of barriers to vastly increase their sales in Mexico. Further, the agreement opens new markets in Mexico for U.S. banks, insurance companies, investment houses and oil service companies, all of which faced restrictions or bans on doing business there.

"Mexico is our fastest growing export opportunity ... and this agreement not only locks in the economic reforms and export opportunities that we have secured to date, but builds upon them and creates a real job machine at our back door," said U.S. Trade Representative Carla A. Hills.

She signed off on the trade pact shortly before 2 a.m. yesterday, after a final, intense two-week round of talks that concluded 14 months of negotiations.

The White House, apparently anxious to gain political capital from the conclusion of the trade pact, arranged for the presidential announcement hours before final agreement was reached. Nonetheless, Hills said she was under no political pressure to conclude the agreement before next week's Republican convention.

Both President Carlos Salinas de Gortari of Mexico and Canadian Prime Minister Brian Mulroney praised the accord yesterday. Salinas, who sought the trade agreement with the United States, is banking on it to lift Mexico into an economic force in the world.

Canada joined the talks late to gain improvements in its bilateral trade pact with the United States.

Bush, in his short Rose Garden announcement, sounded themes that are certain to be a part of his reelection campaign. He said that open markets in Canada and Mexico mean more and higher-paying American jobs, "the kind that our nation needs to grow and prosper, the kind that showcase American talent and technology."

Congressional Democrats, however, attacked the pact on the jobs issue. Sen. Donald W. Riegle Jr. (D-Mich.) called it "a real danger to Michigan and the entire American economy ... because we have plants closing all across America and moving to Mexico to take advantage of very low wage rates."

The Republican side was more supportive. Sen. John C. Danforth (R-Mo.) called it "a bold and exciting idea" that ranks "among the most important economic developments for the United States since World War II."

Hills and her chief negotiator, Deputy U.S. Trade Representative Julius Katz, said lawyers will go over the agreement next week to make sure its language is clear and all its provisions are consistent. At the same time, some 40 industry advisory groups will prepare reports for Congress on the impact it will have on their businesses.

The completed text and those reports will be presented to Congress when it returns from the Labor Day recess in early September. Under the law, Congress has 90 days to study the agreement and to work with the administration to

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draft legislation that will implement the agreement into law. Congress then has 90 legislative days, which could stretch out for as long as eight months, to pass that legislation under special "fast-track" provisions that permit no delays or amendments.

This means the legislation will be acted on by a new Congress, with as many as 125 new members, and could be presented by a new president with ideas of his own on the contents of agreement.

Organized labor and major environmental groups joined in the attack on the accord, which AFL-CIO Secretary-Treasurer Thomas Donahue called "a bad deal for American workers, consumers and the long-term health of the American economy."

But practically across the board, the agreement was hailed by major U.S. industrial groups and corporations, which feel it will help them sell more in Mexico's previously closed markets, help them compete better against foreign rivals in North America and allow them to manufacture across the continent so they can become more efficient competitors in European and Asian markets.

Typical of comments on the agreement from big business, General Motors Corp. Chairman Robert C. Stempel said, "It has the potential to create jobs in the United States and increase trade by all three countries."

Despite attacks by environmental groups, Hills and Environmental Protection Agency Administrator William K. Reilly praised the environmental sections of the agreement, which they said preserves stringent U.S. health, safety and environmental laws.

" NAFTA is the most environmentally sensitive trade agreement ever negotiated anywhere, and it will be seen as a model for other countries. Rejecting NAFTA on environmental grounds would be the environmental mistake of the decade," Reilly said.

GRAPHIC: ILLUSTRATION, KEY PROVISIONS, PETER HOEY; ILLUSTRATION, TWP

TYPE: NATIONAL NEWS, FOREIGN NEWS

SUBJECT: CANADA; UNITED STATES; MEXICO; TREATIES; TRADE REGULATION; FOREIGN INVESTMENTS; INTERNATIONAL TRADE

ORGANIZATION: NORTH AMERICAN FREE TRADE AGREEMENT

NAMED-PERSONS: GEORGE BUSH; BILL CLINTON; RICHARD A. GEPHARDT; MAX BAUCUS

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EXECUTIVE OFFICE OF THE PRESIDENT

25-Aug-1992 05:36pm

TO: Andrew Ferguson

FROM: Edward J. Walters
Office of Communications

SUBJECT: OHIO

In Ohio, exports are up ___ percent over the last three years -- 28.5 billion worth of goods shipped to 172 countries.

I'm not sure Ohio has recent enough figures to fill in the first blank, but if they do, I'm going to find it.

Also, in the Missouri speech using the line above, you say they export to every continent. Must be a tough trek to Antarctica.

EXECUTIVE OFFICE OF THE PRESIDENT

25-Aug-1992 05:29pm

TO: Andrew Ferguson

FROM: Edward J. Walters
Office of Communications

SUBJECT: Findlay, OH

This just in . . .

Once again, you are prescient. Findlay Machine and Tool does not export (although they assure me that they have sold to Japanese and German companies in the U.S.). Some of their bigger customers are Catepillar machinery, GM, and Briggs and Stratton.

They boast a new kind of machine-cleaning equipment that is environmentally friendly. Two of their machine cleaners will flank the stage area, as will two 30-ft. flags and a banner. Expected audience is 1,500.

(Ferguson/Walters)
August 25, 1992
6:40 p.m.
STLOUIS

92 AUG 25 P6:43

PRESIDENTIAL REMARKS: PUBLIC SAFETY EQUIPMENT, INC.
ST. LOUIS, MISSOURI
AUGUST 27, 1992
9:00 A.M. (??)

Thank you and good morning.

(Acknowledgments, humor)

Together we have seen a world transformed these past three and a half years -- a world made new by American strength and resolve. But now that the Cold War is over, the defining challenge of the '90s is to win the economic competition of the new global economy -- to win the peace.

Our goal is simple and profound: We must be a military superpower, an economic superpower and an export superpower.

In this election, you'll hear two versions of how to do this. My opponents' answer is to look inward, and protect what we already have from the challenges of this new world. My approach is to look forward -- to open new markets, prepare our people to compete, to restore our social fabric -- to save and invest, so that we can win.

Twenty five years ago, where you're standing was a patch of bleak, undeveloped real estate. Now look around -- because of your dreams and hard-work, that patch of ground is a bustling factory, creating light bars and sirens that help save lives and keep the peace from Manila to Santiago.

There was a time when companies like PSE could be satisfied with a national market -- sell your goods in the fifty states and leave it at that.

But you here at PSE know that's no longer good enough. So five years ago, you took on the world. I'm told that now 35 percent of what you build right here is sold outside our borders, in 66 different countries. That bold, forward-looking strategy has helped you weather the uncertainties of the past few years.

PSE's story is a parable for our entire country's economic future -- never settling for less, always pushing ahead, embracing the challenges of foreign competition and reshaping them as opportunities.

Let me offer a personal note -- tell you how I learned about competing in the world.

I spent a good part of my life out in West Texas, in the oil business. I painted rigs for a while, even lived out of a suitcase as a traveling salesman. And all around me in those days -- the fifties and early sixties -- I saw towns and businesses bloom from those dusty plains like desert flowers.

Why? The reason was simple: The world wanted what Texas had to offer -- cotton and cattle and crude.

We understood that the more goods we sold outside our borders, the more jobs we could create within them.

Later on, when I started my own business, I learned again: we had to take a global view to compete. I shopped for investors on the west coast, on the east coast, but I couldn't stop there.

I traveled the world -- to Europe and the Far East. Every dollar we could bring into this country was a dollar that went to expand our company, create jobs in our community.

I've seen it over and over again: as U.N. ambassador, envoy to China, and now as president. You learn how important America is to the world, but you also learn how important the world is to America -- not just for national security, not just for military preparedness, but for creating jobs, right here at home.

We've held steady to this vision for three years now, and with great success. As we knock down trade barriers, American companies are rushing to meet the demand. Exports are up xxx in the last five years; America is once again the world's leading exporter.

What does that mean right here? I'll bring it closer to home. In Missouri, exports are up 37 percent over the last three years -- $4.5 billion worth of goods shipped to 166 countries on every continent.

Impressive numbers, but when you get behind the abstractions of export figures and trade statistics, you find the real benefit of the new world economy -- in a word, it's jobs. Here in Missouri, 100,000 jobs are supported by foreign trade. Across the country, more than 7 million Americans are employed for the same reason.

That's the way the world works these days. It's a world where products can be shipped at the speed of sound and investment money can cross borders at the speed of light.

Everyone recognizes that the world is moving at a faster pace than ever, but I see something more: it's moving our way. Right now we're building on the export success of the last three years. Two weeks ago we entered a new era of open trade. Along with Mexico and Canada, we initialed the North American Free Trade Agreement, with the goal of creating one of the largest free-trade areas in the world -- an integrated economy worth more than $6 trillion dollars.

Here in Missouri, you already export $2 billion worth of goods to Mexico and Canada. That's a lot of paychecks, but our new agreement will make that success look like kid's stuff.

NAFTA is a solid agreement -- when you've been in as many tough negotiations as I have, you learn to tell the difference. It will protect the environment, and more important, it will protect American workers. And more: it will create new jobs for this generation and the next -- especially the kind of high-tech, high-wage jobs we'll be proud to pass on to our children.

We're going to take this case to the liberal Democrats on Capitol Hill, because they need to hear it. A free-trade agreement isn't a way of dividing up the economic pie, where one side's loss is another side's gain; it's a way of making the pie bigger for everyone who participates.

The liberals don't seem to get it. Right now, in fact, before our initials are even dry on the agreement, the liberals in Congress -- led by somebody who might be familiar to you,

Congressman Dick Gephardt -- are calling for us to slap a tarriff on any new trade that comes from NAFTA.

Think about that for a minute -- ((which is a minute longer than they've thought about it)). After years of tough negotiations with our two closest trading partners, we've agreed to end tariffs. The congressional Democrats say: Okay, fine. But first you have to put on a new tariff.

In other words, the only way they'll agree to reduce tariffs is if they can raise tariffs.

That's like telling us they want us to hit a homerun, but please don't hit it out of the park because we don't want to lose the ball.

This "transaction tax," as they call it, will increase the cost of goods you want to buy, and discourage the creation of new jobs for you and your neighbors. It turns the agreement on its head -- defeats the whole purpose.

Now, I suppose I could ask my opponent to help me out with his liberal Democrat colleagues on Capitol Hill. Governor Clinton says he's for free trade "in principle."

But "in practice" may be a different story. Actually, it's not clear where the governor stands. Last year, Mr. Clinton called a free-trade pact with Mexico "imperative." Then this April, the Washinton Post reported that the protectionists were "breathing easier" because he endorsed their trade position. Then in July, he said he was "applauding Majority Leader Gephardt's efforts."

This week, maybe the governor delivered his final word on the subject. He said he was studying our agreement. Then he said: "When I have a definitive opinion, I'll say so."

The way Governor Clinton wiggles on free trade, I'm not surprised he compares himself to Elvis.

No matter how much Governor Clinton would like to fudge the issue, the difference couldn't be clearer -- and the difference is based on two very different views of America's future. My opponents see trade barriers falling and they say: Hold everything. They see new markets for American goods and they say: Wait a minute. We can't compete. The American worker can't cut it. So let's pull down the blinds, lock the doors and hope the world goes away.

Well, let me tell them something you already know. The American worker doesn't have to hide from anybody. We have the most productive workforce in the world. Americans can outwork, out-think, out-compete anybody, anywhere, anytime.

That's something everyone in the world seems to understand -- everyone but the protectionist Democrats. Over the last decade, we've seen a flood of foreign investment in the United States, with businesses from all over the world setting up shop from Portland, Oregon to Portland, Maine. These investors are following a simple logic: if you want the best science and universities in the world, if you want the best workers in the world, you have to come to the U.S.A.

Now, this investment makes some people uneasy. I understand that -- particularly when the other side tries to stir up fear and resentment against foreign capital. I was in Utah not long ago, and a very articulate woman confronted me on the issue. I told her we probably couldn't see eye to eye on it, but I tried to tell her why I felt so strongly against the isolationism that would keep foreign investment out of America.

There was an irony in her timing. I had just returned from meeting with the heads of the industrialized countries in Munich, and while I was there I was pleased to team up with Governor Carroll of South Carolina and the head of BMW to announce a new BMW plant in South Carolina. That means 10,000 jobs to the people of that state.

Now, I don't think the 10,000 South Carolinians who get those jobs are going to argue against foreign investment. One out of every ten manufacturing workers in the United States works for a company supported by foreign investment. That's the bottom line on foreign investment in the U.S.: jobs -- jobs for Americans, and growth for the American economy.

That's the way the world works in a global economy. Again, Governor Clinton just doesn't seem to understand. But he's not wiggling on the issue of foreign investment -- not at all. He's surveyed the issue and come out foresquare for -- you guessed it -- a tax increase.

He's proposed to increase taxes on foreign investment in the United States, each one of those companies that employ a total of 4 and one-half million Americans.

Governor Clinton says his new tax will raise $45 billion. He might want to talk to his own Democrats on Capitol Hill. The Joint Committee on Taxation says that estimate is about 45 times too high.

Governor Clinton says his tax increase will "crack down" on foreign companies, but all it will really do is drive them out. And if they go, they'll take those jobs with them.

Travel around this state. Go to New Madrid (MA-drid), talk to the 1200 employees at Noranda Aluminum -- or to Joplin, talk to the 425 employees of Atlas Powder. Go to any of the 244 foreign-owned companies that employ 60,000 workers right here in Missour.

If Governor Clinton's tax hike had been in effect these past few years, few if any of those companies would have located in the United States -- few if any of those jobs would have been created for Missourians.

And it's not just Missouri. Whether it's the Nissan plant in xx Tennessee -- whether it's the xx plant in xx, xx -- Governor Clinton's tax increase would be felt in every region of every state of this country.

Governor Clinton forgets something about international relations. If he raises this tax, our foreign competitors are going to say: "What's good for the goose is good for the gander."

His tax is like a gilded invitation sent to foreign governments where U.S. companies also do business. And the invititation reads: "Please retaliate."

The result would be not just a reduction in investment here, but a contraction worldwide. There was another occasion when that happened. It was in 1930. Right before the great depression.

No other major industrial nation has the kind of tax Governor Clinton proposes -- not Germany, not Japan. But I can tell you one nation that does tax foreign investment as he would like: India.

Well, here's a promise I am proud to make: As long as I am president, India will not be a model for how to conduct economic policy in the United States of America.

So let's review the facts about Governor Clinton's tax: It won't raise revenue. It won't create a single job. It will discourage investment. And it threatens to start a trade war at the very moment when markets the world over are opening up to American products.

We should ask why, given all this, Governor Clinton would ever propose such a tax in the first place. I can tell you why. Today change is accelerating, and change breeds uneasiness, skepticism, even fear. And by disparaging foreign investment, Governor Clinton hopes to exploit the darker fears of this uncertain age -- fear of the future, fear of the unknown, fear of foreigners.

Well, let me tell Governor Clinton something: You can play politics with, but those are American jobs you're playing politics with. Those are American workers you're putting at risk.

The American people won't buy it. We're bigger than that. The proudest people on earth have never stooped to fearmongers before, and we're not going to start now.

In talking about America's future in the global economy, I mentioned my own experience, because I want you to understand why I believe what I do about America's ability to compete. Governor Clinton takes a different view, and it is borne of his life experience -- a life spent in government.

You see the difference on issue after issue. I understand that you boost the economy by cutting taxes. I understand that you cut the deficit by cutting spending. I understand that you open markets by tearing down barriers -- by sitting down at the table and hammering out a tough and fair agreement.

So the American people have a clear choice this year. It's a choice between the patrons of the past and the architects of the future. I believe we can shape what lies ahead -- not by turning away from challenges but by doing what you here at PSE have done. You didn't shrink from challenge, you embraced it. You didn't shrink from competition, you met it head on. You didn't retreat from foreign markets, you conquered them.

I have faith in America's future -- because I have faith in the American people. It's the same faith that brought me out to

Texas more than 40 years ago -- the same faith that brought me into public life -- the same faith that has led me to fight for open markets -- because I know that no challenge is too great for the American heart.

Thank you and God bless you.

# #

E X E C U T I V E O F F I C E O F T H E P R E S I D E N T

25-Aug-1992 03:29pm

TO: Andrew Ferguson

FROM: Edward J. Walters
Office of Communications

SUBJECT: OHIO trade numbers

25.8 billion dollars tied to exports (direct and indirect), representing 6.5 percent of the state's economy.

315,000 workers in jobs tied to exports (1 in 7 jobs in the state).

Andy

August 16, 1992

MEMORANDUM FOR SPEECHWRITERS/RESEARCHERS

FROM: STEVEN D. PROVOST
Assistant to the President
for Speechwriting

RE: Upcoming Speeches

Here's a synopsis of the speeches that will be delivered the week after the convention. Please let me know if you have any questions or comments. The only constant is change, so I'll provide more information as it becomes available.

Friday, Saturday and Sunday rally remarks will all be "stump" summaries of the acceptance speech. The one exception is the National Affairs Briefing with the Evangelicals (Curt Smith) which should cover the social issues of concern to that audience.

After the weekend, we will devote all the next week's events to the economy, both explaining the President's new proposals and attacking the Clinton-Gore economic platform.

If time allows, each speech should begin with the same litany, covering specific points we want to drive home.

1. The President is the only candidate who has run a business. (Example: "The simple fact is, there is only one candidate for President who has lived a life beyond government, and known a call above political ambition. Bill Clinton has never created a single job -- since the day he graduated from law school, every paycheck he has earned has come out of the taxpayer's pocket. I built a company -- met a payroll. Keep that in mind when you consider who you trust to get this economy moving faster."

2. A concise philosophical indictment of the Clinton economic strategy on two counts. First, he is a liberal in moderates' clothing. (Example: "Governor Clinton says he favors enterprise, but proposes the largest tax increase in history. He says he wants smaller government, but of the thousands of federal programs -- proposes only cutting the vaunted honey bee subsidy. He says he is for fiscal

responsibility -- but came out against a balanced budget amendment. Bill Clinton is the "Karaoke candidate" -- he'll sing any tune he thinks will get him elected") Second, Clinton-Gore are "patrons of the past," wanting to protect old jobs. We are "architects of the future," wanting to create new jobs in a high-tech, information-based, knowledge-driven world economy.

3. A concise statement of the President's economic philosophy, drawing the link between his success in foreign affairs and the challenge of competing in a global economy. (Example: In the past four years, more people have breathed the first breath of freedom than in any time in human history. America's leadership -- your leadership -- made it happen. We've cornered the markets on American concepts, now let' s get to work on creating good jobs by exporting American commodities. Today, one out of 13 Americans owe their jobs to foreign trade, and over the past five years, one-third of our economic growth has come from selling products outside our border. This is our future. We've sold the world on our freedom -- now let's sell them farm machinery. We've covered the world with democracy -- let's introduce them to Diet Pepsi. They love liberty -- maybe they'll try our Levis. How do we compete? At a time when all the world is going our way, it doesn't make much sense to go back their way, with big government and high taxes. I offer a program of smaller government, with more incentives for people to create jobs, save and produce. I offer radical, conservative alternatives to improve the fundamentals of our economy: our schools, our welfare system, our research and development capabilities, and our cities.

4. Then go into the specific news of the day. This part of the speech should be factual, loaded with substance, both on the President's proposals and the Clinton criticism. Our speeches continue to be criticized, somewhat fairly, for relying too heavily on rhetoric, not enough on facts, anecdotes, quotes, etc. Having said that, you should let your creativity flow and identify the one "soundbite" that captures the essence of the day's story. If the substance of the issue requires a full 10-12 minutes to explain, skip the stuff above, and we'll fold it into an economic "stump" message later in the day.

5. All speeches must include a pitch for voters to elect a "responsible" Congress (not Republican, this is impractical) that is willing to try new ideas and not tied to special interests.

Here are the speeches, by day.

Monday, August 24: New Jersey and Connecticut: (McGroarty)

This day is devoted to explaining the President's new job training initiatives (for both at-risk young people and displaced workers) which may be touched upon briefly in acceptance speech.

The New Jersey event is at Lincoln Technical Institute. It should start with background on the economy, then explain the job training initiatives in some detail and context. Tom Scully has all the details, the main (and somewhat academic) points of distinction with Clinton are a) Clinton wants to tax workers to pay for their own retraining (there is a pattern here) and b) Clinton's plan to gut the defense budget would throw a million Americans out of work immediately, making more retraining necessary.

The Connecticut event is a lunchtime rally, with members of service clubs. The President should give the basic economic stump message, as outlined above, with special attention to Clinton's defense cuts (need to figure out exactly what Connecticut industries will be effected), Clinton's effect on small business, and then, finally, a condensed description of the job training initiatives discussed that morning. As much as possible, we want the story of the day to be the New Jersey event.

Tuesday, August 25: American Legion (Smith) and Michigan Event (Provost)

A decision will be made Tuesday morning on American Legion. One of three speeches are possible. The basic "We won the Cold War/Veteran's pander" (ala VFW) a pure "foreign policy of the future" address or a speech that tries to drive home the connection between foreign policy and domestic economic policy. The key factor will be whether we decide to have the news of the day come out of the afternoon event in Michigan.

The Michigan event is a main street rally in Canton, Michigan, a town in Western Wayne County outside of Detroit. Clinton will have spoken at the Detroit Economic Club the Friday before and met with the CEO's of the big auto companies. His bus tour will be starting the next day from the same area.

At this outside event, the President should open with the same abbreviated stump speech he gave the day before in Connecticut, then devote specific attention to criticizing the Clinton-Gore ticket for public statements that the automobile is evil and should be abolished, and advocating higher CAFE standards and a gas tax. The President should paint a picture of the havoc this would wreak with the already weak Michigan economy.

Thursday, August 27th: Missouri, Cincinnati, Findley, Ohio.
(Ferguson)

The news event of the day is the Missouri event. The President will appear at a TBD plant that is an American subsidiary of a foreign company. The speech should outline the President's free trade philosophy and agenda, then make the case that Governor Clinton is a closet protectionist, who doesn't understand the world economy. Specific criticism should be levied at Clinton's proposal to tax foreign investment, and the President should list the plants and jobs that would threaten in key states. Andy should call Dan Crippen with the campaign for help in researching the true impact of Clinton's proposals and developing a fact sheet to accompany the speech.

not so

The noon rally in Cincinnati will be outside, off cards. The President should deliver the basic economic stump speech he delivered in Connecticut, with a specific insert on trade, summarizing the speech of the morning (with local anecdotes). We will use the same speech for Findlay, Ohio that evening.

Friday, August 28th: Louisiana:

This event has just been added, so I'm not sure of appropriate topic. Tuesday morning we will decide topic and make the assignment.

Transfer tax
300,000 not including
over 4 yrs.

(Ferguson/Walters)
August 24, 1992
Draft One
STLOUIS

PRESIDENTIAL REMARKS: PUBLIC SAFETY EQUIPMENT, INC.
ST. LOUIS, MISSOURI
AUGUST 24, 1992
9:00 A.M. (??)

Thank you and good morning.

(Acknowledgments)

humor

We're told this election is about change, and it is. The world is in transition, and we're feeling that transition in our homes, in our jobs, in the future we imagine for our kids.

The question we face is, How do we take advantage of this changing world, so that we make this transition work for us.

Now that the Cold War is over, the defining challenge of the '90s is to win the ~~economic~~ competition of the new global economy -- to win the peace.

Our goal is simple and profound: We must be a military superpower, an economic superpower and an export superpower.

In this election, you'll hear two versions of how to do this. My opponents' answer is to look inward, and protect what we already have from the challenges of this new world. My approach is to look forward -- to open new markets, prepare our people to compete, to restore our social fabric -- to save and invest, so that we can win.

I'll give you an example of the winning strategy -- of how we turn change into unbounded opportunity. You're the example.

Twenty five years ago, where you're standing, was a corn-field. Now look around -- because of your dreams and hard-work,

that cornfield is bustling factory, creating products that save lives from xx to xx.

There was a time when companies like PSE could be satisfied with a national market -- sell your goods in the fifty states and leave it at that.

But you here at PSE know that's no longer good enough. So five years ago, you took on the world. I'm told that now 35 percent of what you build right here is sold outside our borders, in 66 different countries. That bold, forward-looking strategy has helped you weather the uncertainties of the past few years.

PSE's story is a parable for our entire country's economic future -- never settling for less, always pushing ~~forward~~ ahead, embracing the challenges of foreign competition and reshaping them as opportunities.

Let me offer a personal note -- tell you how I learned about competing in the world.

I spent a good part of my life out in West Texas, in the oil business. I painted rigs for a while, even lived out of a suitcase as a traveling salesman. And all around me in those days -- the fifties and early sixties -- I saw towns and businesses bloom from those dusty plains of West Texas.

Why? The reason was simple: The world wanted what we had to offer -- crude and cattle and cotton.

We understood that the more goods we sold outside our borders, the more jobs we could create within them.

Later on, I started my own business, trying to build it from the ground up, and I learned again: we had to take a global view to compete. I shopped for investors on the west coast, on the east coast, and around the world -- to Europe and the Far East. Every dollar we could bring into this country was a dollar that went to expand our company, create jobs in our community.

I've seen it over and over again: as U.N. ambassador, envoy to China, and now as president. You learn how important America is to the world, but you also learn how important the world is to America -- not just for national security, not just for military preparedness, but for creating jobs, right here at home.

We've held steady to this vision for three years now, and with great success. Trade barriers are falling, and American companies are rushing to meet the demand. Exports are up xxx in the last five years.

Bring it still closer to home. In Missouri, exports are up 37 percent over the last three years -- $4.5 billion worth of goods shipped to 166 different countries. Impressive numbers, but when you get behind the abstractions of export figures and trade statistics, you find the real benefit of the new world economy -- that's jobs. Here in Missouri, 100,000 jobs are supported by foreign trade. Across the country, more than 7 million Americans are employed for the same reason.

That's the way the world works these days. It's a world where products can be shipped at the speed of sound and investment money can cross borders at the speed of light.

Everyone recognizes that the world is moving at a faster pace than ever, but I see something more: it's moving our way. Right now we're building on the export success of the last three years. ~~are building on this success~~. Two weeks ago we entered a new era of open trade. Along with Mexico and Canada, we initialed the North American Free Trade Agreement, creating one of the largest free-trade areas in the world -- an integrated economy worth more than $6 trillion dollars.

Here in Missouri, you already export $2 billion worth of goods to Mexico and Canada. Those manufactured exports alone support 78,000 jobs for workers right here. Our new agreement will make that success look like kid's stuff.

NAFTA is a solid agreement -- when you've been in as many tough negotiations as I have, you learn to tell the difference. It will protect the environment, and more important, it will protect the jobs we have. ~~And more:~~ Furthermore, it will create new jobs for this generation and the next -- particularly the jobs that showcase America's high-tech talent.

We're going to take this case to the liberal Democrats on Capitol Hill, because they need to hear it. A free-trade agreement isn't a way of dividing up the economic pie, where one side's loss is another side's gain; it's a way of making the pie bigger for everyone who participates.

The liberals don't seem to get it. Right now, in fact, before our initials are even dry on the agreement, the liberals

in Congress [Rudy/Missouri Congressman Dick Gephardt] are calling for us to slap a tarriff on any new trade that comes from NAFTA.

Think about that for a minute (which is probably more than they've done). After years of tough negotiations with our two closest trading partners, we've agreed to end tariffs. The congressional Democrats say: Okay, fine. But first you have to put on a new tariff.

In other words, the only way they'll agree to reduce tariffs is if they can raise tariffs.

That's like telling us they want us to hit a homerun, but please don't hit it out of the park because they're afraid of losing the ball.

This transaction tax, as they call it, will increase the cost of goods you want to buy, and discourage the creation of new jobs for you and your neighbors. It will defeat the purpose of the agreement.

Now, I suppose I could ask my opponent to help me out with his liberal Democrat colleagues on Capitol Hill. Governor Clinton says he's for free trade "in principle."

But "in practice" may be a different story. [Clinton quotes]

After watching him wiggle on this issue, I'm not surprised he compares himself to Elvis.

This whole approach is based on a way of seeing the future. My opponents see trade barriers falling and they say: Hold everything. They see new markets for American goods and they

say: Wait a minute. We can't compete. The American worker can't cut it. So let's pull down the blinds, lock the doors and hope the world goes away.

Well, let me tell them something you already know. The American worker doesn't have to hide from anybody. We have the most productive workforce in the world. Americans can outwork, out-think, out-compete anybody, anywhere, anytime.

That's something everyone in the world seems to understand -- everyone but the protectionist Democrats. Over the last decade, we've seen a flood of foreign investment in the United States, with businesses from all over the world setting up shop from xx to xx. Their reasoning is simple: if you want the best science and universities in the world, if you want the best workers in the world, you have to come to the United States.

Now, this investment makes some people uneasy. I understand that -- particularly when you have the other side trying to stir up fear and resentment against foreign capital. I was in Utah not long ago, and a very articulate woman confronted me on the issue. I told her we probably couldn't see eye to eye on it, but I tried to tell her why I felt so strongly against the isolationism that would keep foreign investment out of America.

There was an irony in her timing. I had just returned from negotiating with the heads of the industrialized countries in Munich, and while I was there I was pleased to team up with Governor Carroll of South Carolina and the head of BMW to

announce a new BMW plant in South Carolina. That means 10,000 jobs to the people of that state.

Now, I don't think the 10,000 South Carolinians are going to argue against foreign investment. One out of every ten manufacturing workers in the United States works for a company supported by foreign investment. That's the bottom line on foreign investment in the U.S.: jobs -- jobs for Americans, and growth for the American economy.

That's the way the world works in a global economy. Again, Governor Clinton just doesn't seem to understand. He's proposed to increase taxes on foreign investment in the United States, especially those companies that employ a total of 4 and one-half million Americans.

Governor Clinton says his new tax will raise $45 billion. He might want to talk to his own Democrats on Capitol Hill. The Joint Economic Committee says that estimate is about 25 times too high.

Governor Clinton says his tax increase will "crack down" on foreign companies, but all it will really do is drive them out. And if they go, they'll take those jobs with them.

Travel around this state. Go to New Madrid, talk to the 1200 employees at Noranda Aluminum -- or to Joplin, talk to the 425 employees of Atlas Powder. Go to any of the 244 foreign-owned companies that employ 60,000 workers in this state.

If Governor Clinton's tax hike had been in effect these past few years, few if any of those companies would have located in

the United States -- few if any of those jobs would have been created for Missourians.

Governor Clinton forgets something about international relations. If he raises this tax, our foreign competitors are going to say: "What's good for the goose is good for the gander." His tax is like a gilded invitation sent to foreign governments where U.S. companies also do business. And the invititation reads: "Please retaliate."

The result would be not just a reduction in investment here, but a contraction worldwide. There was another occasion when that happened. It was in 1930. Right before the great depression.

No other major industrial nation has the kind of tax Governor Clinton proposes. But I can tell you one nation that does tax foreign investment has he would like: India.

Well, here's a promise I am proud to make: As long as I am president, India will not be a model for how to conduct economic policy in the United States of America.

In talking about America's future in the global economy, I mentioned my own experience, because I want you to understand why I believe what I do about America's ability to compete. Governor Clinton takes a different view, and it is borne of a very different life experience.

He has spent almost his entire working life inside a government office building, so it's not surprising that when he talks about the economy he puts government first. He thinks you

can fix the economy by raising taxes by $150 billion. He thinks you can cut the deficit by increasing spending by $220 billion. He thinks you can open markets by raising new tariffs.

If you ask me this guy not only inhaled -- he never exhaled.

There's a clear choice here. I understand that you boost the economy by cutting taxes. I understand that you cut the deficit by cutting spending. I understand that you open markets by sitting down at the table and hammering out a tough and fair agreement to open markets.

So we have a clear choice. Do we turn to the tattered blanket of bigger government that other nations are tossing away? Or do we giver our people the freedom and incentives to build security for themselves?

Here's what I'm fighting for: lower government spending; tax relief: opportunities for small business; legal and health reform; job training; and new schools, built on competition, ready for the 21st century.

And I'm fighting for this: Open markets for American products -- <u>your</u> products. I won't rest until every American business is given a fair shake in every country in the world. I know what those opportunities mean to every American who has a job or wants one. Because I know that this country -- this country that has changed the world -- is destined to lead in the new century now being born.

The Missouri Advantage™

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To ED WALTERS	From R. McCLURE
Co. WHOUSE RESEARCH	Co.
Dept.	Phone # 314/751-3292
Fax # 202/456-6218	Fax # 751-2128

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D2

NEWS RELEASE

For Immediate Release
March 16th, 1992

Contact: Dan Barber
314-751-9065

FOREIGN INVESTMENT SUMMARY

(Jefferson City)--The State of Missouri actively seeks foreign investment from all parts of the world. The Department of Economic Development has overseas offices in Duesseldorf, Germany; Tokyo, Japan; Seoul, Korea; and Taipei, Taiwan to assist in promoting economic growth and job creation in our state.

To date there are 244 foreign companies from 21 countries in Missouri. These foreign investments amount to an estimated $3.5 billion and employ more than sixty-thousand Missourians. The major countries investing in our state are Japan, United Kingdom, Germany and Canada. These four countries account for 62% of the jobs and approximately 60% of the investments.

The next four major investors are Ireland, The Netherlands, Switzerland, and France. These four account for another 28% of the jobs and approximately 15% of the investments.

The state takes several different approaches to attracting foreign investment. The local office and the overseas offices do direct mail campaigns and attend international trade shows. The Department of Economic Development has a joint venture program that matches Missouri companies with interested foreign companies. The state also has a number of cooperative agreements with Japanese banks and securities companies, international chambers of commerce, and foreign governments.

- more -

Department of Economic Development - add one

The state is open to foreign investment and has no laws or regulations prohibiting investment. For more information contact Dan Barber, Public Information Officer at the Missouri Department of Economic Development (314) 751-9065.

- 30 -

FOREIGN INVESTMENT IN MISSOURI ASAP

CANADA

NORANDA ALUMINUM COMPANY - NEW MADRID - 1200 EMPLOYEES
POLYTAINERS - LEE'S SUMMIT - 65 EMPLOYEES

FRANCE

ELF AQUITAINE ASPHALT, INC. - ST. LOUIS - 190 EMPLOYEES
PHONE POULENC, INC. - ST. JOSPEH - 40 EMPLOYEES

GERMANY

F.A.G. BEARINGS - JOPLIN - 305 EMPLOYEES
FRU-CON CONSTRUCTION CORP. - BALLWIN - 350 EMPLOYEES
M & W PACKAGING INC. - CAPE GIRARDEAU - 190 EMPLOYEES
MEMC ELECTRONICS - ST. PETERS - 1500 EMPLOYEES

IRELAND

BILLY GOAT INDUSTRIES - LEE'S SUMMIT - 62 EMPLOYEES
JEFFERSON SMURFIT - ST. LOUIS - 4500 EMPLOYEES

JAPAN

BIOKYOWA INC. - CAPE GIRARDEAU - 86 EMPLOYEES
KAWASAKI MOTORS - MARYVILLE - 115 EMPLOYEES
OPTEC D.D. - MEXICO - EMPLOYEES
SONY CORP. - KANSAS CITY - 73 EMPLOYEES

NETHERLANDS

AMERICAN INGREDIENTS COMPANY - KANSAS CITY - 50 EMPLOYEES
LEVER BROTHERS COMPANY - ST. LOUIS - 600 EMPLOYEES

SWITZERLAND

CONSOLIDATED ALUMINUM CORP. - ST. LOUIS - 60 EMPLOYEES
SUNMARK - ST. LOUIS - 900 EMPLOYEES

UNITED KINGDOM

ATLAS POWDER COMPANY - JOPLIN - 425 EMPLOYEES
D R G PLASTICS - UNION - 180 EMPLOYEES
FASCO INDUSTRIES - OZARK - 2900 EMPLOYEES
TRIMFOOT COMPANY - FARMINGTON - 425 EMPLOYEES

government plan. Play-or-pay would quickly lead to most Americans being in a government-run health plan.

-- According to the CBO, $80 billion in new taxes would be required to finance play-or-pay.[30]

o Clinton also proposes to collect $45 billion over four years by imposing higher taxes on foreign companies operating in the U.S.[31]

-- Contradicting Clinton's accounting, the Democratic-dominated Joint Committee on Taxation has said that this tax could generate at most $1 billion, and that over four years.[32]

-- The tax jeopardizes current and future American jobs by penalizing foreign firms that want to invest in jobs here at home. Thus, firms like BMW, which have been attracted by America's high worker productivity and hospitable business climate, will likely turn their backs on creating new jobs in the U.S.

-- In Ohio, for example, 215,000 persons are employed in industries related to foreign-owned businesses. These businesses have invested $5 billion in the state and have created millions of dollars in tax revenue for communities and school districts.[33]

-- Coming at a time when President Bush is pushing the Europeans to cut unfair subsidies to their farmers, and other nations to end barriers to American goods, the Clinton tax will invite retaliation against American products and cost more American jobs. One of the IRS's former top international tax experts described as "just nuts" the thinking that underlies a Clinton-style tax.[34]

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30 Preliminary CBO estimate of the cost of play-or-pay, (H.R. 3205, August 2, 1991).

31 "Putting People First: A National Economic Strategy," June 20, 1992. See Table 2 for tax revenue estimates.

32 Joint Committee on Taxation revenue estimate, conveyed via letter to Senator Pete Domenici, dated July 15, 1992.

33 "Republican Development Director Criticizes Clinton's Economics," AP, July 19, 1992.

34 Kevin Dolan, former IRS Associate Chief Counsel/International, quoted in BNA Tax Management Report on Transfer Pricing, June 10, 1992.

Ed - Be sure to get copies of these A.

FOOTNOTE 30 BACKUP
(including next page)

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102D CONGRESS, 2D SESSION

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(18)

JUL 15 1992

Honorable Pete V. Domenici
Committee on the Budget
United States Senate
Washington, DC 20510-3101

Dear Senator Domenici:

This is in response to your request dated June 30, 1992, for revenue estimates of H.R. 5270, the Foreign Tax Simplification Act of 1992.

Enclosed is our Table #92-1139 which provides the estimated effects on Federal revenues for fiscal years 1993 through 1997 on a provision-by-provision basis.

Sincerely,

Harry L. Gutman

Harry L. Gutman

Enclosure

Revenue Effects of H.R. 5270, Foreign Tax Simplification Act of 1992
(Fiscal years, billions of dollars)

	1993	1994	1995	1996	1997	1993–97
Revenue losers (largest to smallest):						
Revise application of interest allocation rules	−0.7	−1.2	−1.3	−1.3	−1.4	−5.9
Recharacterization of overall domestic loss	−−	−0.3	−0.4	−0.5	−0.5	−1.6
Repeal limitation on AMT foreign tax credit	−0.2	−0.3	−0.2	−0.2	−0.2	−1.1
Controlled foreign corporation election	−*	−0.2	−0.2	−0.2	−0.2	−0.7
Extend period of foreign tax credit carryback/carryover	−0.1	−0.1	−0.1	−0.1	−0.2	−0.5
Modification of certain look−through rules	−*	−*	−*	−*	−*	−0.1
Estate tax marital credit	−*	−*	−*	−*	−*	−0.1
Title V Simplification	−*	−*	−*	−*	−*	−0.1
Regulatory authority for uniform capitalization rules	−−	−−	−−	−−	−−	−−
Subtotal, revenue losers	−1.0	−2.1	−2.2	−2.3	−2.5	−10.1
Revenue raisers (largest to smallest):						
Treatment of passive income related to foreign oil and gas extraction income and shipping income	0.3	0.5	0.6	0.6	0.6	2.6
Reduction of Puerto Rico and possessions tax credit	0.2	0.5	0.5	0.6	0.6	2.4
Repeal deferral, election to treat controlled foreign corporations as domestic corporations	0.6	0.8	0.3	0.1	0.1	1.8
Special section 482 rules for foreign and foreign−owned corporations	0.1	0.2	0.3	0.4	0.5	1.5
Source of income from certain sales of inventory property	0.1	0.3	0.3	0.3	0.4	1.4
Taxation of certain stock gains of foreign persons	0.1	0.3	0.2	0.2	0.1	0.8
Excise tax on certain premiums paid to certain foreign persons	0.1	0.1	0.1	0.1	0.1	0.5
Limitation on treaty benefits	*	0.1	0.1	0.1	0.1	0.3
Treatment of certain grants	*	*	*	*	*	0.1
Subtotal, revenue raisers	1.5	2.8	2.4	2.4	2.5	11.5
GRAND TOTALS	0.5	0.7	0.2	0.1	0.0	1.4

CLINTON PROPOSAL

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Republican Development Director Criticizes Clinton's Economics

COLUMBUS, Ohio (AP) - Democrat Bill Clinton as president would raise taxes and strictly regulate small businesses in Ohio, a state official said.

Ohio Development Director Don Jakeway, a Republican, said Clinton's economic plans would hurt Ohio's agriculture-related businesses and many of its 600 foreign-owned corporations as well.

Jakeway and Columbus Mayor Greg Lashutka, also a Republican, spokes Saturday at a news conference. Clinton and running-mate Al Gore are campaigning in the state.

Jakeway said about 215,000 Ohioans are employed in industries related to foreign-owned businesses. Those corporations have investments of about $5 billion in the state and create millions of dollars in tax revenue for communities and school districts.

"That kind of protectionism is not good," Jakeway said about Democratic plans to raise taxes for those companies.

But a state Democratic Party spokesman said the Republicans are feeling desperate.

"They're down 25 percent in the polls," David Duffey said.

Duffey said the only taxes Clinton has spoken about are those for people with incomes of $200,000 or more.

"They better research their facts a little better," Duffey said. "We finally have a presidential candidate who has a plan, and they're trying to scare people and say it's tax and spend.

"It's not. It's investment to bring jobs back to America."

1 copy – Phil / Jay
1 copy – Tony C.

Pls put in budget & Ohio briefings. Thanks.

Jeremy –
Good fact -- let's use in our budget fact sheet.

Jim

BNA

Transfer Pricing Report

FOOTNOTE 32 BACKUP

Vol. 1, No. 3 | A biweekly update on transfer pricing and related issues | June 10, 1992

HIGHLIGHTS

IRS Officials Discuss Litigation Designation, Competent Authority: A company should not expect access to competent authority without an agreement with the Internal Revenue Service regarding adjustments, Assistant Commissioner (International) Regina Deanehan and Director of International Programs Stanley Novack say. [p. 75]

Rostenkowski Bill Would Draw Retaliation, Practitioners Say: Legislation designed to help U.S. business compete globally would violate treaties and draw retaliation from U.S. trading partners, practitioners say. [p. 69] . . . Law Professor Stanley Langbein says the bill would radically change transfer pricing rules for foreign firms, and mitigate U.S. taxation of U.S. companies' foreign income. [p. 88] . . . Peter Barnes of General Electric Co. says the bill's minimum tax formula could produce unfair results. [p. 86]

Chevron Argues Against Designated Summons: Chevron asks an appeals court to overturn an IRS designated summons, contending violations of the Constitution and Congress' intent. [p. 65]

No Matches In Second Round For Apple Arbitrators: Apple Computer Inc. and the IRS again fail to exchange matching names in the second round of nominations for a panel to settle the dispute over the company's Singapore subsidiary. [p. 68]

IRS Group Reviewing Availability Of §482 Data: An IRS task force is investigating the availability of data needed to comply with proposed §482 regulations and may recommend legislation to resolve data sharing issues, an IRS official says. [p. 59]

IRS To Issue Guidance On Currency Fluctuations: The IRS plans a memorandum on the effect of currency fluctuations on its transfer pricing decisions, Ernst & Young's Michael Patton says. [p. 68]

Attorney Says Competitiveness Issues Ignored: The IRS' proposal to change the §482 regulations needs revision to better reflect efforts by U.S. companies to remain competitive globally, says Joel Williamson, partner at Mayer, Brown & Platt, Chicago. [p. 62]

Subs Blocked From Claiming Intangible Profits, Economist Says: U.S.-controlled overseas affiliates may be unable to claim profits from intangibles, such as manufacturing savings, under proposed §482 regulations. Arthur D. Little's Irving Plotkin tells a conference. [p. 61].

IN THIS ISSUE

At The IRS [p. 59]
☐ Treasury International Tax Counsel Philip Morrison says the IRS may not penalize taxpayers for transfer pricing valuation misstatements if they prepare a regulatory analysis of their transfer pricing situation and maintain contemporaneous documentation. [p. 59]

In The Courts [p. 65]
☐ The IRS says Exxon and Texaco consented to and profited from the 1979 price restrictions on Saudi oil and must pay taxes on those earnings. [p. 66]

In Congress [p. 69]

Around The World [p. 73]
☐ The proposed §482 regulations' comparable profit interval should be delayed until other countries accept the method, a Japanese trade group says. [p. 73]
☐ The IRS should limit the proposed CPI to clearly abusive transfer pricing, says an international business group. [p. 74]

Interview [p. 75]

Full Text [p. 80]
☐ Rep. Rostenkowski's HR 5270 §304 proposing a new §482(b) for inbound transfer pricing is printed in full. [p. 80]

Analysis [p. 86]

Perspective [p. 88]

Journal [p. 91]

Directory [p. 92]

...rnes, international tax counsel for General Electric Co.; and

☐ Observations from University of Miami Law School Professor Stanley I. Langbein on transfer pricing reform.

Minimum Tax

Section 304 of the bill would add a new subsection to §482 that would establish a minimum tax on foreign-owned companies operating in the United States whose U.S. gross receipts total either $2 million or more, or 10% or more of the corporation's overall gross income.

According to the Joint Committee on Taxation staff's technical explanation, shifting profits of a foreign-controlled U.S. company to its parent through transfer pricing would no longer shelter the income, under §304 of the legislation.

The bill would provide an exception for companies that either make advance pricing agreements with the government, or are granted permission to avoid the minimum tax after satisfying the Treasury Department that the intercompany prices yielded a fair result, according to the technical explanation of the bill.

The provision would set a floor for the income on which a foreign-owned U.S. company would be taxed. The floor would be 75% of the average taxable income of the company's industry in the United States, as prescribed by the Treasury Department for the calendar year.

Proposal Labeled 'Draconian'

Leonard Terr of Baker & McKenzie's Washington, D.C., office said he was surprised by the steepness of the proposed minimum tax for foreign-owned U.S. corporations. Terr, a former Treasury international tax counsel, said that the Rostenkowski bill is "far more draconian" than many in the multinational tax world had expected.

The minimum tax approach is contained in §842(b), the minimum effective investment income provision for foreign-owned insurance businesses operating in the United States, he noted. Sec. 842(b) has created controversy because it departs from the arm's-length standard, and so the tax floor proposed in HR 5270 will be considered monumentally controversial, Terr said. (For a discussion of the §842(b) experience, see the Analysis section of this issue.)

The JCT staff said the minimum tax approach does not necessarily depart from the arm's-length standard. It is in some ways analogous to applying the resale price method or the cost-plus method under Regs. §1.482-2(e)(3) and (4), in which gross amounts of the taxpayer's actual arm's-length transactions are multiplied by an appropriate markup percentage or appropriate gross profit percentage, the technical explanation said.

The document also said the minimum tax provision is in some ways analogous to the approach taken in the Service's proposed §482 regulations in that they would adopt comparability of net profit as a check on the reliability of intercompany transfer prices.

The technical explanation discusses in detail the difficulty of obtaining information to allow the IRS to determine a true arm's-length price. Simulating transactions that the controlled parties would have entered into had they not been related, the explanation said, "may require access to significant amounts of information from each of the related parties that might be considered comparable to the transactions between the related parties. In a multinational context it may be especially difficult for the IRS to obtain the desired information from foreign members of the multinational enterprise.

"It may also be difficult to obtain adequate information about comparable or near-comparable transactions involving unrelated persons," the explanation continued. This information may be proprietary, the congressional staff wrote, and the parties involved may not include the taxpayer. "Even if the IRS could use its powers to obtain such information, disclosing it to the taxpayer may constitute a breach of confidentiality laws," the explanation continued.

Normative Rule Said Unconstitutional

But Terr said proposed §482(b) would be discriminatory because it would subject companies to a normative rule based on domestic industry averages that would, by definition, be skewed. "This very clearly would impose on the world a system, a formula, that would bear no relation to the results of the companies involved," he stated.

Dolan said the proposal does not make sense because it assumes that every business in a certain category is equally profitable. "That's just nuts," he said.

Robert Mattson, assistant treasurer of International Business Machines Corp., questioned whether Congress could impose a minimum tax on gross receipts because the Constitution requires that income be earned before there can be taxation.

Mattson also said the provision "tells the world we're going to discriminate" between foreign parent companies and U.S. parents. He said the legislation "clearly goes back to the high tariffs of the 1930s" which are thought to have contributed to the depression.

Richard V.L. Cooper of Ernst & Young, Chicago, told Tax Management that the proposed 75% tax floor is "within the ballpark" of the alternative minimum tax that U.S. parent companies have been protesting since it was enacted in 1986. What is rancorous about the proposed §482(b), he said, is that calculations would be based on gross revenue rather

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THE WHITE HOUSE

Office of the Press Secretary
(Hoover, Alabama)

For Immediate Release August 22, 1992

REMARKS BY THE PRESIDENT
TO MAIN STREET WELCOME

Woodstock, Georgia

1:06 P.M. EDT

THE PRESIDENT: Thank you very much. You know, this reminds me of a great country song -- if you want to see a rainbow, you've got to take a little rain. (Applause.) And we're going to show the American people a rainbow.

May I salute Mayor Rogers and thank my friend of longstanding, and I hope your next senator, Paul Coverdell, for that introduction. (Applause.) Salute our leader, Newt Gingrich, who helps us so much in Washington. (Applause.) Members of the City Council here, the cheerleaders and bands from Cherokee, and Etoyah and Sequoia High Schools -- (applause.) And Daron Norwood, the Spirit of Atlanta; and of course, Dr. Johnny Hunt, who I'm told is not only a spiritual leader here but that First Baptist Church here in Woodstock stands for family -- family values, one nation under God. (Applause.)

Jane Hancock and Audra Dinsmore and Johnny Isaacson, thank you all. And, of course, I'm glad to be standing here with one of Woodstock's own, my friend, Orlando Wilson, who is a good -- if anybody likes bass fishing they know all about this guy.

Now, Fred Cooper, my chairman; and Alec Poitevint, our leaders, thank you all. And it's great to be here in Cherokee County, the land of the free and the home of the Warriors. (Applause.) Okay, and let's not forget the Chiefs and the Eagles. (Applause.)

And, frankly, it's great to be out of that D.C. mode and out on the campaign trail, taking our case to the American people. And we are going to give them something to talk about down at Dean's Store here in Woodstock. (Applause.)

And so I want to talk briefly -- and the skies have cleared now, I'm glad to say -- about the sharp choice; the clear, sharp choice that we're going to offer every American. And it's a choice between different agendas, different directions for our great country, and it's a choice about the character of the man that you want to lead this nation for another four years. (Applause.)

They say this election is about change. Well, they're right. But let's not forget the things that must guide change are the things that never change -- our belief in a strong defense, in strong families, and in leaving the world a better and more prosperous place for the young kids here today. That's what this election is about. (Applause.)

Think for a minute about the world we've already seen, a world of change: the Berlin Wall down; millions of people around the world took that first breath of freedom; and America, her ideals and her strengths intact, won the Cold War. And that is good for every American. (Applause.)

And I can't come to Georgia without saluting one other thing; thanks for the contribution that this state made to

that wonderful victory of Desert Storm. It says something strong about the American spirit. (Applause.)

And all this change didn't come about by accident. The world changed because we, the American people, stayed true to our unchanging principles. And my opponents -- let them say this -- they say I spent too much time on national security and foreign policy. Well, let me tell you, when I took office I saw a chance to help finish off imperial communism and I did it, with your help. (Applause.)

And perhaps even more important, I saw a chance to help rid our children's dreams of the nuclear nightmare, to help them live in a safer world. And I did that, with your help. And that is good. (Applause.)

And so let the Clinton-Gore ticket understand one thing: I am not going to apologize for one minute for having spent time making the world a place of peace for all the children in this country. (Applause.)

For 40 -- I'll get to that -- for 40 years this was a change that Americans fought and died for. And now it offers us a defining challenge of the '90s, to take advantage of our victory around the world and then to build a stronger and more prosperous nation right here at home.

And so for these next 73 days I'm going to ask the American people: Who do you trust to bring it all home -- foreign policy, security policy, and economic policy -- who do you trust?

AUDIENCE: Bush! Bush! Bush!

THE PRESIDENT: And so I came here to Georgia today to ask the good people of this patriotic state to give me your support based on my experience, my ideas, and my character. I will not let you down. (Applause.)

Here we go. Let me spell out the differences. Okay, we're going to start it right here, right now in Woodstock. I believe our government is too big and it spends too much of your money. (Applause.) And I believe the deficit is a dark cloud on the future of these young people. And you know it and I know it. And Clinton does not know it, and Gore does not know it. (Applause.)

Hey, listen, you listen to these guys and you think the deficit is a big game of the Wheel of Fortune. You know that one? They want to buy three vowels -- I, O, U. That's not good enough for the American taxpayer. (Applause.)

In Houston two nights ago, I announced a freeze on government spending, and let me repeat it right here. If Congress sends me a bill spending one penny more than I requested, I will veto it faster than a spinner bait after Orlando's lure. We're going right after it. (Applause.) For the past three years -- past three years -- we've endorsed and proposed significant cuts in federal spending, but that gridlocked, liberal, Democrat-controlled Congress has chosen to direct your taxpayer dollars to their favorite projects. And if they need more help curing the pork addiction, I'll say as I said the other night, let's give the taxpayers the power to dedicate up to 10 percent of their tax dollars to the deficit. And if Congress won't cut that spending, the people of America will. It's just that clear. (Applause.)

And, yes, we must cut spending. And with a new Congress, cutting that spending -- I'll propose a tax cut to give you more of the money to pay the bills; to give the businesses the incentives to create the new jobs that this economy so desperately needs; and we will do more to jump-start the economy.

Frankly, it's the small businesspeople that are hurting. They're the ones that create the jobs. And I want to give small business a shot in the arm -- small businesses, they create two-thirds of the jobs in this country. And you take places like the Cost Plus on South Main Street, or Morgan's Hardware -- and if we're going to get this country moving, small business needs relief from taxation, these awful lawsuits, and from regulation. (Applause.) And we are going to give it to them.

Now, let me tell you this: the Governor of Arkansas, the Commander of the Arkansas National Guard, he wants a different kind of change.

AUDIENCE: Boooo --

THE PRESIDENT: He is -- now, wait a minute. This is a fact. He has actually proposed already -- isn't even in there yet and he's proposed raising government spending by $220 billion, and raising taxes, the biggest increase in history, by $150 billion. And we cannot have that.

AUDIENCE: Booo --

THE PRESIDENT: You think those guys only know one word -- change. They talk about it. Well, that's change all right; that's about all you'll have left in your pocket when they get through with you. (Applause.) Yes, we want change. But it's also a question of trust. Look at every big issue we face and you're going to see a choice between the people who put their faith in everyday Americans and those who put their faith in the government.

And I trust you, the families and the parents, to make the decisions that matter in life. And I trust the parents, not the government, to choose their children's schools -- private, public, or religious. (Applause.) And very, very candidly, the Congress opens a meeting with a prayer; I think the school children ought to have a voluntary prayer in schools. (Applause.)

You could argue that Congress needs it more, but I think everybody ought to have that option.

And I trust the parents, not the government, to choose the children's child care. It's better to have parents do it than have some subcommittee in Washington tell you how to look after your kids. (Applause.)

Frankly, it all sums up to this: I think the government is already big enough and they tax people too much. It's that simple. And if you want fewer lawsuits and fewer regulations, and more opportunity for small business, vote for me. (Applause.)

I wonder about the Governor of Arkansas. I wonder why it is that whenever he's faced with any problem his solution is always to put government first. But, you know, it's not so surprising, when you spent more of your life in government like he has, government is all you know anything about. I've got my believe in trust, about limited government from working out in the oil fields of West Texas, from trying to build a business, and trying to meet a payroll. And that's where I learned how jobs are created. And that's where I learned this: In this country, the government works for the people, not the other way around. (Applause.)

But Bill Clinton isn't the only one who's forgotten that lesson, if he ever knew it, there's a whole party of his colleagues up there on Capitol Hill who have spent their lives on the government payroll. They, that liberal Democratic gridlock

has been controlled by one party for 38 years -- 38 years. And I call them the gridlocked Congress. And I'm going to remind the American people, 38 years -- clean the House, clean the House, clean the House. You have to do it; we ought to do it.

AUDIENCE: Clean the House! Clean the House! Clean the House!

THE PRESIDENT: Let me just put it parenthetically, the last thing this country needs is a rubber check Congress and a rubber stamp President. We don't need it and we're not going to have it. (Applause.)

I think the American people know this. That I've tried to work with these people. You remember when I said we didn't come here to bicker we came here to do something for the people? I held out my hand and that liberal, Democrat-controlled Congress bit it off. And now I'm going to take that case to the American people and say, change the Congress. (Applause.)

Every American knows the truth that Congress has become corrupt and conceited and confused, a body of these PACs and privileges and partisanship and paralysis. They can't run a tiny bank. They can't run a tiny post office and, yet, they're running your lives. And we've got to change it. (Applause.)

You know, Harry Truman took it this way. He went out across the country. He got in his sights the Congress, took his case to the people, and then he linked his opponent right into those sights. Well, let me tell you this. I'm going to do the same thing.

And I am for Paul Coverdell, and here's why. He was willing to stand up and think anew. As Truman did, he's willing to single out those who talk one way and vote another. And the thing in this Senate race is this: I stand for a balanced budget amendment; Wyche Fowler is against it. I stand for the line item veto; Whyche Fowler is against it. I stand for those who stood at Desert Storm; and he opposed me. And now we want a change. (Applause.) That is the fact. It's fine to talk one way in downtown Woodstock and vote differently in Washington, but we cannot have that anymore. (Applause.)

You know, I know this race is long. Know it -- read all these polls about being behind. But, yes, I really believe and have a confidence that we will win. We're going to win not because of a victory for me, but because we trust the American people. We win because our ideas are strong and we win because we understand the American way. And we'll win also because I think we've got a great First Lady who stands for the family and family values. (Applause.)

So you tell Governor Clinton and that gridlocked Congress, if you can't run with the big dogs, stay under the porch. We're coming after them. (Applause.)

And thank you very, very much. And may God bless the greatest, freest country on the face of the Earth. And thank you for this fantastic rally. Thank you so very much.

END 1:22 P.M. EDT

STATE OF MISSOURI

FACSIMILE TRANSMITTAL SHEET

DATE 8-24-92

TO	FROM
Ed Walters	Yolanda Dunphy Dr. Ashcroft's Office
FAX NUMBER	FAX NUMBER

RE

SPECIAL INSTRUCTIONS/REMARKS

Ed - Here's the stuff Dr. Ashcroft
requested 12 expert opinions on
his Expert Team last Month.

ANY PROBLEMS WITH TRANSMITTAL, CALL 314-751-3222

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MO 999-8012 (12-90)

PUBLIC SAFETY EQUIPMENT

Public Safety Equipment is a privately owned firm located at 10986 N Warson Road in St. Louis, Missouri. Mike Latta is President of the company, Ed Ryan is Executive Vice-President. The phone number is 314-426-2700. The Fax is 314-426-1337.

Governor Ashcroft recently honored Public Safety during a statewide tour highlighting Missouri's export successes. During the last three years, exports from Missouri have increased 37% - more than 1600 Missouri businesses exported a combined $4.5 billion in products, services and goods to 166 countries in 1991. Missouri exports support an estimated 100,000 jobs in the state.

Public Safety Equipment's 200 employees are literally lighting up the world with police sirens, light bars, and other warning devices used by police and fire departments in 48 countries. The company's exports have grown from 15% to 35% over the last five years.

The company builds most equipment to order, allowing employees to define their work flow and work with end users -- often highway patrols -- to meet changing needs and design improved products.

Public Safety Equipment has been assisted by Missouri's export business development office. "We've participated in international meetings, catalog shows, etc.," said Ed Ryan, vice president of marketing. " The state office in Tokyo also has helped us in locating distributors on the Pacific rim."

The state of Missouri has international trade offices in Germany, Japan, Korea and Taiwan. The state will soon open a fifth international trade office in Mexico.

Public Safety is a very employee oriented firm and the plant is very clean and colorful providing many visual opportunities.

Public Safety Equipment was very appreciative of the Governor's recent visit and the company went out of its way to include its employees and local community leaders in what was a very successful and enjoyable stop on the "Exports for Success" tour.

PUBLIC SAFETY EQUIPMENT, 7/22/92, ST. LOUIS

I'm pleased to be in St. Louis today to focus attention on a local company that is excelling in the international marketplace. Missourians are grateful to Mr. Michael Latta and the hard-working employees here at Public Safety Equipment who are supplying world-class products to nations all around the globe.

Exporting is no longer the province of large companies in major port cities. The world market is fast becoming the new frontier for small- to medium-sized firms in Missouri.

Businesses across the state are adding jobs, breaking ground for additional plant space and purchasing new equipment to keep pace with fast-growing export sales. In many cases, international sales allowed these companies to continue growing during the recession, . . . and now with the U.S. recovery, they're looking to expand and hire.

During the last four years, exports from Missouri have increased 31 percent -- more than sixteen hundred Missouri businesses exported a combined $4.5 (b) billion in products, services, and goods to 166 countries in 1991. Missouri exports support an estimated 100,000 jobs in the state.

The state of Missouri, through the Department of Economic Development, is assisting the sixteen hundred exporters in Missouri and actively seeking out the unlimited number of firms with export potential that is not yet being realized.

World Trade magazine recently recognized the work and dedication of the state's export development staff. The article says Missouri runs a top-notch economic development program for companies that want to expand their business overseas.

The state has trade development offices in Kansas City, Jefferson City, and St. Louis. Missouri also has offices and very capable staff in Duesseldorf, Germany; Tokyo, Japan; Seoul, Korea; and Taipei, Taiwan. We soon will be opening a new trade office in Mexico.

During this two-day salute to companies exporting for success, we will visit and honor 12 Missouri businesses. I commend the Hawthorn Foundation for sponsoring this tour. Hawthorn Vice-chairman Al Fleischer Sr. is here with us today. Al, thank you for the opportunity to honor this deserving company and to raise awareness about the importance of exporting.

It is a pleasure to meet the people here at Public Safety Equipment who literally are lighting up the world with these Missouri-made products.

Five years ago, Public Safety made a commitment to the export business, and today, the company's exports account for about 35 percent of its total annual sales.

Public Safety's sirens, light bars and other warning devices clear the way for police and fire vehicles in at least 48 countries. I am pleased the state's export development staff has been able to assist Public Safety with locating sales leads and international distributors.

On behalf of all Missourians, I commend Mr. Michael Latta and the dedicated employees of Public Safety for excellence in exporting, becoming a worldwide innovator and leader in the field of emergency warning equipment.

(PRESENT AWARD)

Thank you and may God richly bless you with a productive and profitable future here in St. Louis.

202-347-9570

POLITICAL ANALYSIS:

This morning, the Bulletin invites Stephen Entin, former Deputy Assistant Secretary of the Treasury for Economic Policy in the Reagan Administration who is now a Resident Scholar at the Institute for Research on the Economics of Taxation, and Robert Shapiro, an economic advisor to Bill Clinton who is Vice President of the Progressive Policy Institute, to discuss Governor Clinton's proposal to increase taxes on foreign companies doing business in the United States.

BULLETIN: Bill Clinton believes that foreign companies are getting unfair tax breaks and they should pay more for doing business in our country. Economically speaking, what do you think of that proposal?

ENTIN: First of all, Clinton's economic proposal not only raises taxes on foreign companies operating in the US, but also US companies operating abroad. Contrary to Clinton's assertions, those additional taxes on foreign investment by American firms will not cause them to shift the investment back to the United States. It will merely reduce the foreign investment. The US firms will become less able to service their foreign customers efficiently. They will become less competitive in world markets. They will order fewer US-made parts to supply their plants abroad. US savings, investment, employment, and income will be lower than otherwise, and tax revenue will be lower, not higher.
Clinton also claims that foreign firms operating in the US have an unfair tax advantage. Specifically, he claims that they overcharge their US subsidiaries for parts and products to reduce taxable profits in the US and inflate them abroad. It would not make sense for them to be doing this, and the IRS has found little or no evidence of this. It would not pay most foreign investors to shift reported income from the United States to Japan or Europe, where corporate tax levels generally exceed US levels. They'd actually lose money by doing it. Foreign firms that have expanded here in recent years have little taxable income because they are still legitimately writing off major outlays for plant, equipment, structures, and other start-up costs. It would take discriminatory taxation of non-existent income to collect the additional $13.5 billion per year assumed in the Clinton plan. Such taxation would drive foreign investment out of the United States, and retard the growth of US productivity, employment, and wages. It would also invite retaliation by foreign governments against US firms operating abroad. It would have the effect of contracting the world economy. And the last time we had a major contraction, it was in the early 1930s, with all the good that did.

SHAPIRO: As a point of clarification, the US subsidiaries of foreign corporations aren't getting a special tax break, they are evading US taxation almost entirely. Today, the foreign

J. D. Foster

Revenue estimate

no est of underpayment – some is going on
but refuse to

Harry Gruber (Treas) $40 b
airtight auditing: $15 b
$45 b

using the tax code as a trade barrier

dissuade any from coming

another example of protectionism
discourage them from investing

anyplace – there will be some foreign-owned
manufacturing plant
w/in 100 miles

Chamber of Commerce or Treasury

Fred Goldberg at Treasury testimony

the company would never have come if Clinton

USTR – David Walters

~~anti~~ nativist – direct for investment has dropped off
Who owns Rockefeller
x Nissans in Tennessee

Playing on a darker impulse:

UNITED STATES DEPARTMENT OF COMMERCE
Economics and Statistics Administration
Bureau of Economic Analysis
Washington, D.C. 20230

BEA FACSIMILE TRANSMISSION SHEET

8/21/92
Date

TO: Ed Walters
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White House - Speech writing
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Table 7.—Employment by Nonbank U.S. Affiliates and All U.S. Businesses, 1988–90, by State

	1988			1989			1990		
	U.S. affiliates	All U.S. businesses [1]	U.S. affiliates as a percentage of all U.S. businesses	U.S. affiliates	All U.S. businesses [1]	U.S. affiliates as a percentage of all U.S. businesses	U.S. affiliates	All U.S. businesses [1]	U.S. affiliates as a percentage of all U.S. businesses
Total [2]	3,844.2	91,344.0	4.2	4,511.5	93,754.0	4.8	4,705.3	94,974.0	4.9
New England	249.5	5,894.3	4.2	290.3	5,866.1	4.9	284.1	5,685.2	5.0
Connecticut	72.3	1,511.6	4.8	87.6	1,508.4	5.8	78.3	1,468.9	5.3
Maine	24.4	452.9	5.4	27.1	464.3	5.8	27.1	456.0	5.9
Massachusetts	110.3	2,817.5	3.9	129.1	2,797.9	4.6	131.8	2,664.9	4.9
New Hampshire	22.4	473.9	4.7	25.1	471.7	5.3	26.3	449.3	5.8
Rhode Island	12.2	415.9	2.9	13.1	418.4	3.1	12.7	404.2	3.1
Vermont	7.9	222.4	3.5	8.3	227.5	3.7	8.0	221.9	3.6
Mideast	838.4	17,197.3	4.9	928.1	17,368.7	5.3	926.3	17,292.5	5.4
Delaware	41.8	295.4	14.1	41.9	306.5	13.7	43.1	308.8	14.0
District of Columbia	8.8	413.8	2.1	10.5	419.3	2.5	10.5	422.4	2.5
Maryland	62.1	1,776.7	3.5	71.7	1,818.2	3.9	80.9	1,824.1	4.4
New Jersey	203.9	3,182.4	6.4	222.8	3,215.5	6.9	225.5	3,153.3	7.2
New York	342.8	6,999.7	4.9	376.8	7,044.1	5.4	348.2	6,994.5	5.0
Pennsylvania	178.0	4,468.4	4.0	204.3	4,565.1	4.5	217.0	4,589.8	4.7
Great Lakes	655.0	15,803.4	4.1	772.4	16,364.6	4.7	806.8	16,602.8	4.9
Illinois	214.1	4,500.5	4.8	244.8	4,608.9	5.3	242.8	4,667.3	5.2
Indiana	83.4	2,091.9	4.0	98.1	2,187.1	4.5	124.5	2,199.7	6.7
Michigan	118.2	3,290.0	3.5	142.8	3,404.8	4.2	142.8	3,448.1	4.1
Ohio	170.2	4,116.7	4.1	207.9	4,223.7	4.9	217.9	4,273.2	5.1
Wisconsin	71.1	1,904.3	3.7	78.9	1,960.1	4.0	78.8	2,013.5	3.9
Plains	185.1	6,605.8	2.8	235.5	6,797.5	3.5	248.3	6,817.8	3.6
Iowa	25.6	868.3	2.9	30.9	1,030.8	3.0	36.7	1,051.2	3.5
Kansas	27.8	870.4	3.2	30.7	891.6	3.4	28.1	911.2	3.1
Minnesota	51.4	1,774.7	2.9	61.9	1,822.5	4.5	88.5	1,857.5	4.8
Missouri	59.0	1,987.4	3.0	72.1	2,018.3	3.6	71.8	2,031.3	3.5
Nebraska	12.7	566.0	2.2	13.7	605.1	2.3	14.6	620.9	2.4
North Dakota	2.7	203.7	1.3	2.9	205.8	1.4	3.0	210.5	1.4
South Dakota	2.9	215.4	1.4	3.2	223.3	1.5	4.5	234.8	1.9
Southeast	949.5	20,516.7	4.6	1,105.5	21,114.9	5.2	1,140.2	21,487.3	5.3
Alabama	42.0	1,283.0	3.3	54.7	1,317.9	4.9	55.0	1,344.6	4.1
Arkansas	26.7	750.5	3.4	32.2	770.9	4.2	28.7	792.2	3.7
Florida	154.1	4,505.4	3.4	178.3	4,654.4	3.8	200.1	4,747.2	4.2
Georgia	143.7	2,452.9	5.9	157.2	2,501.7	6.3	159.6	2,527.5	6.3
Kentucky	47.7	1,169.8	4.1	56.0	1,216.5	4.6	63.4	1,247.8	5.1
Louisiana	56.2	1,237.2	4.5	65.2	1,251.7	5.2	61.2	1,306.4	4.7
Mississippi	20.2	722.8	2.8	24.1	741.0	3.2	22.8	753.5	3.0
North Carolina	157.4	2,597.2	6.1	176.7	2,657.8	6.6	180.8	2,695.2	6.7
South Carolina	85.1	1,220.3	7.0	101.4	1,256.6	8.1	104.2	1,295.8	8.0
Tennessee	98.2	1,804.7	5.4	114.1	1,870.0	6.1	115.8	1,891.9	6.1
Virginia	92.7	2,268.0	4.1	106.2	2,380.0	4.5	112.2	2,377.8	4.7
West Virginia	26.8	484.9	5.5	29.4	494.7	5.9	35.2	507.3	6.9
Southwest	337.9	8,216.8	4.1	381.5	8,412.5	4.5	417.5	8,687.8	4.8
Arizona	48.0	1,244.0	3.9	54.4	1,272.7	4.3	56.1	1,294.0	4.3
New Mexico	15.1	423.3	3.6	15.8	435.2	3.6	17.4	450.3	3.9
Oklahoma	38.4	908.0	4.2	41.5	929.6	4.5	44.0	956.0	4.6
Texas	236.4	5,641.6	4.2	269.7	5,775.0	4.7	300.0	5,987.5	5.0
Rocky Mountain	62.8	2,432.1	2.6	74.0	2,526.2	2.9	98.9	2,918.3	3.4
Colorado	34.2	1,223.4	2.8	42.0	1,264.1	3.3	53.1	1,300.8	4.1
Idaho	5.6	301.0	1.9	8.0	316.0	2.5	11.4	332.5	3.4
Montana	3.8	226.7	1.7	4.1	236.1	1.7	5.1	241.8	2.1
Utah	15.4	535.2	2.9	15.8	562.9	2.8	19.7	592.4	3.3
Wyoming	3.9	143.9	2.7	4.2	147.1	2.8	9.8	151.8	6.3
Far West	501.7	14,082.1	3.6	635.0	14,588.8	4.3	698.9	15,039.5	4.6
California	407.1	10,832.7	3.7	514.9	11,344.2	4.5	552.5	11,555.6	4.8
Nevada	13.7	492.1	2.8	19.5	533.6	3.6	22.4	570.0	3.9
Oregon	25.1	987.2	2.5	30.8	1,038.2	3.0	38.1	1,072.8	3.6
Washington	53.8	1,670.0	3.3	59.9	1,772.8	3.9	75.9	1,861.1	4.1
Alaska	7.8	151.5	5.0	10.6	162.7	6.5	13.2	171.4	7.7
Hawaii	34.8	404.1	8.8	45.0	429.9	10.5	50.2	450.4	11.2
Puerto Rico	14.7	n.a.	n.a.	19.0	n.a.	n.a.	15.8	n.a.	n.a.
Other U.S. areas [3]	4.8	n.a.	n.a.	8.6	n.a.	n.a.	9.0	n.a.	n.a.
Foreign [4]	2.6	n.a.	n.a.	5.9	n.a.	n.a.	8.9	n.a.	n.a.

n.a. Not available.

1. The data on employment of all nonbank U.S. businesses are from BEA's Regional Economic Information System. The totals are equal to employment in private industries less employment of banks and private households. The all-U.S.-business employment totals shown in this table differ slightly from those shown in Table 6, which are from Table 8.4C of the "National Income and Product Accounts (NIPA) Tables" in the January 1992 SURVEY. The all-U.S. employment data in this table are derived as the sum of the state estimates. They differ from the NIPA estimates of employment because they include banking and, by definition, they exclude U.S. residents temporarily employed abroad by U.S. businesses. They also differ from the NIPA estimates because of different data sources and revision schedules.

2. For consistency with the coverage of the all-U.S.-business employment data, U.S. affiliate employment in Puerto Rico, in "other territories and offshore," and in "foreign" was excluded from the U.S. affiliate employment total when the percentage shares on this line were computed.

3. See footnote 2 to table 6.

4. See footnote 3 to table 6.

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Table 8.—Manufacturing Employment by U.S. Affiliates and All U.S. Businesses, 1988–90, by State

	1988			1989			1990		
	U.S. affiliates	All U.S. businesses [1]	U.S. affiliates as a percentage of all U.S. businesses	U.S. affiliates	All U.S. businesses [1]	U.S. affiliates as a percentage of all U.S. businesses	U.S. affiliates	All U.S. businesses [1]	U.S. affiliates as a percentage of all U.S. businesses
Total [2 3]	1,811.9	19,496.0	9.2	1,865.4	19,536.0	9.6	2,005.4	19,261.0	10.4
New England	96.7	1,353.6	7.3	118.3	1,302.7	9.1	116.5	1,223.1	9.5
Connecticut	28.4	374.7	7.6	38.9	361.5	10.8	34.9	343.7	10.2
Maine	8.4	108.7	7.7	6.7	106.2	6.2	7.7	102.8	7.5
Massachusetts	41.7	588.2	7.1	49.0	562.4	8.7	52.0	522.5	10.0
New Hampshire	10.2	118.4	8.6	11.8	114.1	10.4	11.3	106.3	10.6
Rhode Island	7.5	113.7	6.6	7.5	109.7	6.8	6.8	101.2	6.8
Vermont	2.5	50.0	5.0	3.0	48.9	6.1	3.8	46.7	8.1
Mideast	302.2	3,254.2	9.3	348.6	3,196.5	10.9	363.2	3,064.5	11.9
Delaware	13.3	70.9	18.7	12.8	73.8	17.1	11.9	72.2	16.5
District of Columbia	.4	16.7	2.5	.4	16.1	2.4	.8	16.5	4.8
Maryland	24.1	212.2	11.4	28.0	208.6	13.4	30.7	207.3	14.8
New Jersey	78.6	686.8	11.8	97.0	645.8	15.0	95.3	604.2	15.8
New York	91.8	1,222.2	7.5	99.1	1,196.8	8.3	101.5	1,139.7	8.9
Pennsylvania	93.9	1,045.4	8.8	111.4	1,055.5	10.6	113.0	1,024.5	11.0
Great Lakes	343.3	4,250.3	8.1	398.7	4,286.6	9.3	436.8	4,244.7	10.4
Illinois	94.0	990.3	9.5	106.0	968.2	10.9	113.0	985.9	11.5
Indiana	59.6	638.6	9.4	65.1	647.7	10.0	95.2	699.3	13.3
Michigan	67.0	953.2	7.0	69.4	966.2	7.2	75.3	945.0	8.0
Ohio	88.3	1,113.7	7.9	113.5	1,124.2	10.1	120.0	1,113.2	10.8
Wisconsin	40.2	554.6	7.2	42.8	580.4	7.8	46.3	561.3	8.2
Plains	82.1	1,386.5	5.9	100.8	1,409.9	7.2	106.1	1,416.0	7.5
Iowa	17.3	228.3	7.6	20.0	235.8	8.5	21.8	236.9	9.1
Kansas	9.0	183.0	4.9	10.1	184.4	5.5	10.7	186.2	5.7
Minnesota	22.1	395.0	5.6	25.8	400.7	7.4	30.5	401.1	7.6
Missouri	26.1	435.4	6.0	31.4	442.0	7.1	32.5	439.2	7.4
Nebraska	5.0	96.7	5.1	6.8	96.1	6.7	7.3	101.0	7.3
North Dakota	1.1	16.5	6.5	1.2	16.6	7.0	1.1	17.5	6.3
South Dakota	1.5	31.6	4.8	1.6	32.4	5.4	2.4	34.2	7.0
Southeast	460.7	4,718.0	9.8	515.9	4,738.6	10.9	555.7	4,711.0	11.8
Alabama	25.0	383.2	6.5	27.0	387.6	7.0	34.6	387.2	9.0
Arkansas	15.2	228.4	6.8	18.3	231.3	7.9	18.7	233.2	8.0
Florida	33.7	543.4	6.2	44.6	536.6	8.3	47.4	523.1	9.1
Georgia	62.2	580.5	10.7	68.4	570.5	12.0	71.8	562.9	12.7
Kentucky	27.1	275.3	9.8	37.4	284.5	13.1	41.1	287.6	14.3
Louisiana	16.8	171.3	9.8	20.4	176.5	11.5	20.9	184.1	11.4
Mississippi	13.6	240.1	5.7	15.2	244.5	6.2	14.8	247.3	6.0
North Carolina	93.4	873.3	10.7	101.1	873.5	11.6	107.3	862.7	12.4
South Carolina	47.4	388.3	12.2	52.3	390.6	13.4	63.4	384.5	16.5
Tennessee	62.0	512.3	12.1	68.3	523.6	13.0	68.5	521.3	13.1
Virginia	39.6	432.1	9.2	45.1	430.2	10.5	49.3	428.7	11.5
West Virginia	14.7	87.7	16.8	17.8	88.2	20.0	17.9	87.9	20.3
Southwest	113.4	1,361.8	8.3	126.2	1,374.5	9.2	138.3	1,396.5	9.9
Arizona	12.7	192.3	6.6	13.4	188.4	7.1	12.1	187.2	6.4
New Mexico	2.6	40.9	6.3	2.6	43.0	6.1	3.3	43.8	7.4
Oklahoma	12.0	163.4	7.4	13.3	164.7	8.1	16.5	168.9	9.8
Texas	86.1	965.2	8.9	96.9	978.5	9.9	106.4	996.6	10.7
Rocky Mountain	20.4	378.2	5.4	24.1	389.3	6.2	25.0	395.9	6.3
Colorado	9.4	190.8	4.9	10.4	193.9	5.4	11.0	193.5	5.7
Idaho	2.3	58.1	4.0	4.3	61.0	7.0	4.5	63.4	7.1
Montana	1.4	21.7	6.5	1.4	22.4	6.2	1.4	22.5	6.2
Utah	6.5	98.9	6.5	7.3	103.1	7.1	7.4	107.1	6.9
Wyoming	.8	8.8	8.7	.7	8.9	8.1	.7	8.5	7.2
Far West	187.7	2,758.2	6.8	230.3	2,796.0	8.2	252.4	2,770.8	9.1
California	157.0	2,173.1	7.2	196.6	2,186.5	9.0	214.2	2,151.0	10.0
Nevada	1.2	25.1	4.7	1.7	25.8	6.6	2.1	26.5	8.1
Oregon	10.6	218.1	4.9	11.8	220.5	5.2	13.8	222.1	6.2
Washington	18.9	342.0	5.5	20.5	363.4	5.8	22.3	371.3	6.0
Alaska	2.8	15.5	18.8	2.3	16.1	14.3	3.9	17.4	22.7
Hawaii	1.6	21.8	7.2	2.6	21.7	11.8	2.8	21.3	13.1
Puerto Rico	7.9	n.a.	n.a.	12.9	n.a.	n.a.	8.9	n.a.	n.a.
Other U.S. areas [4]	.2	n.a.	n.a.	2.1	n.a.	n.a.	2.0	n.a.	n.a.
Foreign [5]	.8	n.a.	n.a.	3.0	n.a.	n.a.	.7	n.a.	n.a.

n.a. Not available.

1. The data on the manufacturing employment of all nonbank U.S. businesses are from BEA's Regional Economic Information System. The all-U.S.-business manufacturing totals shown in this table differ slightly from those shown in table 6 (see footnote 2 to table 6). The all-U.S.-business employment data in this table are derived as the sum of the State estimates. They differ from the NIPA estimates of employment because, by definition, they exclude U.S. residents temporarily employed abroad by U.S. businesses. They also differ from the NIPA estimates because of different data sources and revision schedules.

2. Total affiliate manufacturing employment and the shares of all-U.S.-business manufacturing employment accounted for by affiliates in this table differ from those shown in table 6 (see footnote 4 to table 6).

3. For consistency with the coverage of the all-U.S.-business employment data, U.S. affiliate employment in Puerto Rico, in "other territories and offshore," and in "foreign" was excluded from the U.S. affiliate employment total when the percentage shares on this line were computed.

4. See footnote 2 to table 5.

5. See footnote 3 to table 5.

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Table 15.1—Employment by Nonbank U.S. Affiliates, State by Country of Ultimate Beneficial Owner, 1989

	All countries	Canada	Europe						Latin America and Other Western Hemisphere	Africa	Middle East	Asia and Pacific			United States
			Total	Of which:								Total	Of which:		
				France	Germany, Federal Republic of	Netherlands	Switzerland	United Kingdom					Australia	Japan	
Total	4,611.5	721.4	2,711.1	276.4	443.8	314.4	271.6	1,621.5	227.7	17.4	38.2	781.8	186.1	629.0	33.1
New England:															
Connecticut	87.6	8.9	70.9	8.9	13.2	12.4	11.9	18.9	2.9	.3	.5	5.4	.9	4.8	.4
Maine	27.1	12.5	12.4	.9	1.0	1.9	1.2	5.3	1.1	.1	(D)	1.0	.3	.4	(D)
Massachusetts	129.1	31.1	81.5	9.1	11.8	8.4	4.5	37.5	8.5	.5	2.1	17.9	3.4	14.0	(D)
New Hampshire	26.1	(D)	18.2	.5	3.4	1.8	.9	7.4	2	0	0	2.9	.1	2.2	(D)
Rhode Island	13.1	2.6	9.5	.3	1.6	.8	.5	4.2	.3	.1	0	.5	0	.5	0
Vermont	8.9	2.7	4.5	.2	.5	.3	1.1	.5	.2	0	0	.4	(D)	.4	0
Mideast:															
Delaware	41.8	(D)	9.9	.3	1.4	.4	.5	5.9	.5	0	.8	(D)	.3	1.1	(D)
District of Columbia	10.8	1.9	6.7	.4	.3	1.0	.5	3.4	.4	.1	.1	1.4	.5	1.0	0
Maryland	71.7	15.1	48.1	7.2	7.2	7.3	5.8	14.9	1.8	.3	1.0	5.3	1.5	3.6	.3
New Jersey	222.8	28.4	154.2	15.1	33.0	13.7	28.9	42.1	5.5	.3	.3	33.0	4.0	25.0	(D)
New York	378.8	82.7	232.7	18.8	43.7	15.8	23.8	93.3	13.5	.4	.3	55.7	16.5	43.1	.8
Pennsylvania	204.3	27.9	148.4	16.7	27.1	12.8	10.9	64.1	9.1	.4	(D)	16.2	4.9	10.8	(D)
Great Lakes:															
Illinois	244.8	27.9	169.3	11.4	24.2	11.4	19.5	70.4	9.6	.4	1.0	48.3	4.8	40.3	1.4
Indiana	96.1	15.2	59.1	11.9	12.9	6.8	3.3	16.2	2.4	.4	.3	19.8	.9	11.4	(D)
Michigan	142.8	18.7	85.3	10.9	25.2	4.7	8.1	25.8	8.2	.5	.1	30.8	9.7	20.2	1.2
Ohio	207.9	27.2	120.2	10.8	18.8	12.9	13.1	48.6	18.1	1.3	.3	44.9	4.0	34.2	1.4
Wisconsin	78.9	11.8	58.4	5.8	10.5	8.9	8.7	18.9	1.8	.1	1.0	6.1	2.8	2.9	(D)
Plains:															
Iowa	30.9	5.2	20.2	1.7	8.8	3.7	1.5	4.1	.5	.4	.3	4.2	.1	3.0	.3
Kansas	30.7	6.0	18.5	2.1	1.9	4.0	1.7	6.8	1.3	.3	.1	2.9	.1	1.4	.3
Minnesota	61.9	9.4	48.0	3.8	8.7	3.9	4.7	22.4	2.7	.1	.1	21.2	(D)	3.4	.2
Missouri	72.1	16.9	44.4	3.9	8.2	8.3	5.0	14.0	4.5	.3	.3	5.3	1.3	3.4	.2
Nebraska	15.7	1.5	10.0	.9	(D)	1.8	1.2	4.0	.5	.1	0	1.7	.5	1.1	0
North Dakota	2.9	1.0	1.5	.1	.1	.2	.1	.9	.1	0	0	.2	.1	.1	0
South Dakota	3.2	1.1	1.8	(D)	(D)	.5	.1	.9	(D)	0	0	.3	.1	.2	0
Southeast:															
Alabama	64.7	16.2	35.7	5.4	2.9	1.2	3.3	8.9	(D)	.4	.4	11.8	4.8	5.4	.1
Arkansas	32.2	9.2	17.7	2.9	.7	4.8	1.6	5.8	1.5	.3	.3	6.5	1.1	5.3	0
Florida	178.3	51.6	101.4	9.7	8.9	10.3	7.0	45.8	21.9	.4	.3	17.7	6.4	8.4	.4
Georgia	157.2	33.8	92.7	7.5	13.5	9.5	8.8	32.2	(D)	.3	.8	22.8	4.0	17.5	.8
Kentucky	56.0	10.8	27.9	3.5	7.7	2.9	.9	11.4	1.0	.3	.2	15.0	1.2	13.8	.1
Louisiana	65.2	9.7	42.0	3.0	5.1	11.1	2.6	16.8	7.7	.1	.1	3.8	.5	1.7	.4
Mississippi	34.1	3.5	13.6	3.0	1.3	1.2	2.4	4.4	3.4	.1	.3	3.2	.8	2.4	.1
North Carolina	175.7	30.6	125.2	9.5	30.9	5.5	7.4	46.8	8.7	.2	.1	12.3	1.0	8.7	.5
South Carolina	101.4	9.4	69.5	10.8	15.9	15.3	5.0	14.4	9.2	.2	.2	9.9	1.0	7.6	.1
Tennessee	114.1	19.6	70.4	8.7	8.9	11.1	5.2	23.1	(D)	.3	.3	19.4	4.0	13.4	.2
Virginia	106.8	22.1	70.2	5.4	14.1	5.1	5.2	24.4	8.9	.5	.1	8.0	1.1	4.8	.7
West Virginia	29.4	12.7	15.2	1.9	2.7	2.0	3.3	3.8	.5	.2	.2	.8	.1	.7	.1
Southwest:															
Arizona	54.4	11.4	23.2	3.9	1.8	5.1	1.9	7.2	(D)	.1	(D)	16.0	11.0	4.4	.2
New Mexico	15.8	3.0	9.1	.2	(D)	1.9	.2	2.2	.8	.1	.1	2.7	(D)	1.5	.2
Oklahoma	41.8	9.4	24.4	2.3	2.9	3.9	1.1	11.4	3.1	.2	.2	3.9	.3	3.0	.2
Texas	259.7	35.8	174.8	18.8	25.8	25.7	19.4	86.1	14.8	1.8	7.4	33.2	9.6	19.5	1.2
Rocky Mountains:															
Colorado	42.0	7.8	24.2	2.8	1.8	2.3	3.3	11.6	2.2	.1	.1	8.8	1.8	4.4	(D)
Idaho	8.0	1.8	4.8	.2	.2	.2	.9	2.8	.3	.1	.5	1.8	.5	.8	.5
Montana	4.1	1.4	1.8	.5	(D)	.2	.2	.5	.3	.1	.1	1.0	.7	.2	.1
Utah	15.8	2.9	11.0	.2	.1	1.9	1.2	4.3	.2	.2	.2	1.8	.2	.8	.1
Wyoming	4.2	.5	3.0	1.1	(D)	.2	.1	1.4	.2	.2	.2	.1	(D)	.1	0
Far West:															
California	514.9	83.8	355.8	25.0	30.6	29.8	31.1	116.8	32.7	1.1	2.6	145.0	29.0	109.4	4.0
Nevada	19.8	4.9	8.8	.2	1.1	1.3	.5	4.7	1.0	.1	.1	5.4	1.5	3.8	(D)
Oregon	30.8	9.6	18.8	.6	4.7	.8	1.4	6.0	.8	.2	.1	9.4	1.6	7.1	.1
Washington	69.9	13.8	33.0	2.1	5.0	3.8	4.8	14.1	4.2	.8	.1	17.9	8.0	10.1	.8
Alaska	10.6	1.0	2.8	.1	.1	.2	.2	2.0	.3	0	0	6.0	.5	5.3	.7
Hawaii	45.0	.8	4.0	.2	.1	.7	.4	1.8	3.7	0	0	36.1	2.5	30.3	.4
Puerto Rico	19.0	1.4	11.9	.3	1.4	.7	1.9	5.4	.4	0	0	5.7	(D)	2.8	.2
Other U.S. areas[1]	5.8	.2	1.8	.2	0	.2	.2	.8	1.5	0	.2	4.9	(D)	1.8	0
Foreign[2]	5.9	(D)	2.5	.5	(D)	.2	.2	1.5	(D)	.2	.1	(D)	(D)	(D)	(D)

(D) Suppressed to avoid disclosure of data of individual companies.
* Less than 50 employees.
1. See footnote 2 to table 5.
2. See footnote 3 to table 5.

NOTE.—Estimates for 1989 are revised.

Table 15.2—Employment by Nonbank U.S. Affiliates, State by Country of Ultimate Beneficial Owner, 1990

	All countries	Canada	Europe						Latin America and Other Western Hemisphere	Africa	Middle East	Asia and Pacific			United States
			Total	Of which: France	Germany[1]	Netherlands	Switzerland	United Kingdom				Total	Of which: Australia	Japan	
Total	4,708.3	748.6	2,800.5	334.8	518.3	280.2	277.6	1,039.2	182.1	19.2	25.5	883.2	166.3	616.7	27.7
New England:															
Connecticut	78.3	7.5	53.4	7.0	12.0	12.9	9.6	17.3	1.1	[3]	[3]	5.6	1.2	4.4	[3]
Maine	27.1	12.4	12.4	.9	1.0	1.8	1.3	5.7	[3]	[3]	[3]	[3]	.4	.7	[3]
Massachusetts	131.8	23.3	85.3	12.7	13.8	3.4	4.7	39.3	3.7	.4	2.1	18.4	3.6	12.3	.6
New Hampshire	26.3	[D]	16.0	1.2	3.9	1.2	.9	6.8	.6	[3]	[3]	2.0	.1	1.6	[3]
Rhode Island	12.7	1.3	10.6	.4	1.8	.8	.5	5.6	.1	[3]	[3]	.7	[3]	.6	[3]
Vermont	8.0	3.1	3.8	.5	1.0	.3	1.1	.3	[3]	[3]	[3]	.9	[3]	.9	.1
Mideast:															
Delaware	43.1	[D]	11.1	1.1	1.5	.4	.5	6.2	.3	[3]	[3]	2.1	.1	1.4	[3]
District of Columbia	10.8	1.9	6.4	.4	.8	.7	.7	3.3	[3]	[3]	.7	1.8	.3	1.4	[3]
Maryland	80.9	18.4	54.0	7.3	8.3	7.4	7.7	17.5	1.9	[3]	[3]	5.8	1.9	3.7	[3]
New Jersey	225.6	29.4	152.6	14.9	31.0	13.7	27.5	44.1	6.3	[3]	.4	36.8	3.0	28.3	.3
New York	349.2	58.9	213.9	28.0	36.8	17.4	22.9	82.9	6.9	.4	1.6	62.0	13.6	41.3	7.5
Pennsylvania	217.0	28.9	160.9	23.5	29.3	18.0	10.6	54.5	8.5	.4	1.3	19.8	5.7	13.1	.8
Great Lakes:															
Illinois	242.9	29.5	162.5	12.7	24.0	11.3	26.3	57.6	8.7	.4	.8	52.4	5.6	44.4	1.7
Indiana	124.5	16.5	88.5	16.5	12.5	9.0	3.7	20.7	2.5	[3]	[3]	37.5	1.4	26.3	[3]
Michigan	142.6	21.4	91.3	11.2	23.3	4.7	2.9	29.2	9.5	[3]	[3]	38.1	11.1	23.6	.8
Ohio	217.9	28.6	125.8	16.7	19.4	13.9	12.6	48.5	9.8	1.5	[3]	52.4	6.0	39.6	.2
Wisconsin	79.8	13.1	57.5	7.3	14.6	8.7	5.6	15.3	.5	.1	1.0	8.8	3.0	3.1	[3]
Plains:															
Iowa	36.7	10.0	21.7	1.7	4.9	4.1	1.8	6.6	.2	[3]	[3]	4.1	.1	3.1	[3]
Kansas	28.1	6.7	17.2	2.5	2.0	1.5	2.3	6.8	.2	[3]	[3]	3.5	[3]	2.1	[3]
Minnesota	80.5	10.3	54.4	3.8	12.0	9.2	6.4	20.8	.2	[3]	[3]	23.7	6.6	4.4	.1
Missouri	71.8	17.1	46.3	5.8	8.9	4.6	6.4	15.9	1.3	[3]	[3]	6.3	[3]	4.0	.4
Nebraska	14.6	1.5	10.9	1.1	2.4	1.2	1.2	4.8	.3	[3]	[3]	1.8	[3]	1.1	[3]
North Dakota	3.0	.9	1.7	.2	.3	.2	.1	.7	[3]	[3]	[3]	.5	.1	.1	[3]
South Dakota	4.5	1.1	2.9	.2	.3	.2	.1	1.8	[3]	[3]	[3]	.5	.1	.4	[3]
Southeast:															
Alabama	55.0	7.8	34.5	11.2	4.1	1.1	3.5	10.4	1.7	.4	.3	10.0	2.2	7.2	[3]
Arkansas	29.7	5.8	15.7	3.1	.7	2.1	1.7	5.5	.2	[3]	[3]	6.7	1.0	5.3	.1
Florida	200.1	40.2	120.9	11.6	17.3	10.9	7.6	48.9	12.1	1.9	.3	23.3	6.4	13.6	.4
Georgia	169.8	30.4	96.0	11.9	13.6	11.4	8.9	34.8	9.4	.4	1.8	36.9	8.2	18.7	.8
Kentucky	63.4	10.7	32.1	4.8	7.8	2.7	1.0	14.1	.8	[3]	[3]	18.8	1.5	16.4	[3]
Louisiana	61.2	10.5	38.6	3.8	6.7	7.8	2.7	14.1	7.5	.1	.7	3.5	1.0	1.7	.1
Mississippi	22.8	3.8	13.5	2.1	1.5	1.0	2.5	4.6	.2	[3]	[3]	3.1	1.0	2.0	[3]
North Carolina	180.5	29.7	134.1	11.2	31.5	5.1	8.3	43.3	1.8	.1	.7	14.9	1.0	11.8	.1
South Carolina	104.2	9.3	76.8	13.1	16.7	12.8	4.8	17.1	2.7	.1	.3	18.9	.6	11.8	.6
Tennessee	115.8	19.0	73.0	10.4	8.6	7.7	8.9	27.7	1.3	.4	.3	21.5	3.7	15.6	.1
Virginia	112.2	17.9	80.8	6.7	14.4	4.6	4.8	29.6	6.0	.4	.3	7.9	1.8	6.1	.1
West Virginia	38.2	13.0	20.1	2.0	3.7	2.0	2.3	6.4	.4	.3	.3	1.4	.3	1.1	[3]
Southwest:															
Arizona	66.1	10.4	23.7	4.4	2.5	2.3	1.7	9.1	1.5	.1	1.7	18.5	13.0	4.4	.2
New Mexico	17.4	2.7	11.0	1.0	5.8	1.3	.2	2.4	.6	[3]	[3]	3.0	1.4	1.5	[3]
Oklahoma	44.0	9.6	28.1	5.0	2.2	1.5	[3]	12.5	2.6	.1	.1	4.6	.4	4.0	.3
Texas	300.0	40.1	200.5	22.8	35.5	34.8	17.4	82.2	13.2	2.1	4.5	35.9	10.0	21.6	.8
Rocky Mountains:															
Colorado	53.1	7.8	35.5	3.2	5.4	2.7	3.7	10.7	1.1	.1	.4	7.8	1.8	5.4	.5
Idaho	11.4	1.4	8.0	.4	[3]	.2	[3]	2.3	.1	[3]	[3]	1.5	.6	[3]	[3]
Montana	5.1	1.5	2.6	.4	[3]	.2	[3]	1.1	[3]	[3]	[3]	.9	.6	[3]	[3]
Utah	18.7	2.2	15.6	.7	4.4	1.5	[3]	5.9	.2	[3]	[3]	1.5	.9	.4	[3]
Wyoming	9.6	.5	8.2	1.3	.7	.5	[3]	2.1	[3]	[3]	[3]	.4	[3]	.3	[3]
Far West:															
California	552.2	63.5	390.9	28.2	48.0	34.5	28.0	102.5	15.1	1.3	1.1	178.1	31.7	134.6	2.5
Nevada	22.4	4.5	10.5	.7	2.7	3.3	.4	2.6	.2	[3]	[3]	6.3	2.0	4.0	[3]
Oregon	38.1	4.9	21.1	1.0	5.3	1.0	1.3	8.1	.2	[3]	[3]	11.6	1.8	8.3	.1
Washington	75.9	14.8	57.9	2.5	9.3	4.4	4.8	13.4	[3]	[3]	[3]	19.6	5.2	11.7	[3]
Alaska	13.5	1.5	3.7	.1	.2	.4	.2	2.7	.4	[3]	[3]	6.9	.7	6.0	.7
Hawaii	50.2	.8	8.9	.3	.2	.8	.4	1.5	2.5	[3]	[3]	39.8	3.1	32.7	.3
Puerto Rico	15.3	1.5	10.4	.2	1.2	.7	1.3	4.6	.4	[3]	[3]	2.7	[3]	1.6	[3]
Other U.S. areas[3]	9.0	.3	1.6	.3	[3]	0	.4	.7	1.5	[3]	[3]	5.5	[3]	1.9	[3]
Foreign[3]	6.9	.5	2.9	.4	.1	.2	.2	1.2	.1	[3]	[3]	[3]	[3]	[3]	[3]

[D] Suppressed to avoid disclosure of data of individual companies.
[3] Less than 50 employees.
1. See footnote 1 to table 4.
2. See footnote 2 to table 5.
3. See footnote 3 to table 5.

NOTE.—Estimates for 1990 are preliminary.

SENT BY:DEPT. COMMERCE/BEA/IID ; 8-21-92 ; 5:25PM ; 2025236569→ 2024566216;# 6

Table 16.—Gross Property, Plant, and Equipment of Nonbank U.S. Affiliates, by State, 1988–90

[Millions of dollars]

	1988		1989 r		1990 p		Change in commercial property	
	Total	Of which: Commercial property [1]	Total	Of which: Commercial property [1]	Total	Of which: Commercial property [1]	1988–89	1989–90
Total	418,088	184,046	466,481	184,836	572,342	146,811	20,791	21,771
New England:								
Connecticut	3,810	1,486	4,841	1,587	5,334	1,753	129	166
Maine	2,036	426	1,843	391	2,077	326	-83	-65
Massachusetts	6,816	2,847	7,286	3,314	8,848	3,470	466	157
New Hampshire	994	258	1,119	256	1,497	378	-3	121
Rhode Island	580	166	667	242	1,081	335	74	92
Vermont	449	86	492	82	636	151	26	69
Midwest:								
Delaware	4,786	880	5,343	636	5,811	736	59	97
District of Columbia	2,230	2,086	3,004	2,788	3,489	3,226	751	438
Maryland	8,786	1,291	4,722	1,472	6,784	1,844	182	372
New Jersey	13,960	3,721	16,276	3,884	18,447	4,306	-58	843
New York	26,386	14,387	33,554	16,884	38,203	21,188	4,497	2,274
Pennsylvania	11,582	2,523	14,509	3,012	18,486	3,350	489	338
Great Lakes:								
Illinois	16,869	4,726	19,670	6,070	23,229	8,558	1,344	488
Indiana	8,828	788	7,995	1,048	13,255	1,011	259	-36
Michigan	8,774	-1,097	10,537	1,187	11,919	1,413	89	226
Ohio	12,912	2,866	17,262	2,821	20,308	3,177	-245	356
Wisconsin	3,874	549	4,323	518	5,044	619	-31	102
Plains:								
Iowa	2,219	273	2,244	235	2,815	252	-38	27
Kansas	5,254	239	4,780	330	5,031	255	91	-45
Minnesota	8,540	1,432	11,818	1,888	12,420	1,811	456	-77
Missouri	4,484	918	5,006	960	5,776	1,064	46	104
Nebraska	556	75	710	110	780	102	36	-8
North Dakota	1,189	9	1,109	24	1,200	35	15	11
South Dakota	441	36	465	28	552	47	-9	20
Southeast:								
Alabama	4,852	486	5,873	609	7,346	480	143	-129
Arkansas	1,707	375	2,912	485	2,476	480	109	-5
Florida	11,906	6,190	14,902	7,317	17,677	8,887	1,127	1,571
Georgia	10,856	3,678	13,895	4,806	16,506	5,485	1,128	679
Kentucky	5,581	658	6,786	801	9,011	835	143	233
Louisiana	16,896	1,323	15,994	1,216	17,221	1,482	-106	276
Mississippi	2,579	193	2,686	224	2,912	236	31	12
North Carolina	11,792	1,584	13,819	1,702	15,160	2,000	117	298
South Carolina	7,288	1,002	8,664	1,316	10,183	1,400	314	84
Tennessee	7,292	1,136	8,940	1,486	10,124	1,881	352	395
Virginia	7,982	2,040	9,155	2,593	10,618	3,052	553	459
West Virginia	5,020	191	5,532	271	8,023	195	80	-86
Southwest:								
Arizona	5,060	1,866	6,070	2,298	7,298	2,548	432	257
New Mexico	3,589	275	3,799	296	4,334	427	21	131
Oklahoma	5,709	650	5,795	781	6,982	746	131	-15
Texas	46,213	10,421	47,958	11,329	57,170	12,767	908	1,439
Rocky Mountain:								
Colorado	5,469	2,494	5,822	2,841	6,268	3,287	347	256
Idaho	432	22	616	38	768	200	15	162
Montana	1,801	71	1,916	(D)	2,151	97	(D)	(D)
Utah	3,502	120	3,547	264	4,009	481	143	217
Wyoming	2,990	30	2,008	36	2,872	175	6	140
Far West:								
California	52,411	19,876	53,706	23,809	77,487	25,896	3,933	6,087
Nevada	2,853	549	3,865	586	5,377	961	36	375
Oregon	2,099	554	2,457	673	3,205	1,078	119	405
Washington	4,803	1,372	6,052	1,545	8,066	2,188	273	643
Alaska	18,312	284	18,114	(D)	19,435	249	(D)	(D)
Hawaii [2]	4,990	3,318	8,224	5,166	10,658	7,495	1,853	2,327
Puerto Rico	663	145	1,245	155	1,303	175	9	20
Other U.S. areas [3]	17,247	212	17,416	277	19,057	553	65	277
Foreign [3]	2,548	193	1,881	133	1,841	225	-60	92

r Revised.
p Preliminary.
(D) Suppressed to avoid disclosure of data of individual companies.
1. See footnote 1 to table 1.
2. See footnote 2 to table 5.
3. Consists primarily of movable fixed assets temporarily located outside the United States and of any foreign assets, including mineral rights, carried on the U.S. affiliates' books.

Please see page 10.

Statement of

Shirley D. Peterson
Commissioner of Internal Revenue

Before the

Subcommittee on Oversight
House Committee on Ways and Means

International Tax Administration Issues

April 9, 1992

STATEMENT OF
SHIRLEY D. PETERSON
COMMISSIONER OF INTERNAL REVENUE
BEFORE THE SUBCOMMITTEE ON OVERSIGHT
HOUSE WAYS AND MEANS COMMITTEE
HEARING ON TAX UNDERPAYMENTS
BY U.S. SUBSIDIARIES OF FOREIGN CORPORATIONS
APRIL 9, 1992

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today in my first appearance as Commissioner before this Subcommittee to discuss the U.S. taxation of foreign controlled corporations doing business in the United States and the issue of transfer pricing. With me today are Chief Counsel Abraham "Hap" Shashy, Assistant Commissioner (International) Regina Deanehan, and Deputy Associate Chief Counsel (International) Charles Triplett.

I. INTRODUCTION

The Internal Revenue Service testified on this issue in 1990. At that time, my predecessor Fred Goldberg indicated that the IRS was concerned with the transfer pricing practices of both foreign controlled corporations and U.S. controlled corporations. Congress responded to these concerns and enacted legislation to assist the IRS in enforcing section 482, which governs transfer pricing. The IRS for its part undertook an intense effort to develop and to implement administrative means to improve compliance with section 482.

My testimony today will speak to how the picture has changed since the 1990 hearing. In so doing, I will respond generally to a series of questions this subcommittee sent us less than a month ago in the context of its investigation of tax underpayments by foreign controlled corporations, or FCCs.

Mr. Chairman, you asked important questions that focused on four general topics. These topics are:

-- How the IRS has used the new legislative tools, in particular the designated summons and expert witness procurement procedures;

-- What staffing, enforcement, and other administrative efforts the IRS has committed to the transfer pricing area;

-- The status of our advance pricing agreement or APA program; and

-- The degree to which the IRS coordinates transfer pricing issues with our treaty partners.

These topics are very similar to those that Congress asked us to address in our Report on the Application and Administration of Section 482, which we are releasing today. The topics can be summarized in two direct questions: Has the 1989 and 1990 legislation been effective; and has the IRS taken appropriate and effective steps to implement the legislation and to respond administratively where possible to police transfer pricing noncompliance? Mr. Chairman, in answer to these questions, much remains to be done, but we have a positive story to tell. Before I provide you with the details, let me summarize:

First, our field experience suggests that the legislative amendments are responsive to the problems identified in 1990. Our experience is that the changes are increasing compliance with the transfer pricing rules.

Second, we have undertaken numerous administrative efforts to enhance the administration of section 482. These efforts have three aims: to increase voluntary compliance, to strengthen enforcement, and to improve our litigation experience. Our efforts on the compliance front include our successful APA program and the publication of proposed regulations under section 482. Our efforts on the enforcement front include a marked increase in international examinations, increased coordination and centralization of transfer pricing issues, improvements to the competent authority process, and better coordination with treaty partners. In litigation, our efforts include earlier development of our legal position and arguments and greater use of outside experts.

Third, the efforts I have mentioned above are only the beginning. We are looking actively for more innovative ways to address transfer pricing problems. To improve voluntary compliance, we are undertaking an in-depth study of methods to collect and to analyze financial data relevant to transfer pricing issues. We hope to work with the business community to develop a voluntary program for obtaining this information. To strengthen enforcement, we are working to develop more sophisticated case selection criteria. One approach is to establish baseline reporting statistics for specific markets. This baseline data will allow us to target more precisely those companies that are not complying with section 482. To improve our litigation experience, we will continue to involve the Office of Chief Counsel in the early development of cases, and we will continue to seek the assistance of experts. We are also

experimenting with arbitration as a means of reducing the cost and time required to resolve transfer pricing cases.

I now will address each of these points in greater detail.

II. Impact of the Legislation

To assess the impact of the recent legislative changes, we looked to our field experience as a guide. Our field experience suggests that the legislation is responsive to the problems identified in 1990 and is increasing compliance with section 482. I will address three principal legislative provisions: the record-keeping and reporting requirements of section 6038A; the designated summons procedures of section 6503(k), and the expedited procurement procedures for expert witnesses.

A. Record-keeping and Production of Records

Section 6038A, as amended in 1989 and 1990, imposes reporting and record-keeping requirements on U.S. corporations that are 25 percent or more owned by a foreign person. These corporations, known as "reporting corporations," must file Form 5472 disclosing transactions with related parties, and they must maintain records sufficient to determine the correct federal income tax treatment of those transactions.

The IRS issued proposed regulations under section 6038A in December of 1990. The IRS took into account over 70 written comments on the regulations. Six months later, in June of 1991, final regulations were issued. As this chronology demonstrates, the IRS acted expeditiously to implement the legislation.

Our field offices report that the legislation and regulations are working. More taxpayers are complying voluntarily with information requests, and doing so more quickly; the field offices attribute this success in part to the noncompliance penalties adopted under section 6038A. For example, if a taxpayer fails to provide adequate documentation under section 6038A, the IRS may use its discretion to disallow questionable deductions, subject to very limited judicial review. Taxpayers are anxious to avoid this potentially severe result. Consequently, there is greater compliance, and more issues are resolved at the exam level. As one typical District indicated, "the amendments strengthening [section] 6038A [have] proven their value."

The effectiveness of section 6038A is likely to increase even from its current level. The IRS is near the end of a project to revise Form 5472 to require more detailed information about related party transactions. The change to the Form, when

coupled with the noncompliance penalties, should enhance the ability of the IRS to identify noncompliance with section 482.

B. Designated Summons Procedure

Congress provided IRS with the designated summons as a new tool to use when taxpayers refuse to provide requested information or delay their response in the hope that the statute of limitations will expire. The designated summons procedure extends the statute of limitations during the period that a summons is the subject of judicial enforcement proceedings. The designated summons is an extraordinary procedure that the IRS invokes judiciously, only following high level review within Examination and the Office of Chief Counsel.

To date, the IRS has issued three designated summonses relating to transfer pricing issues. Two of these summonses relate to outbound transactions, and the other relates to an inbound transaction. In two of the cases, the taxpayers complied with the summons without the need for judicial enforcement. The IRS believes that compliance resulted in large part from the threat that the statute of limitations would be suspended.

In the third case, a District Court has ordered the taxpayer to comply, and the taxpayer is appealing the order. The designated summons procedure is protecting the government in this instance by keeping the statute of limitations open during the pendency of the appeal.

C. Expedited Procurement of Expert Witnesses

Legislation adopted in 1991 has made outside experts more accessible to the IRS. The assistance of outside experts is of great importance in section 482 cases, which are factually complicated as a rule. Frequently, the products at issue have unique characteristics that complicate our efforts to find comparables. In addition, transfer pricing cases may require valuation of sophisticated intangibles on both sides of a related party transaction. The factual development often requires in-depth knowledge of a particular industry or of economics principles that often are beyond the experience of an examining agent.

The IRS now is able to address this problem through the early involvement of expert witnesses. Under the expedited procurement procedures, the IRS can hire an expert for the examination and litigation phases of a transfer pricing case without substantial delay.

The IRS spent $14.6 million for expert witness procurements during FY 1991. Since the new procurement procedures went into

effect, 112 expert witnesses have been engaged for section 482 cases. In FY 1991, expert witnesses provided assistance in nine transfer pricing cases at the examination level. Three of those exam cases are now complete, with adjustments amounting to $766 million. The FY 1992 budget for expert witnesses exceeds $16 million.

D. Summary

In summary, the majority of our international examiners indicate that taxpayers have been more forthcoming with the information that the IRS needs to develop its transfer pricing cases adequately and to assess the proper amount of tax. As a direct result, taxpayers are more likely to settle cases at the exam level. This result is just beginning to show in our numbers.

For example, in our Manhattan District, a key location for FCCs, settlement rates have increased dramatically in the past two years. In FY 1990, the agreed rate at the examination level was only 2.8 percent. In 1991 that rate increased substantially to 54.7 percent. The favorable trend is continuing upward in the first six months of FY 1992.

These numbers, while encouraging, do not tell the whole story. Too little time has elapsed to obtain a comprehensive picture of the impact of the legislation. Our "hard" tax return data is available only through 1989. Accordingly, additional legislation would be premature at this time.

III. IRS ADMINISTRATIVE EFFORTS

The IRS has three important goals in developing administrative means to address transfer pricing. These goals, a part of Compliance 2000, are: to encourage voluntary compliance; to strengthen enforcement, and to enhance our litigation experience. With these goals we aim to deliver a better audit experience and to ease administrative burdens for taxpayers who comply, and to deal swiftly and firmly with those who do not. I will discuss separately the ongoing administrative efforts that relate to each goal.

A. Encourage Voluntary Compliance

There are two major developments to report concerning voluntary compliance. These are the advance pricing agreement program and the publication of proposed regulations under section 482.

The IRS developed the APA program as an alternative to the ordinary administrative, judicial, and treaty dispute resolution

mechanisms for resolving intercompany pricing issues. The APA process is a cooperative one; both taxpayers and the government derive significant benefits. Taxpayers welcome the concept as a way to obtain certainty in a complex area and to avoid a lengthy confrontation with the IRS and possibly with a foreign tax administration. In addition, both the IRS and the taxpayer benefit from a more rapid and less costly resolution of the transfer pricing issues.

From its recent inception, the APA program has grown quickly. From a small beginning -- seven APA requests -- the IRS program now includes 38 taxpayers, involving 15 different countries. One agreement is fully complete and has been approved by the relevant foreign competent authority. Six others are in their final stages.

The APA process offers an efficient and speedy resolution of transfer pricing issues. The average APA takes about 12 months to complete, far less time than it takes to resolve a significant section 482 issue through the course of examination, administrative appeals, and litigation. The APA process clearly is a win-win situation for taxpayers and the IRS. We are proud of our success with the APA program; we are pleased that taxpayers are willing to work with us cooperatively in this difficult area of the law.

A second aspect of our voluntary compliance effort is the publication of proposed regulations under section 482. The regulations provide specific rules that taxpayers can follow to evaluate the adequacy of their intercompany transfer prices. Consistent with Congressional intent, the actual profit experience of the taxpayer provides an important reference point. If the operating income reported by the taxpayer is within a comparable profit interval, the IRS generally will not make any adjustment under this method. If the operating income is outside of, but not far from the boundary of, the comparable profit interval, the IRS generally will limit the size of any adjustment, based on the proximity of the taxpayer's reported income to the profit interval. These important rules are designed to promote reasonable reporting positions and to streamline the examination process.

B. Strengthen Enforcement

During the past two years, the IRS has instituted a number of changes to improve our enforcement of section 482 issues. Paramount among these changes is an increased commitment of resources and attention to transfer pricing in the international context.

1. Increased Resources

In August, 1991, the IRS began to implement a strategic initiative, called SVC-17, to provide an effective means for identifying and addressing noncompliance with international tax laws, to measure the effectiveness of compliance efforts, and to determine the most effective staffing levels.

As part of this program, we have increased the number of individuals assigned to enforce transfer pricing in the international context. In the past two years we have:

-- increased the number of international examiners by almost 100, from 490 to 582;

-- nearly doubled the number of economists, from 36 to 68; and

-- increased the number of international attorneys, from 122 to 125.

We also have increased the number of FCCs under examination. The number of FCC returns under examination has more than doubled, from 1100 in July of 1990 to 2500 today.

There are two other important initiatives we have undertaken to enable us to use our resources more effectively. First, we established an International Compliance Analysis Division. This Division analyzes multinational trends for their effect on tax administration, identifies significant international tax issues and market segments that warrant greater examination coverage, and develops training sources and materials for specialized international training.

A second initiative is the International Field Assistance Specialist Program, established at the beginning of FY 1992. This program provides greater centralization of section 482 issues. It is designed to provide practical "how-to" technical assistance to the field and to achieve consistency in the administration of section 482 and other international tax issues. The experienced audit specialists assigned to this program develop and disseminate audit techniques, consult with Counsel, and train other examiners.

Our Appeals division also is developing an experienced group of international specialists and has made significant innovations in statistical issue tracking. In addition, Appeals has emphasized improved communications with the Examination Division in the international context and more generally.

2. Coordination With Treaty Partners

Another aspect of our efforts to strengthen enforcement relates to coordination with our treaty partners. We will be looking more frequently to our treaty partners to provide information relevant to transfer pricing issues under our existing information exchange agreements. In addition, we intend to implement a more vigorous use of the simultaneous examination program. Under this program, we can work together with a foreign tax authority to investigate the activities of a multinational taxpayer. Our goal is to explore fully every avenue with our treaty partners to access the information we need for effective enforcement of section 482. In the process, we hope to improve our competent authority procedures to allow taxpayers to resolve double taxation issues more easily.

C. Improved Litigation Experience

We must improve our litigation success rate. We believe the keys are better factual development at the examination level, and earlier identification of our legal position and arguments.

The legislative changes that the Congress adopted in 1989 and 1990 will aid in improving factual development of transfer pricing cases at the exam level. For example, the designated summons rule I discussed earlier prevents taxpayers from taking unfair advantage of a delay in responding to IRS information requests. The penalties under section 6038A provide a strong incentive for taxpayers to comply with reporting and recordkeeping requirements. We also can look more readily to outside experts for assistance, and use our regulations, when issued in final form, for guidance.

The IRS is improving its development of its legal position by involving the Office of Chief Counsel at an earlier stage of the examination process. In the past, examining agents may not have requested the financial information most relevant to the legal approach ultimately pursued in court. One object of earlier Counsel involvement is to develop strong legal arguments along with the facts needed to support those arguments.

IV. INNOVATIONS FOR THE FUTURE

We believe that the administrative programs I have just reviewed with you demonstrate our dedication to addressing transfer pricing issues effectively and swiftly. But we will not stop there. We are continuing to seek out and develop innovative ways to respond to this complex problem. I will give you an example of our pending initiatives in each one of our areas of focus -- compliance, enforcement, and litigation.

Compliance. On the compliance side, we are making an effort to improve access to financial data from business entities other than the taxpayer under examination (i.e., from "third parties"). This information is highly relevant in applying the arm's length standard to determine the proper transfer price among related parties.

We are now undertaking an in-depth study of methods to obtain and analyze third party information outside the context of a particular examination. In the past, we have not made an integrated effort to compile third party information, but instead have sought it out on a case-by-case basis.

Our new approach is to work with the business community, trade associations, and other industry groups to develop a voluntary program to collect and analyze third party information. As part of this program, we will address methods to balance the taxpayer's interest in evaluating and protesting the IRS position against the concern of third parties to preserve the confidentiality of sensitive financial data. We also plan to supplement the voluntary information program by using information that is available in public databases and from other government agencies.

One positive side effect of this program is that we may be able to release information that will help all taxpayers comply. The degree of specificity of the information will depend upon how we ultimately resolve the confidentiality issue I mentioned. At a minimum, we should be able to provide general information that will be of assistance. In this respect, we already plan to release some general conceptual information based on our APA experience, once we have enough participants per industry so that the information disclosed cannot be correlated with any particular taxpayer.

Enforcement. On the enforcement side, our goal is to develop more detailed and sophisticated case selection criteria -- a type of audit screening process -- to direct our resources to those cases most likely to present serious transfer pricing issues. We have two approaches in mind. First, we can use the third party data obtained in our information program, perhaps with the help of statistical analysis, to develop an audit screen. For example, we might construct a range of profitability that our agents could use to assess the likelihood of a substantial transfer pricing issue.

Second, we are targeting certain market segments for in-depth analysis. A market segment is a classification of commercial activity according to the nature of the activity, for example, manufacturing or wholesale trade. Our hope is to identify baseline reporting statistics against which to measure

taxpayer compliance in these market segments. We have convened a task force to carry out this analysis.

Overall, we hope to achieve smarter enforcement that will direct our resources where they are most needed.

Litigation. On the litigation front, we are hoping to streamline the resolution of transfer pricing controversies through the use of innovative procedures such as binding arbitration. We are experimenting with arbitration in one docketed Tax Court case. The government and the taxpayer have both agreed to be bound by the decision of the arbitration panel. The panel is required to choose a figure submitted by one of the parties. As a result, the parties should have a greater incentive to take reasonable positions.

This case is the first transfer pricing dispute that has been submitted to arbitration. We believe this process has great potential as a cost-effective and rapid means of resolving transfer pricing disputes.

V. REVENUE SHORTFALL

Before I conclude, I would like to address an issue I know to be of interest to this committee. That issue is the size of the revenue shortfall, or "tax gap," that results from noncompliance by FCCs with section 482. Our view is that none of the available data allows us to make a reliable estimate of this "tax gap."

The FCC tax gap controversy has yielded claims of unpaid taxes as high as $30 billion and as low as zero. We cannot substantiate any of these speculations. We know that many FCCs have reported sizeable profits and paid substantial amounts of taxes. We also know that in 1989 only 28 percent of all FCCs reported taxable income. In comparison, taxable income was reported by 41 percent of all corporations controlled by United States persons, which I will refer to as USCCs. Measures of profitability also are lower in 1989 for FCCs as compared with USCCs. I have attached charts to my statement that demonstrate this result using the rate of return on assets and using net income (less deficit) as a percentage of total receipts.

Economic analyses of the differential in measures of profitability, as shown on the charts, suggest that the differential is not due wholly to transfer pricing noncompliance. According to a study released last November, as much as 50 percent of the differential was thought to be explainable by non-tax factors. If the remainder were due wholly to transfer pricing noncompliance, the tax gap would be about $3 billion -- but there is no certainty that the remainder is due to transfer

pricing abuse or that the comparison of measures of profitability is valid in this aggregate form.

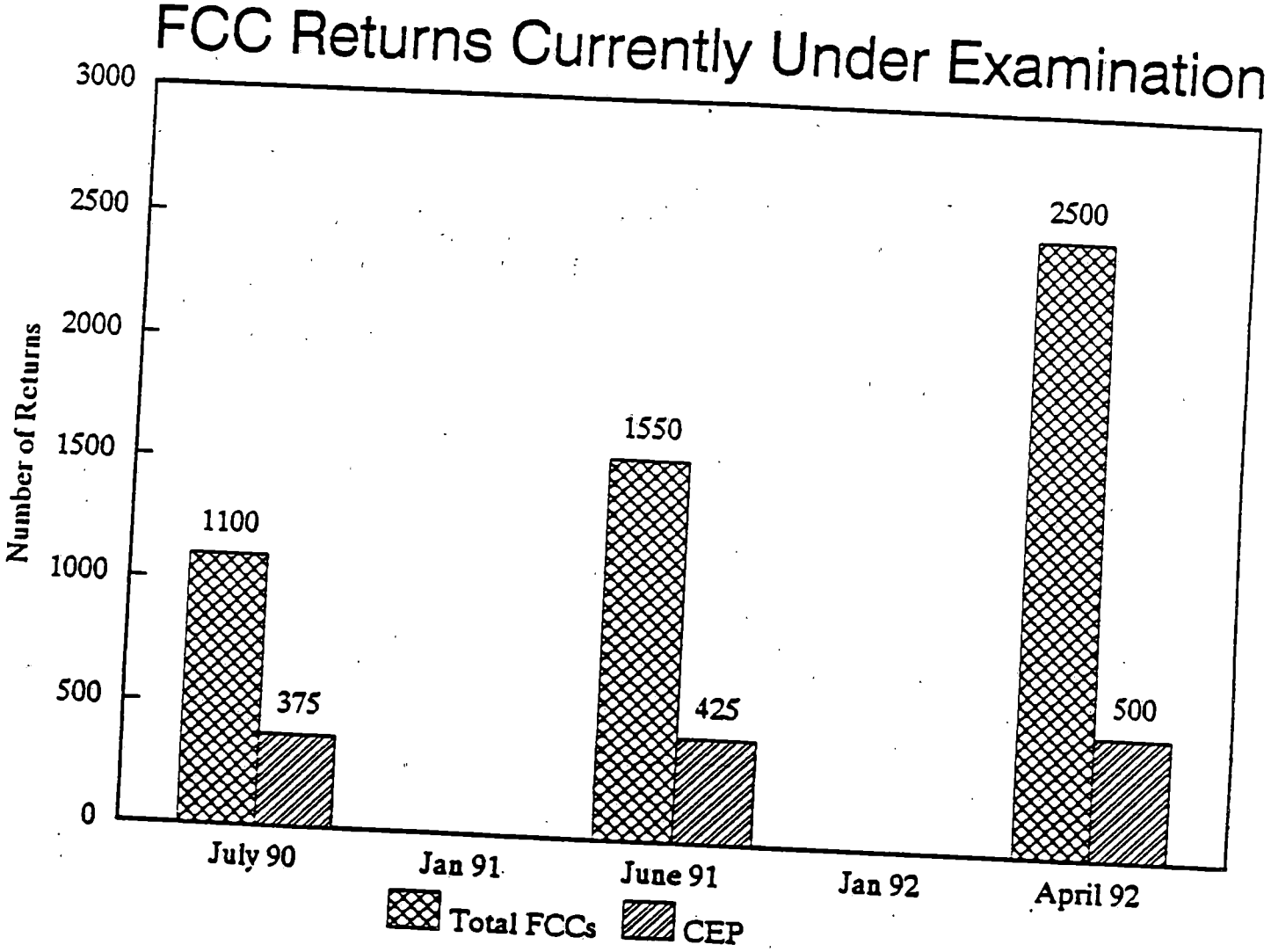
We believe there is a compliance problem under section 482, but we cannot quantify it. We believe the problem exists in the case of our own U.S.-based multinationals as well as for FCCs. We believe the only reliable way to measure noncompliance with section 482 to audit every company -- not a feasible or attractive solution. Our other option is to change the way we do business. We must shift the balance in our favor by making voluntary compliance more attractive and noncompliance more risky.

VI. CONCLUSION

I began this testimony by indicating that I would speak to how the section 482 picture has changed since the 1990 hearings. I believe the picture I have presented demonstrates that our prospects are substantially improved from when the earlier hearings were convened. With the help of the Congress and the Administration, we have put into motion a plethora of tools and programs that have improved the administration of section 482. Now these efforts are beginning to show results. We need more time to assess the ultimate impact before considering additional legislation.

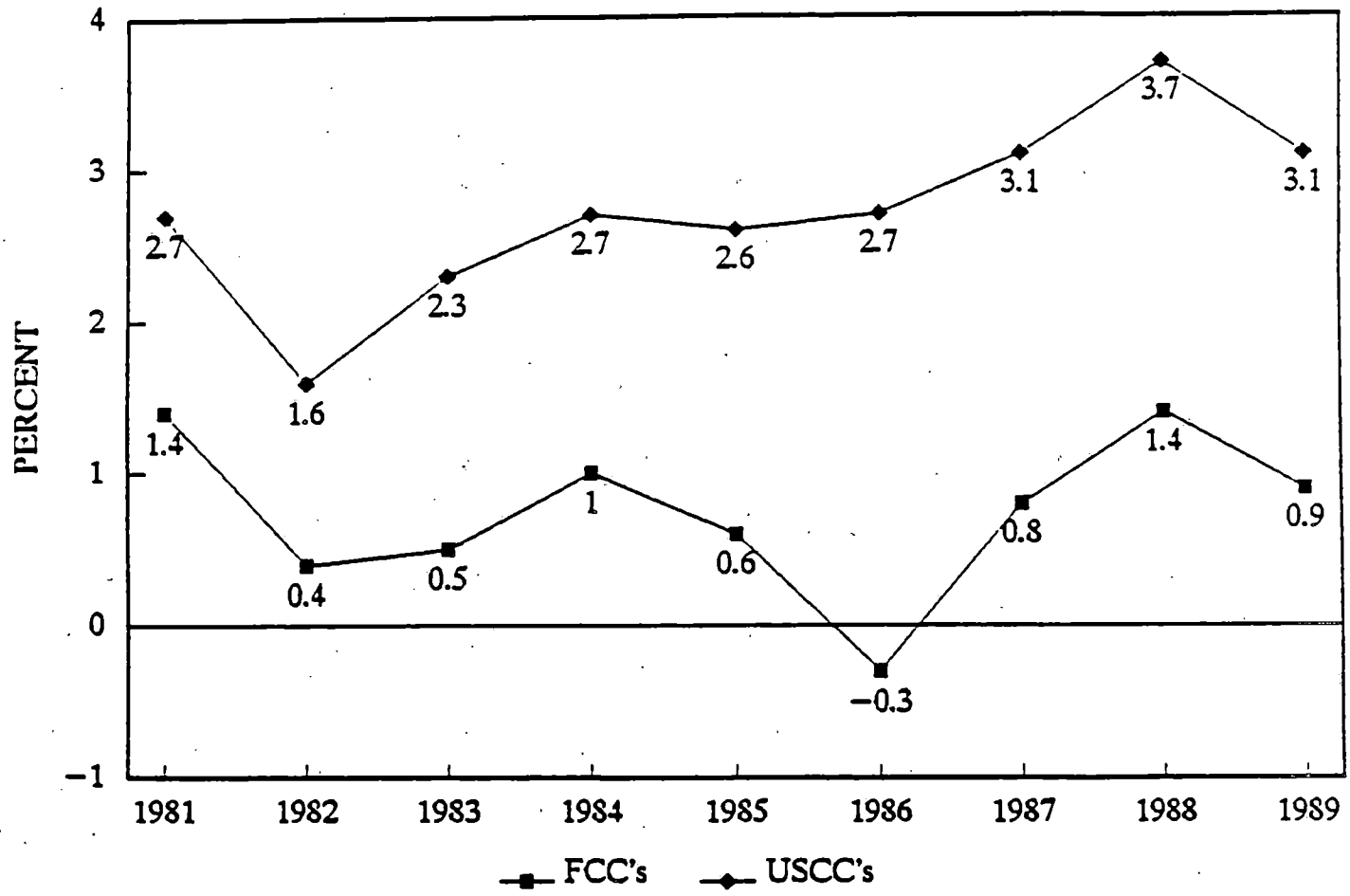
Under my administration, we will redouble our efforts to carry out the philosophy and strategies I have outlined today. My hope is to form a true working partnership with taxpayers. Our experience is that we can all win by working together cooperatively in an atmosphere of mutual trust and respect. We will succeed only if we can find new ways to help taxpayers comply with the law and to assure those compliant taxpayers that we will not tolerate noncompliance by their competitors.

We would be happy to answer any questions you may have.

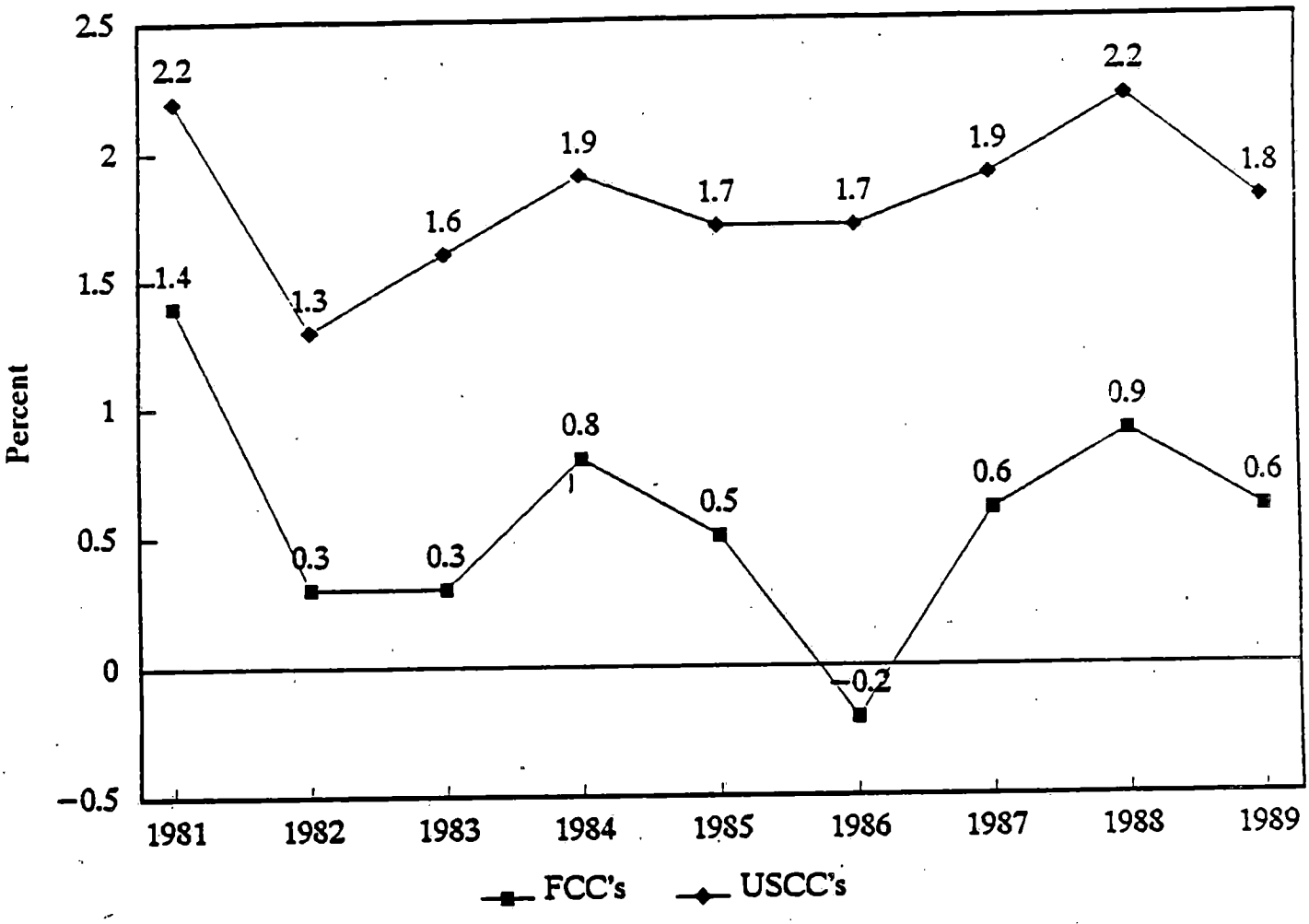

FCC Returns Currently Under Examination
Number of Returns
3000
2500
2000
1500
1000
500
0
1100
375
1550
425
2500
500
July 90
Jan 91
June 91
Jan 92
April 92
Total FCCs
CEP

NET INCOME (LESS DEFICIT) AS A PERCENT

OF TOTAL RECEIPTS



Rate Of Return On Assets



(Ferguson/Walters)
August 26, 1992
11:00 p.m.
STLOUIS

PRESIDENTIAL REMARKS: PUBLIC SAFETY EQUIPMENT, INC.
ST. LOUIS, MISSOURI
AUGUST 27, 1992
9:00 A.M. (??)

Thank you and good morning.

(Acknowledgments, humor)

Together we have seen a world transformed these past three and a half years -- a world made new by American strength and resolve. But now that the Cold War is over, the defining challenge of the '90s is to win the economic competition of the new global economy -- to win the peace.

Our goal is simple and profound: We must be a military superpower, an economic superpower and an export superpower.

In this election, you'll hear two versions of how to do this. My opponents' answer is to look inward, and protect what we already have from the challenges of this new world. My approach is to look forward -- to open new markets, prepare our people to compete, to restore our social fabric -- to save and invest, so that we can win.

I wanted to come here today to St. Louis to lay out the sharp difference between Governor Clinton and me on the crucial issue of investment and open trade. My policies encourage both -- because my experience in business and foreign affairs has shown me that trade and investment create jobs.

In contrast, my opponent and the Democratic Congress want to tax both trade and investment. But taxes stifle things -- and in this case, their taxes would chase away business and jobs.

I know my opponent has lots of slogans and policy buzzwords that sound appealing when you first hear them -- but America can't afford them.

Take the story of PSE as an example. There was a time when companies like PSE could be satisfied with a national market -- sell your goods in the fifty states and leave it at that.

But you know that's no longer good enough. So five years ago, you took on the world. I'm told that now 35 percent of what you build is sold outside our borders, in 66 different countries. Today your light bars and sirens help save lives not only on the streets of Detroit and Peoria, but in Israel, Hong Kong and Spain.

PSE's story is a parable for our entire country's economic future -- never settling for less, always pushing ahead, embracing the challenges of foreign competition and reshaping them as opportunities.

Let me offer a personal note -- tell you how I learned about competing in the world.

I spent a good part of my life out in West Texas, in the oil business. I painted rigs for a while, even lived out of a suitcase as a salesman. And all around me in those days I saw towns and businesses rise up from nothing, for a simple reason:

The world wanted what Texas had to offer -- cotton and cattle and crude.

We understood that the more goods we sold outside our borders, the more jobs we could create within them.

Later on, when I started my own business, I learned again: we had to take a global view to compete. I shopped for investors on the west coast, on the east coast, but I couldn't stop there. I traveled the world -- to Europe and the Far East. Every dollar we could bring into this country was a dollar that went to expand our company, create jobs in our community.

I've seen it over and over again in my work with other nations. You learn how important America is to the world, but you also learn how important the world is to America -- not just for national security in the traditional sense, but for our economic security, for creating jobs, right here at home.

We've held steady to this vision for three years now, and with great success. As we knock down trade barriers, American companies are rushing to meet the demand. Exports are up in the last five years. America is the greatest exporter the world has ever seen -- $422 billion dollars of exports last year alone.

Let me bring it close to home. In Missouri, exports are up 37 percent over the last three years -- $4.5 billion worth of goods shipped to 166 countries around the world.

Impressive numbers, but when you dig behind the trade statistics, you find the real benefit of the new world economy -- in a word, it's jobs. Here in Missouri, 100,000 jobs are

David Walters

supported by foreign trade. Across the country, 8 million Americans owe their jobs to trade.

7.5 for 1991 (>7)

Everyone recognizes that the world is moving at a faster pace, but I see something more: it's moving our way. Right now we're building on the export success of the last three years. Two weeks ago we entered a new era of open trade. Along with Mexico and Canada, we initialed the North American Free Trade Agreement, with the goal of knocking down tariffs and creating one of the largest free-trade areas in the world -- an integrated economy worth more than $6 trillion dollars.

DW

Here in Missouri, you already export $2 billion worth of goods to Mexico and Canada. That's a lot of paychecks, but our new agreement will create still more jobs, and make us even more competitive against our European and Asian competitors.

NAFTA is a solid agreement -- when you've been in as many tough negotiations as I have, you learn to tell the difference. We're going to take this case to the protectionists on Capitol Hill, because they need to hear it. Right now, before our initials are even dry on the agreement, the Democratic leadership in Congress is calling for us to slap a tarriff on any new trade that comes from NAFTA.

Think about that for a minute -- ((that's a minute longer than they've thought about it)). After years of tough negotiations with our two closest trading partners, we've agreed to end tariffs. The congressional Democrats say: Okay, fine. But first you have to put on a new tariff.

In other words, they think the way to eliminate trade barriers is to build a new trade barrier.

That's like telling us they want us to hit a homerun, but please don't hit it out of the park because we don't want to lose the ball.

This "transaction tax," as they call it, will make it more expensive for our businesses to compete with the European and Asians -- and it will discourage the creation of new jobs for you and your neighbors. It turns the agreement on its head -- defeats the whole purpose.

What about Governor Clinton? Where does he stand? Well, just last week, when asked about our new trade agreement, he hemmed and hawed, and at last he said: "When I have a definitive opinion, I will say so."

Detroit 8/21

No matter how much Governor Clinton would like to fudge the issue, the difference couldn't be clearer -- and the difference is based on two very different views of America's future. My opponents see us knocking down trade barriers and they say: Hold everything. They see us open new markets for American goods and they say: Wait a minute. Maybe we can't compete. The American worker can't cut it. So let's pull down the blinds, lock the doors and hope the world goes away.

Well, let me tell them something you already know. The American worker doesn't have to hide from anybody. Americans can outwork, out-think, out-compete anybody, anywhere, anytime.

That's something everyone in the world seems to understand -- everyone but the protectionist Democrats. Over the last decade, we've seen a flood of foreign investment in the United States -- businesses from all over the world setting up shop from Portland, Oregon to Portland, Maine. These investors follow a simple logic: if you want the best science and universities in the world, if you want the best workers in the world, you have to come to the U.S.A.

Sue Maguire

(13)

The result has been jobs: One out of every ten manufacturing workers in the United States works for a company supported by foreign investment. And that's the bottom line: jobs for Americans, a growing economic pie for everyone.

Now, here's one issue where Governor Clinton doesn't waffle. He's surveyed the issue of foreign investment and come out foresquare for -- you guessed it -- a tax increase.

(14)

He's proposed to increase taxes on foreign investment in the United States, even though those companies employ a total of 4 and one-half million Americans.

(15)

Governor Clinton says his new tax will raise $45 billion. He might want to talk to his own Democrats on Capitol Hill. The Joint Committee on Taxation says that estimate is about 45 times too high.

JCT MEMO 7/15/92

Governor Clinton says his tax increase will "crack down" on foreign companies, but all it will really do is drive them out. And if they go, they'll take those jobs with them.

Travel around this state. Go to New Madrid (MA-drid), talk to the 1200 employees at Noranda Aluminum -- or to Joplin, talk to the 425 employees of Atlas Powder. Go to any of the 244 foreign-owned companies that employ 60,000 workers right here in Missouri. I don't think you're going to find any of those Missourians railing against the evils of foreign investment.

Missouri Advantage Fact Sheet

If Governor Clinton's tax hike had been in effect these past few years, few if any of those companies would have located in the United States -- few if any of those jobs would have been created for Missourians.

And it's not just Missouri. Whether it's the Nissan plant in Tennessee -- or the proposed BMW plant in South Carolina -- Governor Clinton's tax increase would be felt in every region of every state of this country.

Governor Clinton forgets something about international relations. If he raises this tax, our foreign competitors are going to say: "What's good for the goose is good for the gander." His tax is like a gilded invitation sent to foreign governments where U.S. companies also do business. And the invititation reads: "Please retaliate."

The result would be not just a reduction in investment here, but a contraction worldwide. There was another occasion when that happened. It was in 1930. Right before the great depression.

No other major industrial nation favors the kind of tax increase Governor Clinton proposes -- not Germany, not Japan.

But I can tell you one nation that does tax foreign investment as he would like: India.

Well, here's a promise I am proud to make: As long as I am president, India will not be a model for how to conduct economic policy in the United States of America.

Let's review the facts about Governor Clinton's tax: It won't raise revenue. It won't create a single job. It will discourage investment. And it threatens to start a trade war at the very moment when markets the world over are opening up to American products.

We should ask why, given all this, Governor Clinton would ever propose such a tax in the first place. I can tell you why. Today change is accelerating, and change breeds uneasiness, skepticism, even fear. And by disparaging foreign investment, Governor Clinton hopes to exploit the darker fears of this uncertain age -- fear of the future, fear of the unknown, fear of foreigners.

Well, let me tell Governor Clinton something: Play politics all you want, but those are American jobs you're playing politics with. Those are American workers you're putting at risk.

The American people won't buy it. The proudest people on earth have never stooped to fearmongers before, and we're not going to start now.

In talking about America's future in the global economy, I mentioned my own experience, because I want you to understand why I believe what I do about America's ability to compete. I've

built a business; I've dealt with foreign nations; I know what it takes to make America secure and strong at home and abroad.

Governor Clinton takes a different view, and it is borne of his life experience -- a life spent in Arkansas government.

So the American people have a clear choice this year. It's a choice between the patrons of the past and the architects of the future. I believe we can shape what lies ahead -- not by turning away from challenges but by doing what you here at PSE have done -- meeting the competition head on, making foreign markets your own.

I have faith in America's future -- because I have faith in the American people. It's the same faith that brought me out to Texas more than 40 years ago -- the same faith that brought me into public life -- the same faith that has led me to fight for open markets -- because I know that no challenge is too great for the American heart.

Thank you and God bless you.

# #

They don't understand – in a world where change is accelerating standing still means falling behind

STATEMENT OF THE ORGANIZATION FOR INTERNATIONAL INVESTMENT ("OFII")

BEFORE THE HOUSE COMMITTEE ON WAYS AND MEANS

REGARDING H.R. 5270

JULY 21, 1992

where'd he get that crazy ideas

Preface

The Organization for International Investment Inc., commonly known as OFII, is composed exclusively of the U.S. subsidiaries of global companies domiciled outside the United States. Many of their parent companies have U.S. persons as shareholders and are listed on stock exchanges in the United States. Most of these global companies are predominantly engaged in manufacturing or producing goods, although a number of them are engaged in rendering services. These parent companies, collectively, have invested billions of dollars in the U.S. economy. Their subsidiaries, OFII's members, employ more than one-half million U.S. citizens as workers in the United States. OFII's members directly contribute to the economy of the United States and plan to do so indefinitely into the future. A list of members is appended. The names of most of them will be quite familiar.

why have they come here? because of our the most productive workers

OFII members regard themselves as good corporate citizens of the United States. They are here because the United States is seen as a secure base for manufacturing, using the skills of the world's most productive workforce. The United States is also seen as a secure base for research and development because of protections afforded intellectual property and access to the faculties and facilities of more major universities than can be found in the entire rest of the world. While some doubts have been expressed about the effectiveness of secondary education in the United States, there is no doubt that U.S. colleges and universities attain a standard of excellence not found elsewhere.

Governor Clinton: these are Americans you want to support. These are Americans you want to help.

OFII's members do not believe that they should be regarded or treated as "foreign." Their employees are American and, with only minor exceptions, their officers and managers are American. OFII's members make their corporate decisions based on the same criteria as companies with predominantly U.S. shareholders -- economic and market considerations, not nationalism.

Foreign direct investments were made in the United States in reliance on the assurance that they would receive national treatment by law and treaty. This means that the domestic companies created by these investments should be subject to the same laws and taxed in the same manner as if they were owned by domestic persons. Foreign direct investors and their subsidiary companies have contributed immensely to the

economic well-being of the United States. They have employed capital to create or preserve jobs, responded to consumer demands, exported goods, and participated in community affairs. OFII's members as well as all foreign direct investors who comply with federal and state laws are, therefore, entitled to receive the same tax treatment that all domestic corporations receive.

Comments on Title III of H.R. 5270

The focus of OFII's interest in H.R. 5270 is Title III, since it is aimed specifically at domestic corporations that represent, in varying degrees, foreign direct investment in the United States. It hardly need be stated that OFII's members resolutely oppose this title in its entirety and seek removal of its principles from this and any future tax legislation that may be proposed. The underlying reason for this opposition is that the concepts found in Title III are in derogation of the principle of national treatment that has been the linchpin of international commerce for nearly three decades. Enactment of this title will signal a return to the economic isolation of the 1930s and start a gradual decline of U.S. participation in the global economy.

Section 304, Minimum Income Tax on Foreign Related Companies

OFII opposes Section 304 with particular vigor. This section not only could affect all of OFII's members adversely, it could have similarly detrimental effects on companies with predominantly (75 percent or less) shareholders that are domiciled in the United States. The thresholds for its application are so low ($2 million or 10 percent of gross income) as to include all corporations with any pretense of global operations. It is driven by the same isolationist/protectionist sentiments that gave us the Smoot-Hawley Tariff in 1930 and kept us in economic depression for eight years.

The most damning criticism of this section is that it virtually denounces the international arm's length method of allocating taxes on multijurisdictional income. There can be no question that it is in derogation of bilateral tax treaties and that it has the capacity for taxing nonexistent income. It is not only discriminatory in the extreme, completely denying national treatment to taxpayers on the basis of their shareholders' nationalities, it is absolutely contrary to the principle of Internal Revenue Code § 482 and the elaborate Treasury regulations which are only now in proposed form.

Section 304 could, under easily conceivable circumstances, become a gross receipts tax instead of an income tax. If the controlled company group incurs a book loss, i.e., has no income to report, there is also unlikely to be any taxable income to tax.

Section 304, nevertheless, says that if a (25 percent or more) foreign-owned company's competitors averaged a profit on their sales, then the foreign-owned company pays a tax on a deemed profit of 75 percent of the competitors' average profit. If there is no income, then this tax is clearly on something other than income.

The courts have long ago decided that the government cannot invent taxable income for a taxpayer where no economic gain exists, and it is very likely that the courts will come to the same conclusion under appropriate circumstances for Section 304, should it become law. But this is not the point -- a law that does not benefit the nation should not be passed even if one is secure in the knowledge that the courts will not enforce them. Section 304 will not benefit the nation or the economy, and it likely will raise very little revenue.

Since 1982 Congress has enacted a series of laws designed, more or less, to improve enforcement and application of transfer pricing rules in international transactions. Some of these laws are so vague, but complex nevertheless, that it has taken the U.S. Treasury many years to write regulations to put these legislative changes into effect. Treasury officials have stated clearly that **no new laws are needed.** There hasn't been enough time to tell if the existing ones work. Every change in the law affecting international trade means more regulations, more rulings, more audits, more litigation, and an exponential increase in paperwork, compliance costs, and professional experts (to say nothing of accountants, lawyers, and lobbyists).

If there is any intention at all to keep the United States competitive in the global economy, the never-ending process of enacting congeries of tax laws upon tax laws had better be curtailed with celerity. When the cost of administration, compliance, record production and record keeping equals the cost of goods sold, U.S. industry will simply fall out of the race with other nations that take a more realistic view of free enterprise. Government cannot manage a national economy. If that is not yet clear, Yeltsin and Gorbachev should be called as witnesses. It is the supreme irony of the century that while our old cold war enemy is struggling to free itself of the failures wrought by government planning, some members of the U.S. Congress are seeking ever increasing government intrusion into the most enduring free economy in history.

Section 301, 10 Percent Capital Gain Tax on Foreign Shareholders

This provision would put the United States in concert with India, Brazil, and those few nations that essay to tax gain on sales of domestic capital stock held by nonresident aliens. It is no coincidence that these same nations also have a difficult time attracting the foreign investment that they desperately need to stimulate their struggling economies. Until now, at least, the United States has been receptive to

foreign investment and has prospered from it. Enactment of this section would be a long step down the dim road of economic isolation. It is also difficult to see how it will produce more than minimal tax revenue.

While the immediate effect of Section 301 would be to drive off portfolio investment, it ultimately will affect direct investment as well. Both are important sources of capital for the U.S. economy, and measures should be considered that will attract, not turn away, both. This section is in derogation of accepted principles of international law giving the host nation the right to tax its citizens and residents, but not foreign citizens to whom it provides no direct services or protection. Although Section 301 does not override newer treaties that deal specifically with the subject, it would unfairly target our oldest and most reliable ally, the United Kingdom, as well as a number of other European trading partners, to say nothing of Australia. It never before occurred to these allies and trading partners that the subject needed to be addressed by treaty because it simply wasn't done by economically progressive nations.

This proposal is a petty revenue grab at the expense of foresighted economic policy, and it is not worthy of the United States of America. It will surely prove ineffective because nonresidents will simply place their funds in less hostile jurisdictions.

Section 302, Limitation on Treaty Benefits

Of the provisions of Title III here considered, this has the least effect on OFII members because they already represent well-established and substantial direct investments in the United States by investors from high-tax countries. What is objectionable to OFII is that the Congress would entertain an enactment that declares international treaties to be unilaterally subject to political expediency. Barring acts of war or violent overthrow of governments, treaties rest on the honor of nations. A nation that unilaterally renounces treaties when their observance becomes inconvenient will soon find itself unable to rely on convenient ones.

If changes are to be made in the way treaty benefits for residents of low-tax nations will be applied, those treaties should be bilaterally renegotiated, not unilaterally abrogated. What will happen to U.S.-owned businesses with direct investments in a foreign country that finds its tax treaty with the United States summarily revoked? Could the United States even intervene to protect its own nationals when the problem lies with an Act of Congress?

The harm in this provision is not that it will have a direct and immediate effect on OFII members, but that it presages an unfortunate turn of mind that may eventuate in

a substantial diminution of commerce among the United States and its trading partners.

Comment on Assumptions Apparently Underlying Title III

It is believed that the pressure to enact statutes so egregiously unfair and unwise as Title III arises from widespread acceptance of some basic -- and erroneous -- assumptions about foreign direct investment. These assumptions, more properly termed "myths," have been often repeated in the news media, particularly television, and appear from time to time in statements by politicians.

OFII has undertaken to address and rebut some of the more ubiquitous of these myths. OFII believes that exposure of the fundamental untruths of these myths will go a long way toward dispelling the attitudes of fear and distrust about foreign direct investment that these myths represent.

Myths about the Taxes Paid by Foreign-Owned Companies

Myth #1: Foreign-owned companies are not paying their fair share of taxes.

FACT: ***According to IRS Statistics of Income (SOI), foreign-owned companies paid federal income taxes at essentially the same rates as domestically-owned companies.***

The most recent IRS data for the period 1983-1988 reveal that the average effective tax rate as a percentage of net worth for foreign owned companies was 2.1 percent. The average, effective tax rate for domestically-owned companies for the same period was 2.2 percent. These percentages are calculated by dividing the total federal income taxes paid by each group by the net worth of all the companies in the group (including those companies which did not pay any taxes because they had no income for the year). The year by year effective tax rates on net worth are as follows:

YEAR-BY-YEAR COMPARISONS FOR EFFECTIVE TAX RATES BASED UPON NET WORTH		
Year	Foreign-owned Companies	All Other U.S. Companies
1988	2.0 percent	2.4 percent
1987	1.8 percent	2.5 percent
1986	1.4 percent	2.1 percent
1985	2.0 percent	1.9 percent
1984	2.9 percent	2.2 percent
1983	2.5 percent	2.0 percent

Comparing effective tax rates using total assets instead of net worth over the same time period reveals that the foreign-owned and domestically owned companies paid identical effective tax rates of 0.6 percent. Calculating an effective tax rate based upon total receipts (i.e., total taxes paid divided by total receipts), foreign-owned corporations paid a slightly lower average rate of 0.7 percent, while other U.S. corporations paid an average effective tax rate of 0.9 percent. Comparing effective tax rates based upon assets or total receipts is less accurate because such comparisons do not take into consideration the differences in the level of debt of the companies. Tax rates based upon net worth are considered a more accurate comparison.

Myth #2: In 1986, foreign-owned companies doing business in the United States were entitled to a tax refund (i.e., a "negative tax liability") of $1 billion.

FACT: ***Foreign-owned companies had net losses of $1.5 billion in 1986 but paid, nevertheless, $3 billion in federal income taxes.*** Even though many foreign-owned companies lost money in 1986, there were enough foreign-owned companies with income to pay $3 billion in taxes. The most recent available IRS Statistics of Income (SOI) data show that foreign-owned companies have paid the following aggregate amounts of federal income tax for each of the years listed.

AGGREGATE FEDERAL INCOME TAX LIABILITY OF FOREIGN-OWNED COMPANIES

1988 - $5.8 billion

1987 - $4.6 billion

1986 - $3.0 billion

1985 - $3.6 billion

1984 - $4.5 billion

1983 - $1.8 billion

The 1986 net loss figure has been misstated consistently in the press and in some political speeches as a "negative tax liability" or refund of moneys from the U.S. government. As can be seen from the following table of SOI data listing the total income of foreign-owned companies, 1986 was the only year in recent IRS statistics in which the foreign-owned companies as a group incurred a net loss.

AGGREGATE NET INCOME OF FOREIGN-OWNED COMPANIES

1988 - $11.2 billion

1987 - $5.6 billion

1986 - ($1.5 billion)

1985 - $3.0 billion

1984 - $4.5 billion

1983 - $1.8 billion

Myth #3: Foreign-owned companies are avoiding paying taxes by using a "scheme" called "transfer pricing" to reduce their income in the United States.

FACT: ***Transfer pricing is not a tax avoidance "scheme" or device. The term "transfer pricing" refers to the price for a product, service, or intangible that a corporation charges to an affiliated corporation. All multinational companies, domestic and foreign, must establish transfer prices for international transactions.***

Income tax rates of major industrial nations are similar or, in many cases, higher than U.S. income tax rates. Income of a multinational enterprise that is not reported in one nation must be reported in another. Transfer pricing determines the portion of income arising from an international transaction that is taxed by each nation involved in the transaction. Unless one of the concerned jurisdictions is a "tax haven," i.e., one with markedly lower tax rates, there is little advantage to shifting income artificially from one jurisdiction to another. It should be noted, for example, that both Japan and Germany have higher corporate income tax rates than the United States.

Since members of a multinational group are located in different nations, the tax authorities of each nation concerned are extremely anxious to ensure that the transfer price is "arm's length" -- that is, the same price at which the seller would have sold the same product to an unrelated buyer.

If, for example, a U.S.-owned company manufactures computers in the United States and sells them to its foreign subsidiary to market abroad, both the parent and its subsidiary may recognize some portion of the total profit from the final sale to consumers. The portion that is reportable in each country is determined by the "transfer price" between parent and subsidiary. If that price is high, the subsidiary has less profit, but the parent has more. If the price is low, the parent has less profit but the subsidiary has more. The total income from the computer sales will be taxed, but the split between the United States and the foreign country may depend on the transfer price. All tax authorities have the power to challenge transfer prices and regularly do so, frequently disagreeing with one another as to the correct income split. These disagreements must be resolved among the taxing authorities themselves in proceedings referred to as "competent authority".

Myth #4: Additional laws are needed to enforce transfer pricing regulations and prevent abuse.

Fact: ***In 1989 and 1990, Congress passed legislation to foster compliance with transfer pricing rules.*** New reporting and record-keeping legislation was enacted,

providing much additional information from foreign-owned companies and imposing penalties on companies that fail to comply. Enforcement tools given to the IRS include a designated summons procedure (for those companies that refuse to provide requested information in the hope that the statute of limitations will expire) and expedited availability of outside experts.

In April 1992 testimony before a House Ways & Means Subcommittee, IRS Commissioner Shirley Peterson stated that " . . . the legislation [passed in 1989 and 1990] is responsive to the problems identified in 1990 and is increasing compliance. . . . " At the same hearing, Alan J. Wilensky, Deputy Assistant Secretary (Tax Policy) of the U.S. Treasury Department, " . . . urg[ed] that these new measures be given adequate time to work before introduction of major new initiatives. . . . "

Myth #5: Foreign-owned companies manipulate transfer prices to report lower U.S. taxable income than domestically-owned companies.

FACT: ***While foreign-owned companies have generally earned lower rates of return on their assets, sales, and net worth than domestically-owned companies, the disparity does not result from transfer pricing abuse.***

Both the IRS Commissioner and the Deputy Assistant Secretary of the Treasury recently explained the difference in levels of profitability for foreign-owned firms in testimony before the Oversight Subcommittee of the House Committee on Ways and Means on April 9, 1992. According to their testimony, "as much as 50 percent of the differential" in profitability between foreign-owned and domestically-owned companies is explained by nontax factors such as start up costs or currency fluctuations. Over the period 1985-1988, foreign investment in the United States increased three times faster than domestic investment. This high growth rate, coupled with historic cost accounting methods used throughout the United States, distorted comparisons between the two groups. Older investments show a higher rate of return than new ones which are valued at closer to current market value. In addition, start-up losses of the new investments decreased the actual rates of return.

The IRS Commissioner went on to state that there is "no certainty that the remainder (of the difference in rates of return) is due to transfer pricing abuse or that the comparison of measures of profitability is valid in this aggregate form."

In June 1992, the U.S. General Accounting Office ("GAO") issued a report on the tax effects of pricing, which confirmed that the lower profitability of foreign-owned companies does not prove transfer pricing abuse. (International Taxation: Problems

Persist in Determining Tax Effects of Intercompany Prices, June 1992 (GAO/GGD-92-89).) The GAO study states that other factors, such as "attempts to increase market share, newness of investment, extent of leverage, fluctuating exchange rates, and managerial skills and experience" could account for this difference in profitability.

Myth #6: There is $30 billion in taxes going uncollected annually from foreign-owned companies who are inflating their transfer prices and reporting too little profit in the United States.

FACT: ***This is a total fabrication that has no foundation in fact and is not supported by the U.S. Treasury.***

The IRS Commissioner specifically discussed this $30 billion myth in her testimony on April 9, 1992 and stated unequivocally that such an estimate could not be substantiated. She further stated that if the unexplained differential in the profitability of foreign-owned companies, described above, were due wholly to transfer pricing abuse (and she specifically states that there is no certainty that this is the case) the "tax gap" would be "about $3 billion," not $30 billion.

The Commissioner went on to state that although transfer pricing problems do exist, they are not presently quantifiable and the problems exist equally for foreign-owned and U.S.-based multinational companies. Indeed, the June 1992 GAO study referenced above makes clear that foreign-owned companies are a small part of the overall transfer pricing problem.

Myth #7: Foreign-owned companies which sell large amounts of popular products, such as automobiles and electronics, should pay more taxes.

FACT: ***All U.S. corporations pay taxes based upon their net taxable income, i.e., their profits. A company that has large sales and many assets is not automatically profitable.*** An example is the "Big Three" U.S. automobile companies which apparently have not reported taxable profits for years. It is entirely wrong to assume that any company, foreign or domestic, should pay income taxes based upon a percentage of its sales or assets irrespective of profits. This concept is that of a "wealth tax" practiced in only a few countries, notably India, which have a small gross national product in comparison to government expenditures. It is not a formula that will promote prosperity. The $30 billion myth discussed above is the result of assumptions that foreign-owned companies should be reporting income based upon

a certain percentage of their assets or receipts. In testimony before a House Ways & Means Subcommittee, IRS Commissioner Peterson noted that 59 percent of U.S.-owned companies report no taxable income.

Myths about Foreign Investment in the United States

Myth #1: Foreign investment hurts domestic business.

FACT: ***Foreign-owned U.S. companies contribute substantially to the productivity of the U.S. economy.*** These companies generally have a good history of investing in capital resources and increasing productivity. The latest Commerce Department statistics show that in 1988 foreign-owned U.S. companies in manufacturing spent almost 50 percent more on investment in plant and equipment per worker than the average for all U.S. manufacturing.

Productivity also grew more rapidly in foreign-owned U.S. manufacturing companies than in the manufacturing sector as a whole between 1980 and 1988. In real terms, the gross product (i.e., value added) of foreign-owned U.S. companies in manufacturing rose nearly four times as fast as all manufacturing establishments in the United States between 1980 and 1987.

Foreign investment can also bring new technologies into an economy, potentially increasing the competitiveness of U.S.-owned companies. According to an August 1991 Commerce Department study on foreign direct investment, "U.S. affiliates have been contributors to the advance of technology in U.S. industry."

Notably, "[i]n the automobile industry, anecdotal evidence suggests that U.S. affiliates of foreign firms appear to have encouraged the diffusion of new technologies, including speeding the adoption of robotics to improve the efficiency of the manufacturing process," according to the Commerce Department report.

Myth #2: Foreigners are buying up America.

FACT: ***As of 1990, foreign direct investment in the United States amounted to approximately $466 billion, based on current or replacement cost measures.*** This is about 3 percent of total U.S. domestic net worth.

Source: U.S. Commerce Department

Myth #3: Foreign investment in the United States only benefits the investor.

FACT: ***Productive investment of any kind benefits an economy, regardless of the nationality of the investor.*** Employment of American workers, increased exports and taxes paid are just some of the benefits foreign-owned companies bring to the United States.

Employment at U.S. subsidiaries of foreign-owned companies totaled 4.7 million in 1990, or about 5 percent of all U.S. nonbank employment. Employment at foreign-owned U.S. manufacturing companies came to more than 2.0 million workers -- about 10.8 percent of the total U.S. manufacturing workforce. In 1990, foreign-owned companies exported $91 billion of merchandise from the United States. Foreign-owned companies paid $24.4 billion in direct taxes (e.g., sales, property) in addition to income and payroll taxes in 1989.

Source: U.S. Commerce Department

Myth #4: Japan is the biggest investor in the U.S. economy.

FACT: ***As of the end of 1991, the United Kingdom was the largest investor in the United States, accounting for 27.4 percent of total foreign direct investment.*** Japanese (20.6 percent) and Dutch (14.9 percent) investors ranked second and third respectively.

Myth #5: The success of U.S.-owned corporations is more important to the U.S. economy than that of foreign-owned U.S. corporations.

FACT: ***Harvard's Robert Reich, building on the work of many economists, has pointed out that the ownership of a corporation is less important than the corporation's willingness and ability to create and maintain high wage jobs in the United States.***

According to Reich, " . . . ownership of the corporation is profoundly less relevant to America's economic future than the skills, training, and knowledge commanded by American workers -- workers who are increasingly employed within the United States by foreign-owned corporations."

Myth #6: Foreign investment plays a larger role in the U.S. economy than it does in all other major industrial nations.

FACT: ***Foreign investment from all sources plays a proportionally larger role in the economies of all other major industrial nations (except Japan) than it does in the United States.***

For example, in 1986 (the most recently available data from all countries), in terms of manufacturing employment, foreign-owned firms in the United States accounted for 7 percent of all manufacturing employment in the U.S. economy. By contrast, foreign-owned firms accounted for two to almost five times as much in the United Kingdom, France, Germany and Canada than that amount. In terms of total assets, the foreign-owned company share for these four countries was one and a half to almost three times as large as in the United States. This information is summarized below.

SHARE OF FOREIGN-OWNED FIRMS		
	Percentage of Manufacturing Employment	**Percentage of Total Assets**
Canada	34	25*
France	21	26*
United Kingdom	14	14
Germany	13	17
United States	7	9
Japan	1	1

*1987

Source: D. Julius & S. Thomsen, "Foreign-owned Firms, Trade, and Economic Integration," *Tokyo Club Papers 2*, Royal Institute of International Affairs, 1988 and Commerce Department.

Myth #7: Foreign businesses play a larger role in the U.S. economy than U.S. businesses play in the home economies of these foreign businesses.

FACT: *U.S.-owned businesses are generally more active in the economies of other major industrial countries than are foreign-owned businesses from these countries in the U.S. economy.*

For example in 1989, the value of U.S.-owned businesses in the United Kingdom, as a percentage of the host-country's gross domestic product, was three times that of British businesses in the United States, 7.5 percent as compared with 2.3 percent. Similar and even larger disparities hold for the other major industrial countries other than Japan. This information is summarized below.

FOREIGN DIRECT INVESTMENT AS A PERCENT OF HOST-COUNTRY GROSS DOMESTIC PRODUCT		
	Percentage of Foreign Holdings in the United States	**Percentage of U.S. Holdings in the Foreign Country**
United Kingdom	2.3	7.5
Netherlands	1.2	6.9
Japan	1.3	0.7*
Canada	0.6	11.9
Germany	0.5	1.8
Switzerland	0.4	10.8
France	0.3	1.4

* 1988

Source: Commerce Department

Myth #8: U.S. businesses are no longer an important source of foreign direct investment to the world economy.

FACT: ***The United States remains, by far, the largest source of foreign direct investment in the world.*** At the end of 1989, the overall value of the stock of all foreign direct investment from all sources around the world came to almost $1.4

trillion, on a historic cost basis. Of this total, U.S. businesses held $380 billion, or 28.3 percent. The next largest national source for direct investment was the United Kingdom. British businesses had $224 billion, or 16.7 percent. Japanese businesses were in third place, with $154 billion in direct investment, or 11.5 percent of the overall total.

Source: Commerce Department

ORAL TESTIMONY OF EVAN GALBRAITH BEFORE

THE HOUSE COMMITTEE ON WAYS & MEANS

CONCERNING H.R. 5270

JULY 21, 1992

Mr. Chairman, Members of the Committee:

Thank you for affording me the opportunity of testifying before you today.

My name is Evan Galbraith and I am appearing on behalf of the Organization for International Investment ("OFII"), which represents a number of American companies that owe their existence to foreign direct investment in the United States. These companies together employ more than one-half million Americans within the United States in manufacturing and distributing a wide variety of products from automobiles to X-ray machines.

I am a director of Morgan Stanley International; I am also Chairman of the Board of LVMH Moet Hennessy Louis Vuitton Inc., Chairman of the Board of National Review, and a director of several companies. From 1981 to 1985, it was my privilege to serve as United States Ambassador to France. Prior to that, I was engaged in investment banking in London and Paris with subsidiaries of American financial institutions. I have spent most of my life dealing with national and international financial and economic matters.

While my remarks are primarily directed at Title III of the bill, it is my firm view that H.R. 5270 will damage the economy of the United States should it become law. It will discourage investment in this country and make it more difficult for American companies to do business abroad. It will weaken American companies at home. Without their overseas earnings, Ford and General Motors would have been in serious financial difficulty over the past few years. Coca-Cola earns more in Japan than it does in the United States. Those Japanese earnings have been instrumental in Coca-Cola's growth in the U.S. and elsewhere.

Why would the Congress even contemplate imposing this burden on the American people -- this certain loss, not only of jobs, but of better, high technology, jobs? We are told that "fairness" dictates the enactment of this destructive legislation, but how can it possibly be fair to do ourselves economic damage? I submit that the true test by which we must judge tax legislation is whether it is conducive to economic growth. It is by growth that we create employment, higher living standards, and the financial means to deal with social problems. There are no shortcuts or substitutes; the mixture can vary, but growth boils down to the investment of capital and the sweat of our collective brows.

Taxes are an obstacle to investment in that they divert capital away from both investment and consumption. Investment is needed to create both factories and employment, and consumption is needed to keep both going. To impose capital gains tax on direct investment, impute taxable income where none exists, tax insurance coverage, circumvent our treaty obligations, and discourage American penetration of overseas markets is intellectually and economically indefensible. This bill is simply another manifestation of the protectionism that lurks in the hearts of those unknowing persons in business management and labor who, with their supporters in Congress, seek to avoid the rigors of competition by having government intervene in the marketplace.

This will not only damage the U.S. economy, it will undermine our efforts under GATT and bilaterally to expand world trade. In the 1980s, U.S. exports doubled in real terms and manufacturing increased as a percentage of our GNP. The United States has become competitive worldwide by creating new jobs and new markets for our goods. It is a strange paradox that one need now plead with the Congress not to burden our growing leadership in world trade -- but plead I do in all earnest: This bill must not pass.

This concludes my oral statement. I request that a copy of our written comments on H.R. 5270 be included in the record of this hearing.

Organization for
International Investment

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FAX: (202) 828-4550

8 April 1992

The Honorable J.J. Pickle
Chairman, House Oversight Subcommittee
242 Cannon House Office Building
Washington, DC 20515-4310

Mr. Chairman:

Hearing before the Subcommittee on Oversight of the House Committee on the Ways and Means, 9 April 1992

In preparation for the Subcommittee's hearing, we earnestly request that you review the annexed summary of a study, prepared by KPMG Peat Marwick, of taxes paid by U.S. companies that are foreign owned (FOC). This study analyzes the latest available data from the Internal Revenue Service and clearly demonstrates that, for tax years 1983 through 1988, FOCs averaged effective tax rates* similar to U.S. owned companies (AOC).

FOCs have reported lower *pretax* rates of return than AOCs. Factors such as faster growth in investment of FOCs in recent years, use of historic cost accounting in measuring returns, and fluctuations in exchange rates (particularly in 1985 and 1986) appear to account for a substantial portion of this difference. The data available to us do not clearly demonstrate that transfer pricing abuse is the cause for differences in pretax rates of return.

Judging from the press release announcing the hearing, Treasury officials will be asked to comment upon measures enacted in 1989 and 1990 to improve compliance with Internal Revenue Code Section 482. Some of these provisions, such as the increased reporting and record keeping provisions of Section 6038A and the "earnings stripping" provisions of Section 163(j), were targeted to apply only to U.S. companies with (some or all) foreign ownership, while other provisions, such as Section 482 penalties under Section 6662, apply equally to AOCs. The hearing is, however, focusing only upon compliance by FOCs.

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* As a percentage of net worth.

In view of the recent enactment of these compliance provisions, it is very unlikely that the Internal Revenue Service has completed audits on a sufficient number of returns for taxable years to which these provisions apply to be able to draw meaningful conclusions. We respectfully urge the Subcommittee to give these provisions time to operate before rushing to judgement about their effectiveness or considering enacting more laws to achieve the same result. The Internal Revenue Service is currently auditing corporate tax returns for tax years generally no more recent than 1985 through 1989. The increased record keeping and reporting requirements were not enacted until 1989. In 1990, the Congress applied the new requirements to all prior years to the maximum extent possible, but the full impact of these provisions cannot be assessed until 1989 and later years' tax returns are audited and the results evaluated.

The Subcommittee's press release indicates that the hearing will review the tax returns of the 36 taxpayers examined in the 1990 hearings. We hope that anecdotal information about 36 specific taxpayers will not prejudice the Subcommittee about tax compliance of FOCs, generally. We do not know the identity of the 36 companies whose tax returns are being examined, and we have seen nothing indicating whether they were selected as truly representative samples of FOCs, or whether they were selected primarily because they were perceived to represent the greatest compliance problems. It would be most unfair to draw conclusions about overall tax compliance of FOCs from an unscientific sample of 36 companies which may be a biased sample. We also note that while the Subcommittee is hearing from the agents who are auditing the tax returns of these 36 taxpayers, these taxpayers, themselves, do not appear to have been afforded the opportunity to present their positions to the Subcommittee.

Members of the Organization for International Investment ("OFII") support efforts of the Subcommittee to assure that all U.S. taxpayers, whether foreign or domestically owned, pay their fair shares of taxes. We implore the Subcommittee to consider all the evidence before arriving at conclusions. Should you have any questions about the Peat Marwick study or taxes paid by U.S. companies with substantial foreign ownership, we hope you will contact us.

A list of OFII member companies is annexed for your information.

James Carter

James M. Carter
General Counsel

Annexures (2)

REVIEW OF INTERNAL REVENUE SERVICE STATISTICS ON FOREIGN CONTROLLED DOMESTIC CORPORATIONS 1983 THROUGH 1988

PREPARED FOR:

ORGANIZATION FOR INTERNATIONAL INVESTMENT

PREPARED BY:

POLICY ECONOMICS GROUP
KPMG PEAT MARWICK

JULY 10, 1992

PREFACE

This report was prepared for the Organization For International Investment ("OFII") by the Policy Economics Group of KPMG Peat Marwick. It is an update and extension of a similar report prepared in 1990. It reviews publicly-available tax return data from the Internal Revenue Service on foreign controlled domestic corporations for the 1983 through 1988 period.

The report has an Executive Summary and five parts: Part I is an introduction; Part II discusses data sources and limitations; Part III compares data on foreign controlled domestic corporations with all other domestic corporations; Part IV analyzes trends in the data and possible reasons for foreign controlled domestic corporations having lower net income and tax liability; and Part V provides the conclusions of our report.

Two abbreviations are used throughout the report: (a) FCDC is used as an abbreviation for foreign controlled domestic corporations, and (b) AOC is used for "all other corporations." All other corporations are active corporations filing income tax returns with the Internal Revenue Service, exclusive of FCDCs and S-corporations.

Data included in this report are from published and unpublished tabulations of Internal Revenue Service statistical data. These data provide much useful information on the general characteristics of FCDCs and AOCs, including some detail on industry groups. While these data provide certain insights into the relatively profitability and tax burdens of FCDCs, they do not allow analysts to draw conclusions about specific companies.

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REVIEW OF INTERNAL REVENUE SERVICE STATISTICS ON FOREIGN-CONTROLLED DOMESTIC CORPORATIONS 1983 THROUGH 1988

EXECUTIVE SUMMARY

This report was prepared at the request of the Organization For International Investment ("OFII") by the Policy Economics Group of KPMG Peat Marwick. It updates and extends a similar report prepared in June 1990 by reviewing publicly-available Internal Revenue Service data on foreign-controlled domestic corporations for the 1983 through 1988 period.

In recent years there has been much discussion over whether foreign-owned companies have paid their "fair share" of U.S. income taxes. OFII requested that we prepare an independent examination of the IRS statistical information. Three key findings emerge from IRS data[1]:

- 1988 foreign-controlled domestic corporation (FCDC) pretax net income increased to $11.2 billion from $5.6 billion in 1987, and from a 1986 loss of $1.5 billion,

- 1988 FCDC U.S. income tax liability increased to $5.8 billion from $4.6 billion in 1987, and $3.0 billion in 1986,

- FCDCs experienced a 1988 U.S. effective tax rate that was close to that of all other corporations (AOCs) and FCDC effective tax rates were essentially the same as those of AOCs over the 1983 through 1988 period.

The critical policy issue of whether FCDCs are paying their fair share of taxes can only be fully addressed by examining the taxes paid and comparing these taxes with those of comparable domestic corporations. Despite the significant increases in pretax income and in taxes paid, FCDCs continue to report lower aggregate pretax rates of return. However, pretax rates of return would generally be expected to vary from industry to industry, and FCDCs

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[1] Foreign-controlled domestic corporations (FCDCs) are U.S. corporations more than 50 percent directly or indirectly owned by any foreign person. All other corporations (AOCs) are all active corporations filing returns with IRS, less FCDCs, and less S-corporations. S-corporations are excluded because they do not generally incur corporation income tax liability.

Data discussed in this report are from published and unpublished tabulations prepared by the SOI Division of the Internal Revenue Service. The most recent publicly-available data are for tax year 1988. SOI Division published data for 1988 are more limited than the detailed unpublished data provided for 1987.

Key concepts used in this report are based on tax reporting requirements. For example, "net income" is a pretax concept calculated using income and deductions reported for tax purposes. "Tax liability" is the total corporation federal income tax obligation for a given year's activity.

The SOI Division collects information from corporation income tax returns when first filed. Subsequent adjustments for a given year are not captured. These adjustments can be audit adjustments that increase the firm's tax liability, and net operating loss or tax credit carrybacks that reduce tax liability. Because these adjustments move in opposite directions, we assume they are roughly offsetting.

represent a somewhat different mix of industries than AOCs. Aggregate data provide only a partial picture of the FCDC rates of return. OFII, therefore, asked us to explore possible reasons why these aggregate rates of return for foreign-owned companies are lower.

FCDC NET INCOME

As shown in Figure A, FCDC net income increased from a $1.5 billion loss in 1986 to a $5.6 billion gain in 1987, and to $11.2 billion in 1988. The 1988 amount of net income is by far the highest reported in any recent year. Average annual net income reported over the 1983 through 1986 period was about $2 billion. Thus by any standard, aggregate FCDC net income in 1987 and 1988 show dramatic increases over earlier levels.

Figure A: FCDC Net Income

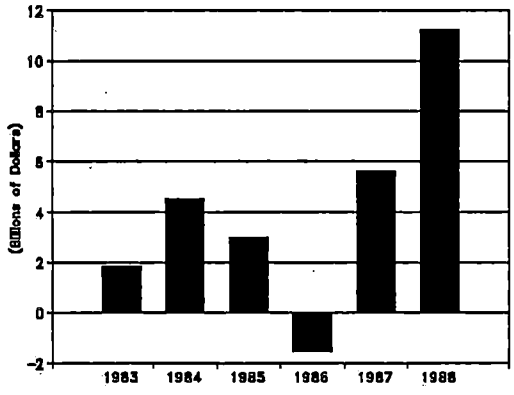
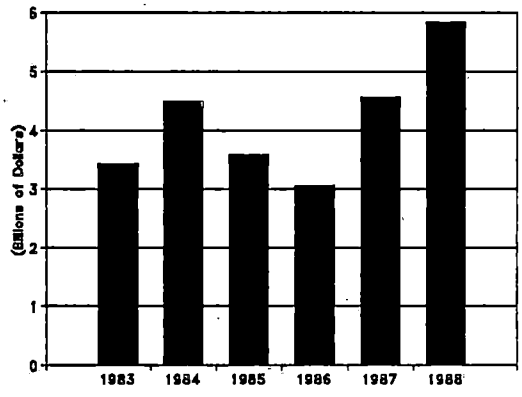


Figure B: FCDC Tax Liability



FCDC TAX LIABILITY

FCDC tax liability, as shown in Figure B, exhibits a pattern similar to that of net income. FCDC tax liability in 1987 was $4.6 billion, which is more than 50 percent above the $3.0 billion tax liability in 1986. Tax liability further increased to $5.8 billion in 1988 -- a 26-percent increase over 1987. The highest tax liability in any previous year was $4.5 billion in 1984. Average tax liability reported over the 1983 through 1986 period was about $3.6 billion.

In each of the four years before 1987, FCDC income tax liability exceeded net income. This is because income tax liability is generally incurred only by those firms with positive net income. A more appropriate comparison is made between tax liability and net income for firms with net income. In 1987, FCDC firms with net income reported $19.8 billion of income, while firms with net losses reported $14.2 billion of losses. The $4.6 billion tax liability was paid principally by the firms with positive net income. Even larger gains in positive net income

occurred in 1988 with $26.5 billion reported by firms with net income. Losses in 1988 increased by a smaller amount to $15.3 billion.

COMPARISON OF FCDCs WITH AOCs

A more complex picture of FCDC net income and tax liability emerges when comparisons are made with AOCs. While there are variations among industries, over the 1983 through 1988 period, FCDCs have lower rates of return than AOCs. FCDC net income when measured as a percent of either assets, net worth, or receipts is below comparable measures for AOCs. Figure C shows net income as a percent of net worth for FCDCs and AOCs, as an example of this relationship.

Figure C: Pretax Rate of Return on Net Worth

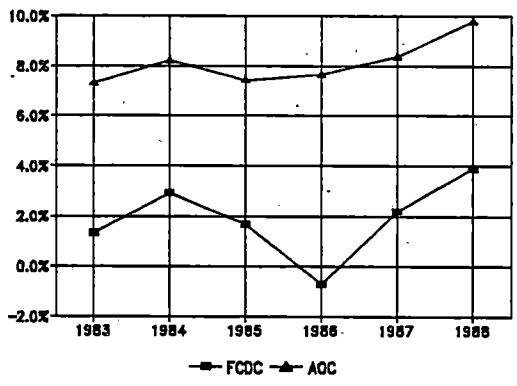
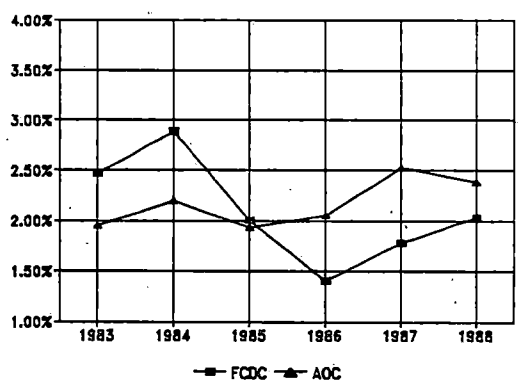


Figure D: Effective Tax Rate on Net Worth



A different relationship holds with tax liability. Figure D provides an effective tax rate measure by computing income tax liability as a percent of net worth for FCDCs and AOCs. FCDC effective tax rates over the 5-year period are, on average, the same as AOC rates. FCDC effective tax rates vary more than AOC effective tax rates with higher rates in 1983 and 1984, lower rates in 1986 and 1987, and a significant narrowing of the difference in 1988.

Both aggregate FCDC net income and tax liability show strong increases in 1987 and 1988. And, while effective tax rates indicate FCDCs have tax burdens similar to those of AOCs over the 5-year period, a comparison of net incomes raises the question of why FCDCs have such relatively low rates of return.

POSSIBLE REASONS FOR DIFFERENCES BETWEEN FCDCs AND AOCs

We explored two differences between FCDCs and AOCs that have been prominently mentioned as issues in recent public debate. These are: (a) whether the fact that FCDC investment has recently been growing at three times the rate of AOC growth is the principal

cause of lower rates of return, and (b) whether differences in gross profit margins between FCDCs and AOCs demonstrate that intercompany transfer pricing is a major concern. The answer to the first question appears to be "yes." The response to the second question is that IRS tax return data do not provide enough information to permit a clear answer.

Differences Related to Growth

FCDC investment has grown rapidly in recent years. Over the 1985 through 1988 period, AOC assets increased at an annual average rate of 7.5 percent. FCDC assets increased 22.3 percent annually -- three times the AOC rate of growth. This high growth rate has two implications: (a) historic cost accounting overstates rates of return and effective tax rates on older investments, and (b) new business investments often have initial losses before becoming profitable.

Effect of historic cost accounting

Balance sheet concepts such as assets and net worth are generally recorded on tax returns on an historic cost basis rather than a fair market value basis. Historic cost accounting tends to understate the fair market value of older assets and net worth. For example, assume two firms have the same net income and the same fair market value of assets. If one firm purchased its assets earlier than the other, any comparison of the two firms' net income or tax liability with total assets or net worth will be distorted. The firm that purchased its assets most recently will exhibit a lower apparent rate of return and lower effective tax rate than the firm with older assets. This is because the reported cost of assets on the tax return will be higher for the firm having purchased its assets most recently.

Because investment by FCDCs has grown much more rapidly than investment by AOCs, recorded asset values of FCDCs will likely be closer to current market values. The net result of the use of historic cost accounting is that comparisons between groups of companies with older assets and companies with newer assets may be misleading. Companies with older assets will appear to have higher effective tax rates than companies with newer assets.

Effect of high growth rates on initial losses

The composition of income and deductions will differ when a group of rapidly-growing firms is compared with a group of firms experiencing slower growth rates. True start-up operations will have many expenses associated with developing new business. IRS data are not sufficiently detailed to examine these effects in depth; however, we did investigate three deductions -- depreciation, amortization, and interest paid -- that may be related to growth.[2] In each case, relative deductions are larger for FCDCs.

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[2] This issue could be explored in more depth and with more accuracy using IRS files of actual corporation tax returns; however, under current disclosure rules these files cannot be released to the public.

- Depreciation and amortization deductions will increase where there are large amounts of new investment, or where acquisitions of existing businesses are made and the tax basis of the assets is increased to reflect the purchase price.

- Interest deductions will increase where debt is used either to make new investments or acquire existing businesses.

A comparison of FCDC deductions with AOC deductions for these items, when adjusted for differences in the composition of activity by industry, shows these deductions as a percent of total receipts are higher for FCDCs.

If, as a simple test, we adjust 1987 FCDC deductions for these items to reflect the relationships found for AOCs, and the actual mix of FCDC industries, we find FCDC net income increases by $11.2 billion to $16.8 billion. If we measure this adjusted net income figure as a percent of net worth, we find FCDC net income would increase from 2.2 percent to 6.6 percent of net worth. AOC net income is 8.8 percent of net worth.

Many other items of income and deduction will also be affected by high growth; e.g., business locations must be established, staff must be hired and trained, and markets must be developed through advertising and promotional efforts. If a complete adjustment could be performed, relative FCDC and AOC growth rates may explain a large part of the observed differences in net income relationships.

Intercompany Transfer Pricing

The Internal Revenue Service is aggressively auditing foreign-owned and U.S.-owned companies to investigate prices charged for goods and services sold to affiliates. IRS believes some foreign-owned and U.S.-owned companies are manipulating these transfer prices to shift profits overseas such that U.S. net income and tax liability are reduced.

We reviewed IRS statistical tax return data in an attempt to see whether transfer-pricing manipulation is occurring and whether foreign-owned companies are not paying an appropriate level of federal income taxes. Unfortunately, IRS statistical data do not include enough information for us to be able to answer this question.[3] The only way to determine whether transfer-pricing abuses exist is on a case-by-case basis with a careful examination all the relevant facts.

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[3] Our findings on the limitations of IRS statistical data are generally consistent with those reported by Harry Grubert, Timothy Goodspeed, and Debrah Swenson in their November 1991 paper "Explaining the Low Taxable Income of Foreign-Controlled Companies in the United States," and of Edward M. Graham and Paul R. Krugman as discussed in Foreign Direct Investment in the United States (2nd edition), Institute for International Economics, 1991.

Transfer pricing issues are often addressed by comparing gross profit margins[4] earned by related affiliates with those earned by independent companies. These comparisons are only appropriate if the activities and markets of the companies are comparable. If the affiliate earns a lower return than independent companies in the same industry and conducting the same kind of business activity, IRS regulations mandate an audit adjustment.

IRS statistical information used in this report is not suitable for resolving transfer-pricing issues. Indeed, IRS does not use these data in transfer-pricing litigation because they are not sufficiently detailed to demonstrate that firms are comparable.

IRS statistics do not include enough information to provide an understanding of the true comparability of FCDCs with AOCs. While we can compare broad industry groups, we cannot determine how similar or dissimilar companies are within these groups. This limitation may be particularly significant for the wholesale trade industry. Many FCDC wholesalers operate as captive factory outlets for the foreign parent's goods. In this capacity they serve simply as a conduit for processing orders and shipping goods to retailers. AOC wholesalers, on the other hand, tend to purchase goods from many suppliers and to provide these goods to many retailers.

Because of the nature of their business, AOCs wholesalers carry larger inventories. Larger inventories require larger gross profit margins to provide a return on the capital invested. Carrying additional inventories also increases business risk, which also means that AOC wholesalers should earn higher rates of return.

While SOI data may be misleading for transfer-pricing issues, it is important to review them because some analysts use them for tax policy analysis. The 1987 gross profit margin of all FCDCs -- without regard to industry -- is 23.9 percent. The corresponding figure for AOCs is 28.2 percent, when adjusted for the actual mix in FCDC industries.

If, for a given level of business receipts, FCDCs reported the same gross profit margin as AOCs, 1987 FCDC net income would be $27.2 billion higher. The resulting FCDC return on net worth would then be substantially above the return for AOCs. Adjusted FCDC net income would be 12.8 percent of net worth, or about 46 percent higher than the corresponding figure for AOCs.

The size of this disparity, coupled with our expectations of lower FCDC profitability given their growth rates, demonstrates the questionability of interpreting these data as indicating the existence of a transfer-pricing problem. Rather, if FCDCs were earning such a high rate of return, it would indicate less than arms-length prices were being charged, thus shifting profits into the U.S. Stated otherwise, if unusually high rates of return were in fact available we would

[4] The gross profit margin is the excess of business receipts over the cost of sales, divided by business receipts. For example, if a firm sells a product for $100 and its cost of sales is $80, the firm will have a gross profit margin of 20 percent ((100 - 80) / 100 x 100).

expect to see both U.S. and foreign-owned companies rushing to enter the market to benefit from these yields.

Gross profit margins in the manufacturing sector are essentially the same (30.6 percent for FCDCs and 31.1 percent for AOCs); however, more significant differences appear in the wholesale trade industry (11.3 percent for FCDCs and 17.8 percent for AOCs). These differences may result from fundamental differences between the operational structures of FCDC and AOC wholesalers. Of course, the similarity in gross profit margins for the manufacturing sector may be misleadingly close given the broad range of activities conducted within the sector.

These differences in gross profit margins more likely mean the companies are not truly comparable than necessarily indicating transfer pricing manipulation to favor foreign affiliates. There is little apparent difference in manufacturing sector cost of sales, and the differences in the wholesale trade sector may result from the functional organization of the business rather than transfer pricing problems.

REVIEW OF INTERNAL REVENUE SERVICE STATISTICS ON FOREIGN CONTROLLED DOMESTIC CORPORATIONS 1983 THROUGH 1988

I. INTRODUCTION

The Policy Economics Group of KPMG Peat Marwick was asked by the Organization For International Investment ("OFII") to review published tax return data on "foreign controlled domestic corporations" (FCDCs).[5] This report updates and extends a 1990 study for a predecessor organization to OFII. The purpose of this analysis is to gain a better understanding of historical trends in the tax liability of FCDCs as compared with other domestic corporations.

Over the past several years there has been much public discussion of the taxes paid by FCDCs. Much this discussion was triggered by the release of Internal Revenue Service statistics showing FCDC net losses in 1986. At that time, 1986 was the most recent year for which IRS data were available. IRS Data now available for 1987 and 1988 show significantly different results.[6]

Recent IRS testimony has focused on several key indicators of FCDC tax burdens. These include net income as a percent of assets, net income as a percent of receipts, and the percent of returns that are taxable.[7] Others have made statements that FCDCs should be paying $30 billion in additional taxes annually.[8]

Treasury analysts have prepared and released a study using econometric techniques with highly detailed tax return information that shows half of the differences in reported net income by FCDCs and other domestic corporations are accounted for by factors other than transfer pricing. This is not an official Treasury Department study; however, because of the researchers association with the Treasury Department they have access to confidential tax return information not otherwise available. Sometimes lost in the discussion of this study is a key point: the

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[5] Foreign Controlled Domestic Corporations (FCDCs) are defined by the Internal Revenue Service as U.S. corporations more than 50 percent directly or indirectly owned by any foreign person.

[6] Because all corporations are allowed to file returns up to 8 and one-half months after the end of their taxable year, and because of the ways in which these data are processed by IRS, there are relatively long delays before data are available to answer some of the questions raised. The most recent published information available is for 1988.

[7] "Statement of Shirley D. Peterson, Commissioner of Internal Revenue Before the Subcommittee on Oversight House Committee on Ways and Means: International Tax Administration Issues," April 9, 1992.

[8] April 9, 1992 press release by Representative Duncan Hunter.

analysts do not say the remaining half of the difference in net income is accounted for by transfer pricing. Rather, they said they have not been able to determine other ways of accounting for it.

The Treasury study is a good addition to our knowledge of taxes paid by foreign-owned companies. Unfortunately, but understandably, the tax return data used by the Treasury analysts cannot legally be released for use by other analysts. The best that can be done is to study aggregate information that can be released. This report will review the aggregate information, including 1988 data not available at the time the Treasury study was completed, and attempt to provide a framework for analysis by discussing the basic statistics and concepts.

IRS data show foreign-controlled domestic corporations reported positive net income for each year in the 1983 through 1988 period, except for 1986. In 1986, net income of FCDCs showed a $1.5 billion loss. This deficit was followed by a strong recovery in 1987, when net income climbed to $5.6 billion, and to $11.2 billion in 1988.

Taxes paid to the U.S. Treasury have generally followed the trend in net income. Tax liability of FCDCs fell to its lowest level of $3.0 billion in 1986. As a result of the 1987 increase in net income, 1987 tax liability rose to $4.6 billion, and to $5.8 billion in 1988.

Table 1 shows FCDC net income and income tax liability over the 1983 through 1988 period. Net income is shown separately for FCDCs reporting positive and negative net income. In each year before 1987 income tax liability exceeded net income. This is because income tax liability is generally incurred only by those firms with positive net income.

TABLE 1

NET INCOME AND U.S. TAX LIABILITY REPORTED BY FCDCS

(Billions of dollars)

	1983	1984	1985	1986	1987	1988
Net income						
Net income for firms with income	12.4	15.4	14.5	12.7	19.8	26.5
Net deficit for firms with deficit	-10.6	-10.8	-11.5	-14.3	-14.2	-15.3
Combined net income less deficits	1.8	4.5	3.0	-1.5	5.6	11.2
Net U.S. tax liability	3.4	4.5	3.6	3.0	4.6	5.8

Note: detail does not add to total because of rounding.

In 1988, FCDCs accounted for approximately 1.3 percent of all active corporations filing income tax returns with the IRS and about 7 percent of total assets. FCDC's importance in the U.S. economy has grown rapidly over the 1983 through 1988 period and accounts for an increasingly larger share of U.S. corporate activity. Table 2 illustrates this growth by showing trends in basic measures of business activity. Each of the four measures shown increased substantially over the 6-year period: assets increased by 126 percent, receipts increased by 112 percent, net worth increased by 107 percent, and tax returns filed increased by 38 percent.

TABLE 2

GROWTH IN FCDC BUSINESS ACTIVITY AND TAX RETURNS FILED

(Dollars in billions, returns filed in thousands)

	1983	1984	1985	1986	1987	1988
Assets	530	553	656	841	959	1,199
Receipts	390	459	514	543	687	826
Net worth	138	155	178	216	256	286
Returns filed	33.6	37.4	36.7	36.8	44.9	46.3

FCDCs are concentrated in three broad industrial sectors: (a) manufacturing; (b) wholesale and retail trade; and (c) finance, insurance, and real estate. In 1988, these three groups accounted for more than 90 percent of FCDC assets and about 80 percent of tax returns filed. Table 3 shows the relative significance of these industrial sectors in 1988.

Each of the four measures of business activity provides a different perspective on the relative size of these industrial sectors. The wholesale and retail trade sector is the largest in terms of number of tax returns filed and total receipts. The finance, insurance, and real estate sector has the largest share of assets. The manufacturing sector has the greatest net worth.

TABLE 3

COMPARISON OF FCDC INDUSTRIAL SECTORS, 1988

(Dollars in billions, returns filed in thousands)

	Assets	Receipts	Net worth	Returns filed
Total	1,199	826	286	46.3
Manufacturing	426	338	146	5.9
Wholesale & retail trade	163	347	31	15.9
Finance, insurance & real estate	508	81	67	15.4
All other	103	60	42	9.1

Trends in FCDC asset growth are shown in Table 4. Total FCDC assets have increased every year since 1983. Especially rapid asset growth occurred in 1986 (+28 percent) and 1988 (+25 percent). The most significant percentage increases have occurred in the finance, insurance, and real estate sector with a 51-percent increase in 1986 and a 37-percent increase in 1988. The most significant increase in the manufacturing sector occurred in 1987 with a 25-percent increase. The wholesale and retail trade sector increased by 24 percent in 1988.

TABLE 4

TRENDS IN FCDC ASSET GROWTH

(Millions of dollars)

	1983	1984	1985	1986	1987	1988
Total	530	553	656	841	959	1,199
Manufacturing	219	216	255	295	370	426
Wholesale & retail trade	66	80	88	104	131	163
Finance, insurance & real estate	191	199	244	369	371	508
All other	54	57	68	73	89	103

Net income of FCDCs, as shown in Table 5, has increased sharply. From a deficit of -$1.5 billion in 1986 it increased to $5.6 billion in 1987, and then doubled to reach $11.2 billion in 1988. The 1988 increase occurred in each of the three major sectors, although the wholesale and retail trade sector remained below 1984 and 1985 levels. The finance, insurance, and real estate sector turned positive in 1988 -- the first time this occurred over the 6-year period. Because of net losses in other sectors, the manufacturing sector has been the source of more than 100 percent of the net income reported over the 6-year period.

Net U.S. corporate tax liability of FCDCs, also shown in Table 5, increased in 1988 to $5.8 billion. Significant increases occurred in manufacturing, and in the finance, insurance, and real estate sector. Over the 6-year period, the manufacturing sector has been the source of about half the total FCDC tax liability.

TABLE 5

FCDC NET INCOME AND TAX LIABILITY BY INDUSTRIAL SECTOR

(Billions of Dollars)

	1983	1984	1985	1986	1987	1988
Net Income						
Total	1.8	4.5	3.0	-1.5	5.6	11.2
Manufacturing	3.8	5.3	2.9	-0.6	5.9	8.5
Wholesale & retail trade	0.9	2.4	2.4	1.3	0.9	1.7
Finance, insurance & real estate	-1.2	-1.7	-0.8	-0.4	-0.4	0.9
All other	-1.6	-1.5	-1.6	-1.8	-0.9	*
Tax Liability						
Total	3.4	4.5	3.6	3.0	4.6	5.8
Manufacturing	2.0	2.4	1.4	1.0	2.1	3.0
Wholesale & retail trade	1.0	1.7	1.6	1.3	1.4	1.3
Finance, insurance & real estate	0.2	0.2	0.3	0.4	0.6	1.0
All other	0.2	0.2	0.3	0.3	0.5	0.5

* Less than $50 million.

Aggregate FCDC net income and tax liability have shown large fluctuations over the 6-year period. These changes will be better understood by making two comparisons:

- FCDC statistics are compared with those of all other corporations during the 1983 through 1988 period, and

- FCDC statistics are compared with other firms in the same industrial sector.

These comparisons are presented in Section III using the number of tax returns filed, aggregate dollar amounts, and effective tax rates. These measures provide alternative perspectives that are useful in understanding the data.

One important difference between this report and the information discussed in IRS studies is our focus on reported tax liabilities. IRS comparisons focus on net income reported by FCDCs and on pretax returns based on net income. While we analyze net income as a reasonable measure of profitability, we also examine the tax liability of FCDCs in comparison with that of "all other corporations" (AOCs)[9], and several measures of effective tax rates. The critical policy questions raised by these data are not limited to pretax rates of return. The issue of whether FCDCs are paying their fair share of taxes can only be fully addressed by also examining the taxes paid and comparing these taxes with those of comparable domestic corporations.

[9] We define AOCs as all active corporations filing tax returns with the Internal Revenue Service, less FCDCs, and less S-corporations filing on Form 1120S. S-Corporations are excluded because they do not generally incur corporate income tax liability.

II. DATA SOURCES AND LIMITATIONS

Corporation tax return data used in this review are based on published and unpublished tabulations prepared by the Statistics of Income Division (SOI), Internal Revenue Service. Published FCDC tables for the 1983 through 1988 period are from four separate studies.[10] Data for all corporations are from the annual SOI Corporation Source Book publication for the 1983 through 1988 period.

Corporation SOI data are developed from a stratified statistical sampling of corporation tax returns filed each year. This procedure is designed to collect information from tax returns of all the largest corporations and from a sample of smaller corporations.

Most of the economic activity covered in SOI data is for calendar years 1983 through 1988. However, for each of these years, tax return data include accounting periods ending from July of the calendar year studied through June of the following year. For example, 1988 statistics include amounts for corporations with fiscal years ending July 1988 through June 1989. Because returns with fiscal years ending in July 1988 generally have fiscal years starting in August 1987, the statistics for 1988 cover a span of 23 months (from August 1987 through June 1989).

Industry coding used in SOI data is determined by the predominant source of corporate receipts. Particularly for consolidated groups with numerous activities and lines of business these data should be interpreted with some caution. For example, a manufacturing firm -- either U.S. owned or foreign owned -- could well have substantial revenues from wholesale trading.

These tax return data are collected from returns as originally filed. That is, these returns do not include audit adjustments, or carrybacks of losses or credits. While these two limitations work in opposite directions, the relative magnitude of each adjustment is unknown because no information is collected by IRS that would allow either adjustment to be made. We therefore make the assumption that these adjustments are roughly offsetting.

Audit adjustments can substantially increase reported tax liability. On the other hand, carrybacks may significantly reduce tax liability. AOC returns may be affected to the same degree as FCDC returns.

Effect of Tax Reform Act of 1986 on IRS Statistical Information

The Tax Reform Act of 1986 made a large number of changes in the Internal Revenue Code that affected all corporations. The repeal of the investment tax credit became effective

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[10] These studies are: (a) James R. Hobbs, "Foreign Corporate Investment and Activity in the United States, 1983," SOI Bulletin, Summer 1987; (b) James R. Hobbs, "Foreign Corporate Investment and Activity in the United States, 1984 and 1985," SOI Bulletin, Spring 1989; (c) James R. Hobbs, "Domestic Corporations Controlled by Foreign Persons, 1987," SOI Bulletin, Summer 1990; (d) James R. Hobbs, "Domestic Corporations Controlled by Foreign Persons, 1988," SOI Bulletin, Fall 1991.

early in 1987, while other changes first became effective in 1987. Among the other more significant changes are the lengthening of depreciable lives, changes in accounting rules, reduction of corporate marginal tax rates, and the adoption of the corporate alternative minimum tax. The repeal of the investment tax credit was, by a large margin, the largest corporate revenue raiser, while the reduction in marginal tax rates was the largest corporate revenue loser.

The 1986 Act significantly increased corporate tax burdens; however, the impact on AOCs and FCDCs should be roughly comparable within a given industry. While we have not performed a detailed analysis, the $1.6 billion increase in 1987 FCDC tax liability over the 1986 level and the additional increase of $1.2 billion in 1988 do not appear to be significantly related to the 1986 Act.

Two 1986 Act items can be easily reviewed. The general business credit, which includes the investment tax credit, claimed by FCDCs declined from $460 million to $381 million in 1987 and then increased slightly to $399 million in 1988. The repeal of the investment tax credit reduced the credit potentially available; however, the increase in FCDC tax before credits probably allowed more carryovers to be used. The corporate minimum tax liability of FCDCs increased from $41 million in 1986 to $143 million in 1987, and to $310 million[11] in 1988. The impact of other 1986 Act provisions cannot be easily measured.

The corporate alternative minimum tax is of particular interest because it was targeted at profitable companies that avoided paying significant amounts of federal income tax. The FCDC share of total alternative minimum tax liability was about 6 percent in 1987 and 7 percent in 1988 -- roughly the same as the FCDC share of total assets. Thus the impact of the minimum tax on FCDCs appears to be generally comparable to its effect on AOCs.

[11] A prior year minimum tax credit of $21 million was also claimed as a reduction in regular tax liability. The alternative minimum tax is designed primarily to adjust tax payments for differences that reverse over time.

III. COMPARISON OF FCDCS WITH AOCS

In general, FCDCs show lower percentages of returns reporting net income, lower pretax rates of return, and lower effective tax rates than AOCs. This section compares FCDCs with AOCs using a variety of financial performance measures. These comparisons are first made using aggregate data and are then broken down into more detail looking at effective tax rates, major industrial sectors, and selected industries where FCDCs tend to be concentrated.

Comparison of FCDC and AOC Net Income and Tax Liability

While FCDCs have been the source of increasingly larger shares of U.S. economic activity, the net income and tax liability of FCDCs does not appear to have kept pace. Income earned and taxes paid by FCDCs over the 1983 through 1988 period can be compared with that reported by AOCs. Such comparisons show why some tax policy analysts have been concerned about FCDC tax liability, especially in 1986. However, 1987 performance of FCDCs as a whole improved markedly. Table 6 compares the percentage of returns showing positive net income and the amount of net income reported over the 6 years.

The percentage of FCDCs reporting positive net income in 1988 was 40.8 percent -- essentially equal to the 41.0 percent average over the 6-year period. In 1988, 55.6 percent of AOC tax returns reported positive net income. This is down slightly from the 1983 through 1988 average of 57.8 percent.

Net income of FCDCs doubled to $11.2 billion in 1988. By comparison, AOC net income increased by 23 percent. Net income of AOCs has increased in every year from 1983 through 1988, while FCDC net income dipped significantly in 1985 and 1986.

Trends in reported tax liability are similar to those of net income; however, FCDC tax liability increase by 28 percent in 1988, while AOC tax liability dropped slightly.

TABLE 6

COMPARISON OF RETURNS WITH POSITIVE NET INCOME, AMOUNT OF NET INCOME AND TAX LIABILITY REPORTED BY FCDCS AND AOCS

(Dollar amounts in billions)

	1983	1984	1985	1986	1987	1988
Percent of tax returns reporting positive net income						
FCDCs	40.6%	40.9%	43.3%	39.0%	41.2%	40.8%
AOCs	58.6%	58.8%	58.1%	58.4%	57.5%	55.6%
Net income less deficits						
FCDCs	1.8	4.5	3.0	-1.5	5.6	11.2
AOCs	181.4	221.5	229.5	262.8	298.5	368.4
Net U.S. tax liability						
FCDCs	3.4	4.5	3.6	3.0	4.6	5.8
AOCs	48.4	59.5	59.7	70.8	90.3	89.9

More meaningful comparisons can be made by comparing net income to relative measures of economic activity. Four measures are shown in Table 7. Three are commonly used relationships that require little explanation. Net income is compared with total assets, total receipts, and net worth. The fourth comparison of net income plus interest expense as a percent of total assets is less obvious, but perhaps the most relevant.

Different industries typically have different relative amounts of debt on their balance sheets. These relationships are especially important when comparing financial industries with nonfinancial industries. Based on 1988 Statistics of Income data, the banking industry (both AOCs and FCDCs) had debt equal to 92 percent of total assets, while the manufacturing sector had debt equal to 63 percent of total assets. Greater debt leads to greater interest deductions and generally leads to less net income.

Relative amounts of debt, or leverage, become important when comparing rates of return across groups with different mixes of industries. If FCDCs have a higher proportion of companies with large amounts of debt one would expect to see greater interest expense and correspondingly lower net incomes. Thus, when the net income of FCDCs is compared with total assets or total receipts one would expect relatively low ratios.

Further, investors receive two types of returns. Lenders receive interest income in exchange for loaning money to finance corporate assets, and shareholders receive dividends and the benefit of accumulated retained earnings in exchange for their equity investments. Because interest is deductible, net income reflects only the return to equity holders.

By adding the interest expense back to net income it is possible to show a more accurate return on total assets than net income by itself will provide. Thus our fourth measure, net income plus interest expense, divided by total assets, provides a better measure of returns on total investment. This measure will be somewhat lower than a pure return on equity because debtholders typically bear less risk.

Similarly, the return on net worth also provides an internally consistent rate of return. Net income is a measure of returns to shareholders and net worth is a measure of the value of the shareholders investment -- although, as will be described later, balance sheet concepts such as total assets and net worth suffer from some valuation problems.

The returns on total assets and total receipts are less meaningful concepts because they mix up returns to equity holders with measures of total economic activity, some of which benefits lenders. Nevertheless, they provide comparative values that are useful in understanding relative levels of economic performance.

Each pretax rate of return measure shows that FCDCs earned lower yields in 1988 than AOCs. Of the four, the comparison using the net income plus interest expense is the most similar. The greatest difference occurs with the pretax return on assets.

Return on assets. FCDC returns on assets have been, and continue to be, lower than AOC returns on assets, although yields for both groups increased in 1988. FCDC returns on assets rose to 0.9 percent in 1988, up from a low of -0.2 percent in 1986. Returns on assets for AOCs were higher, reaching 2.5 percent in 1988. The average return on assets over the 6-year period was 0.5 percent for FCDCs and 2.1 percent for AOCs.

Return on receipts. The FCDC pretax return on receipts was 1.4 in 1988 -- much lower than AOC return of 4.5 percent.

Return on net worth. Pretax returns on net worth also have been consistently lower for FCDCs. In 1988, the return on net worth for FCDCs rose to 3.9 percent. The AOC return on net worth was 9.8 percent.

Return on net income plus interest expense. The FCDCs return on assets, after adjusting net income to include the return to debt holders by adding back interest expense, was 4.8 percent in 1988. The comparable AOC return was 6.6 percent. These relationships, while still showing a significant difference are less pronounced than the other three measures.

TABLE 7

COMPARISON OF PRETAX RETURNS OF FCDCS AND AOCS

	1983	1984	1985	1986	1987	1988	Average
Net income as a percent of total assets							
FCDCs	0.3%	0.8%	0.5%	-0.2%	0.6%	0.9%	0.5%
AOCs	1.9%	2.1%	1.9%	2.0%	2.1%	2.5%	2.1%
Net income as a percent of total receipts							
FCDC	0.5%	1.0%	0.6%	-0.3%	0.8%	1.4%	0.7%
AOC	2.8%	3.2%	3.1%	3.4%	3.8%	4.5%	3.5%
Net income as a percent of net worth							
FCDCs	1.3%	2.9%	1.7%	-0.7%	2.2%	3.9%	1.9%
AOCs	7.3%	8.2%	7.4%	7.7%	8.4%	9.8%	8.1%
Net income plus interest expense as a percent of total assets[a]							
FCDC	n.a.	5.4%	4.7%	3.2%	4.3%	4.8%	4.5%
AOCs	n.a.	7.0%	6.4%	6.1%	6.0%	6.6%	6.4%

[a] Sufficient data are not available from IRS to compute this relationship in 1983. The average is therefore limited to the 1984 through 1988 period.

Comparison of Effective Tax Rates

In some respects effective tax rates are more relevant than pretax returns. That is, regardless of the amount of reported net income, the most basic question is whether FCDCs paid their "fair share" of income taxes. Internal Revenue Service data can be used to develop effective tax rate comparisons based of total assets, net worth, and total receipts.[12]

[12] A fourth effective tax rate comparison could be developed using a concept similar to pretax net income plus interest. The denominator would be total assets and the numerator would be the sum of FCDC tax liability on net income plus the lenders' tax liability on interest paid by FCDCs to lenders. We have not prepared this comparison because it would require assumptions on the tax position of lenders that are more speculative (e.g., whether lenders are related parties).

Effective tax rate analyses usually attempt to measure the tax burden imposed on the pretax economic income of the taxpayer. No clear agreement exists on the definition of economic income, and, even if analysts did agreed, no tax return data exist to support such a calculation.

We use total assets, net worth, and total receipts as proxies for potential economic income because IRS data on net income has changed over time due to modifications in tax law and because tax return concepts do not reflect economic income. Assets and net worth provide indirect measures of the income corporations will earn given a "normal" rate of return. Total receipts is used as an additional measure of the level of economic activity, although it may bear a lesser relationship to the actual earnings potential of a corporation. These measures are divided into current year tax liability to compute an effective tax rate.

Each measure has certain limitations. As with the pretax profitability measures, we believe the comparison with net worth is most reflective of the earnings potential of the corporation.

Limitations of effective tax rates using total assets. Assets can be thought of as the potential to earn net income. If cash is invested in an interest-bearing account it will earn a market yield. Similarly, assets invested in inventories, and plant and equipment should generate a market rate of return. The difficulty with this comparison is that net income is measured after subtracting interest expense, while total assets are financed by both debt and equity. Effective tax rates based on total assets are useful when the debt-equity ratios are similar.

Total assets exclude intangible assets developed by the corporation. Self-developed intangible assets, such as manufacturing know-how and customer lists, increase the earnings potential of the corporation yet they are not reported on the balance sheet. However, the earnings attributable to intangibles are reflected in net income. This inconsistency may lead to an overstatement of returns on assets and effective tax rates. AOC earnings and effective rates are more likely to be overstated than those of FCDCs because intangibles are typically owned by the parent corporation. AOC net income of will generally include the return on intangibles, while FCDC net income will not generally include such a return.[13]

Limitations of effective tax rates using total assets and net worth. Total assets and net worth edited from corporation income tax returns are typically based on financial accounting concepts. These amounts generally reflect historic cost accounting rather than current market value. Some asset categories will be valued at close to market, e.g., inventories, while others may be substantially understated,

[13] Some FCDCs acquired by foreign corporations already owned such intangibles before they were acquired, while other FCDCs invest in and develop their own intangibles separately from their foreign parents. These corporations should be expected to show rates of return and effective tax rates more similar to those of AOCs.

e.g., land. Depreciable, depletable, and amortizable assets will tend to be valued somewhere between these extremes depending upon the relative rates of inflation and write-off.

As long as companies and industries being compared have approximately the same investment patterns, the use of historic cost accounting will not result in a substantial bias. When investment patterns are different, balance sheet-based comparisons may not be meaningful.

The following simple example illustrates this problem. Assume two agricultural companies each have land with a fair market value $100. Also assume the companies generate all their net income using this land, plus labor and materials, which are expensed. If both companies earn a 20 percent pretax rate of return, or $20, on the fair market value of the land, and the federal corporate tax rate is 34 percent, both companies will pay taxes of $6.80. This results in an asset-based effective tax rate of 6.8 percent. Now assume one company purchased its land in the current year for $100, and the other purchased the land five years ago for $60. The first company still has an effective tax rate of 6.8 percent, while the second has an effective tax rate of 11.3 percent (6.80 / 60). Similar, but more complex, problems occur in measuring rates of return and effective tax rates with other kinds of assets.

The net result of the use of historic cost accounting is that comparisons between groups of companies with older assets and companies with newer assets may be misleading. Companies with older assets will appear to have higher effective tax rates than companies with newer assets.

While the impact of historic cost accounting cannot be measured directly, the rapid growth in FCDC investment relative to the slower growth in AOC investment may result in AOC effective tax rates being overstated. This is because FCDC assets are likely to be newer and, therefore, will more closely reflect market values. On the other hand, to the extent FCDC investment occurs through acquisitions of existing companies in purchase-of-stock transactions where existing asset bases are retained, this problem may be less significant.

Growth-related limitations. Two growth-related limitations are start-up costs and the extent to which firms have increasing or decreasing investment levels. To the extent FCDCs are making new investments, start-up costs may be relatively more important resulting in lower net income and reported taxes than amounts reported by AOCs. More slowly growing firms may show unusually high net income and effective tax rates. An old firm that is slowly liquidating its assets by not investing, or investing more slowly than the depreciation of its existing assets, should experience high net income and taxes paid because some of its return is a return of capital being treated as net income.

When all firms are taken together, these growth-related distortions may wash out. However, if a specific group of firms is investing rapidly, while another group tends to have slower asset growth, the effective tax rate on the former group may appear to be lower than the later.

Limitations of effective tax rate using total receipts. Total receipts do not directly suffer from the historic cost limitation of assets and net worth. On the other hand, a comparison of earnings rates and tax liability with total receipts may be distorted if the companies being compared are from different industries. Some industries, such as wholesale and retail trade, often have high levels of receipts relative to net income and tax liability. A comparison of all AOCs with all FCDCs using total receipts will be misleading to the extent these groups have different industry mixes.

Receipts-based comparisons also do recognize different means of financing. Two firms in the same industry with equal receipts may have very different amounts of net income and tax liability because they are leveraged to differing degrees. More highly leveraged firms will pay out larger shares of deductible interest resulting in lower net income and tax liability. The firms may also perform different functions. If one firm is solely a supplier of goods to customers, while the other actively markets goods and holds substantial inventories, one would expect different returns and effective tax rates.

Limitations of effective rates using current U.S. tax liability. Total assets, net worth, total receipts, and net income each include to varying degrees the results of investments in foreign operations. To the extent effective tax rates are computed using U.S. income tax liability after credits, the total tax burden and relative tax burdens may be understated.

If a foreign corporation owned by a U.S. parent repatriates (or is deemed to repatriate) income, this income will be included in total receipts, net income, and U.S. tax before the foreign tax credit. Net U.S. tax after credits can appropriately be compared with income earned in the U.S.; however, effective tax rates based on "world-wide" net income, as reported on the tax return, may be misleading. To the extent AOCs have more foreign-source income and investment than FCDCs, effective tax rates on AOCs will be understated. This measure can be partially corrected by using the foreign tax credit as a proxy for foreign taxes paid and computing a world-wide effective tax rate. We, therefore, use two separate measures of income tax liability to compute effective tax rates: (a) net U.S. income tax after credits, and (b) net U.S. income tax with the foreign tax credit added back to taxes paid.

Because the foreign tax credit is not allowed to exceed the U.S. tax on the same income, the credit may underestimate foreign taxes actually paid. This means world-wide effective tax rates calculated with these data may be understated.

Comparison of Effective Tax Rates

Table 8 shows U.S. and world-wide effective tax rates for FCDCs and AOCs. Average effective tax rates of FCDCs are slightly below those of AOCs over the 6-year period. Effective rates of FCDCs tend to be higher than AOC rates in earlier years and lower than AOC rates in later years. Effective tax rates using net U.S. taxes paid tend to be more similar than those based on world-wide taxes. Under each of the three measures, FCDC effective rates have risen from the low 1986 levels.

TABLE 8

EFFECTIVE TAX RATES OF FCDCS AND AOCS

	1983	1984	1985	1986	1987	1988	Average
Effective U.S. tax rate on total assets							
FCDCs	0.6	0.8	0.5	0.4	0.5	0.5	0.6
AOCs	0.5	0.6	0.5	0.5	0.6	0.6	0.6
Effective U.S. tax rate on total receipts							
FCDCs	0.9	1.0	0.7	0.6	0.7	0.7	0.7
AOCs	0.8	0.8	0.8	0.9	1.1	1.1	0.9
Effective U.S. tax rate on net worth							
FCDCs	2.5	2.9	2.0	1.4	1.8	2.0	2.1
AOCs	2.0	2.2	1.9	2.1	2.5	2.4	2.2
Effective world-wide tax rate on total assets							
FCDCs	0.8	1.0	0.7	0.4	0.5	0.5	0.6
AOCs	0.7	0.8	0.7	0.7	0.8	0.8	0.7
Effective world-wide tax rate on total receipts							
FCDCs	1.0	1.1	0.8	0.6	0.8	0.8	0.9
AOCs	1.1	1.1	1.1	1.2	1.4	1.4	1.2
Effective world-wide tax rate on net worth							
FCDCs	3.0	3.4	2.4	1.6	2.0	2.3	2.5
AOCs	2.7	3.0	2.7	2.7	3.1	3.1	2.9

Effective tax rate on total assets. The average effective U.S. tax rate on total assets over the period is the same for FCDCs and AOCs. In 1988, the FCDC effective U.S. tax rate of 0.5 was slightly below the AOC rate of 0.6. The average FCDC world-wide tax rate on total assets was slightly below the AOC rate; however, the 1988 FCDC rate of 0.5 was noticeably lower than the 0.8 AOC rate. As shown in Figures 1 and 2, FCDC effective tax rates on assets have been more volatile than the AOC rates. FCDC rates declined sharply in 1985 and 1986, followed by a significant increase in 1987, and a flattening in 1988.

Figure 1:
Effective U.S. Tax Rate on Total Assets

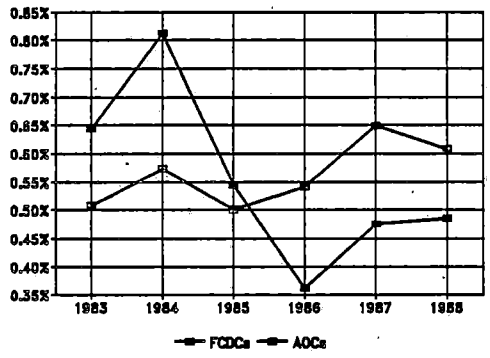
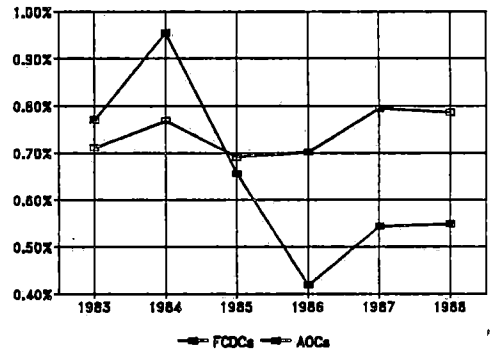


Figure 2:
Effective World-wide Tax Rate on Total Assets



Effective tax rate on total receipts. On average over the 1983 through 1988 period, FCDCs effective tax rates on receipts were below AOC rates. The 0.7 average effective U.S. tax rate on total receipts paid by FCDCs was lower than the 0.9 percent AOC rate. The spread in average world-wide effective rates is slightly greater with 0.9 for FCDCs and 1.2 for AOCs. Figures 3 and 4 show that both U.S. and world-wide effective tax rates on total receipts diverged significantly beginning in 1985.

Figure 3:
Effective U.S. Tax Rate on Total Receipts

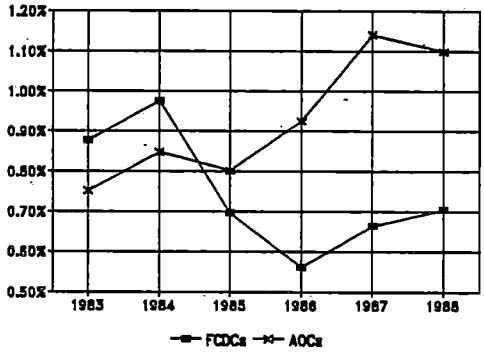
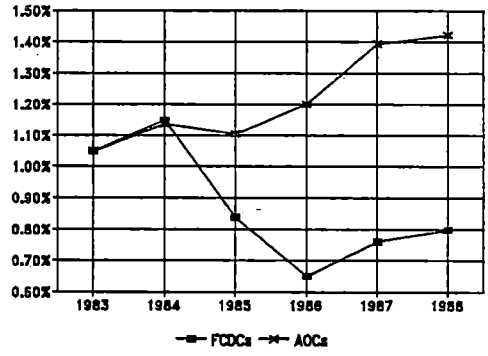


Figure 4:
Effective World-wide Tax Rate on Total Receipts



Effective tax rate on net worth. The average effective U.S. tax rate on net worth is very similar for both FCDCs (2.1 percent) and AOCs (2.2 percent) over the 6-year period. The 2.5 percent average FCDC world-wide effective rate is somewhat lower than the 2.9 percent AOC rate. As shown in Figures 5 and 6, the gap in effective tax rates narrowed significantly in 1988, with the U.S. effective rate narrowing appreciably.

Figure 5:
Effective U.S. Tax Rate on Net Worth

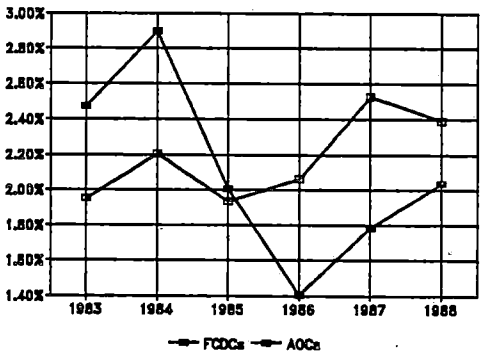
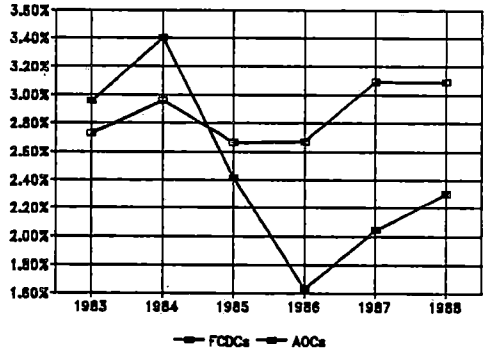


Figure 6:
Effective World-wide Tax Rate on Net Worth



A fourth measure shows the effective tax rate on positive net income. This tax base is useful in that it shows the effective tax rate paid by those firms paying tax. On the other hand, it is potentially misleading because it does not include loss firms, which are of perhaps the most concern to analysts. Differences between AOC and FCDC effective tax rates on positive net

income reflect the benefit of net operating loss carryovers, the dividends received deduction, reduced marginal rates for small corporations, and the availability of tax credits. Firms with losses are excluded from this calculation because they do not generally incur tax liability and their inclusion could produce unrealistic effective tax rates depending upon the extent of firms with pretax losses.

As shown in Figures 7 and 8, FCDCs paid higher effective tax rates on positive net income than did AOCs, whether measured on a year-by-year basis or on a five-year average basis. The rates paid by FCDCs and AOCs have been converging since 1984. Over the 1983 through 1988 period the average effective U.S. tax rate on positive net income was 25.0 percent for FCDCs and 19.3 percent for AOCs. The average world-wide effective tax rate for this period was 29.3 percent for FCDCs and 25.5 percent for AOCs. The 1988 effective U.S. tax rates were 22.0 for FCDCs and 19.3 for AOCs, while the corresponding world-wide rates were 24.9 for FCDCs and 25.5 for AOCs.

Figure 7:
Effective U.S. rate on Positive Net Income

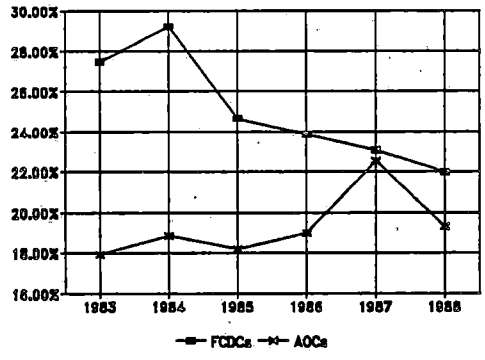
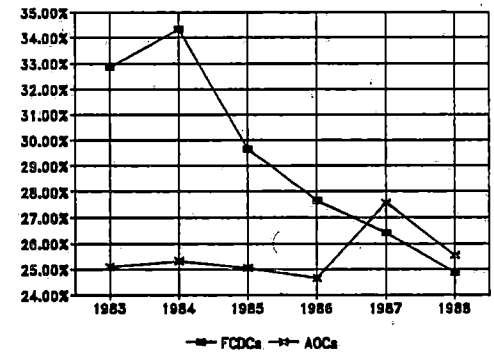


Figure 8:
Effective World-wide Tax Rate on Pos. Net Income



Comparison of FCDC and AOC Data by Major Industrial Sector

Each of the major industrial sectors has different characteristics. Three types of information are presented for each sector: (a) percent of returns with net income, (b) net income, and (c) income tax liability.

Percent of Returns with Net Income

Over the 1983 through 1988 period the proportion of AOCs reporting net income on tax returns has remained relatively constant, ranging between 56 and 59 percent. The percentage of FCDCs reporting net income has also been stable, but consistently lower, varying between 39 and

43 percent (see Table 6). As shown in Table 9, the proportions are more volatile when disaggregated into major industrial sectors -- particularly for FCDCs.

Manufacturing. While the percentage of AOCs reporting positive net income ranged between 60 and 62 percent over the period, the comparable percentage for FCDCs exhibited wide year-to-year swings. From 50.7 percent in 1983, it moved up to 57.2 percent in the following year; then two sharp declines in 1985 and 1986 brought the percentage down to 34.6 percent in 1986. A strong recovery occurred in 1987, with the percentage of FCDCs reporting positive net income rising to 49.8 percent, more than recovering the 1986 loss. The percentage then fell again to 38.5 percent in 1988.

Wholesale & retail trade. The percentage of AOCs reporting positive net income ranged narrowly between 58 and 61 percent over the 1983 to 1988 period. The percentage of FCDCs with net income increased from 1983 to 1985 to reach 45.3 percent. In 1986 the percentage dropped somewhat to 44.9 percent, but that loss was fully recovered in 1987, when the percentage rose back up to 45.3 percent. In 1988, the percentage jumped to its highest point of 50.4 percent.

Finance, insurance & real estate. Between 1983 and 1986, the proportion of AOCs with positive net income remained between 57 and 58 percent. In 1987 that proportion dropped slightly to 55.8 percent, and then fell to 54.9 percent in 1988. The percentage of FCDC firms with net income rose from 30.3 percent in 1983 to 34.5 percent in 1985. The 1986 decline was mostly recovered in 1987, when the percentage moved back up to 33.7 percent. In 1988 the percentage was largely unchange at 33.1 percent.

TABLE 9

COMPARISON OF RETURNS WITH POSITIVE NET INCOME BY MAJOR INDUSTRIAL SECTOR

	1983	1984	1985	1986	1987	1988	Average
Manufacturing							
FCDC	50.5%	57.2%	49.1%	34.6%	49.8%	38.5%	46.8%
AOC	60.3%	61.8%	59.9%	60.2%	61.4%	60.6%	60.7%
Wholesale & retail trade							
FCDC	40.5%	41.4%	45.3%	44.9%	45.3%	50.4%	44.6%
AOC	61.0%	60.9%	58.5%	59.6%	58.7%	59.7%	59.7%
Finance, insurance & real estate							
FCDC	30.3%	33.5%	34.5%	28.9%	33.7%	33.1%	32.3%
AOC	58.5%	57.0%	58.2%	58.5%	55.8%	54.9%	57.2%
All other							
FCDC	45.5%	41.8%	49.4%	42.8%	40.2%	38.4%	43.0%
AOC	56.8%	57.6%	57.5%	57.3%	56.8%	52.6%	56.4%

Net Income

FCDC net income reached its highest level during the 1983 through 1988 period in 1988 when it rose to $11.2 billion. While FCDC net income was volatile over the period, AOC net income increased each year. Net income of AOCs reached $368.4 billion in 1988. Net income by major industry is shown in Table 10.

Manufacturing. Both FCDC and AOC manufacturing firms showed significant declines in net income in 1985 and 1986. FCDC firms showed an aggregate net loss of -$0.6 billion in 1986; however, in the following two years they improved greatly reaching $5.9 billion in 1987 and $8.5 billion in 1988. Like FCDCs, AOCs recovered strongly with net income rising to $131.2 billion in 1987 and $185.7 billion in 1988.

Wholesale & retail trade. FCDC net income rose to $1.7 billion in 1988. This is the highest level since 1985. AOC net income also increased in 1988, reaching $30.8 billion. Net incomes of both FCDCs and AOCs in 1988 remained below their earlier peaks.

Finance, insurance & real estate. Net income for FCDCs turned positive ($0.9 billion) in 1988 for the first time during the 6-year period. Net income of AOCs increased slightly to $88.7 billion in 1988, but remained well below the 1986 peak of $100.1 billion.

TABLE 10

COMPARISON OF AMOUNT OF NET INCOME BY MAJOR INDUSTRIAL SECTOR
(Billions of Dollars)

	1983	1984	1985	1986	1987	1988
Manufacturing						
FCDC	3.8	5.3	2.9	-0.6	5.9	8.5
AOC	89.4	112.8	107.1	98.8	131.2	185.7
Wholesale & retail trade						
FCDC	0.9	2.4	2.4	1.3	0.9	1.7
AOC	32.5	37.2	28.1	31.1	29.9	30.8
Finance, insurance & real estate						
FCDC	-1.2	-1.7	-0.8	-0.4	-0.4	0.9
AOC	32.5	34.0	61.4	100.1	86.1	88.7
All others						
FCDC	-1.6	-1.5	-1.6	-1.8	-0.9	*
AOC	27.0	37.5	32.9	32.8	51.2	63.2

* Less than $50 million.

Tax Liability

U.S. tax liability of FCDCs rose more than 50 percent in 1987 to reach $4.6 billion, and by an additional 26 percent in 1988 to reach $5.8 billion. This increase followed consecutive declines in 1985 and 1986. Table 11 shows FCDC and AOC U.S. tax liability by major industrial sector.

Manufacturing. As with net income, tax liability for both FCDC and AOC manufacturing firms declined in 1985 and 1986, and then recovered strongly. Manufacturing FCDCs reported tax liability of $3.0 billion in 1988 -- up from

$2.1 billion in 1987 and $1.0 billion in 1986. AOC tax liability increased to $38.9 billion in 1988 from $31.9 billion in 1987, and $24.7 billion in 1986.

Wholesale & retail trade. FCDC tax liability remained virtually flat over the 1986 through 1988 period -- between $1.3 billion and $1.4 billion. AOC tax liability increased to $13.9 billion in 1986, and then declined to $12.6 billion in 1987, and $11.4 billion in 1988.

Finance, insurance & real estate. Tax liability for both FCDC and AOC firms continued to increase rapidly during the entire 6-year period. FCDC tax liability reached $1.0 billion in 1988 -- up from $0.6 billion in 1987 and $0.4 billion in 1986. AOC tax liability increased to $16.9 billion in 1988. AOC liability was $15.7 billion in 1987 and $14.2 billion in 1986.

TABLE 11

COMPARISON OF U.S. TAX LIABILITY BY MAJOR INDUSTRIAL SECTOR
(Billions of Dollars)

	1983	1984	1985	1986	1987	1988
Manufacturing						
FCDC	2.0	2.4	1.4	1.0	2.1	3.0
AOC	22.9	28.1	24.0	24.7	31.9	38.9
Wholesale & retail trade						
FCDC	1.0	1.7	1.6	1.3	1.4	1.3
AOC	9.6	10.7	11.8	13.9	12.6	11.4
Finance, insurance & real estate						
FCDC	0.2	0.2	0.3	0.4	0.6	1.0
AOC	5.5	6.5	9.9	14.2	15.7	16.9
All others						
FCDC	0.2	0.2	0.3	0.3	0.5	0.5
AOC	10.4	14.2	14.0	17.9	30.1	22.8

Comparison of Effective Tax Rates by Major Industry Group

Table 12 compares effective tax rates by major industrial sector over the 1983 through 1988 period. While the rates vary significantly from year-to-year, several observations can be made:

- FCDC effective tax rates in the manufacturing sector, regardless of the measure chosen, are consistently and significantly lower than AOC effective rates.

- Average FCDC effective tax rates in the wholesale and retail trade sector are generally equal to or above AOC rates. While both FCDC and AOC effective rates have declined, FCDC rates tend to have fallen further.

- Effective tax rates of FCDCs and AOCs in the finance, insurance and real estate sector are generally similar. In 1988, FCDC effective rates are generally above those of AOCs.

TABLE 12

COMPARISON OF EFFECTIVE INCOME TAX RATES BY MAJOR INDUSTRY USING TOTAL ASSETS, TOTAL RECEIPTS, AND NET WORTH[a]

	1983	1984	1985	1986	1987	1988	Average
Effective U.S. tax rate on total assets							
Manufacturing							
FCDC	0.9	1.1	0.5	0.3	0.6	0.7	0.7
AOC	1.2	1.3	1.0	1.0	1.2	1.4	1.2
Wholesale & retail trade							
FCDC	1.5	2.1	1.8	1.2	1.0	0.8	1.4
AOC	1.4	1.4	1.4	1.5	1.4	1.2	1.4
Finance, insurance & real estate							
FCDC	0.1	0.1	0.1	0.1	0.2	0.2	0.1
AOC	0.1	0.1	0.1	0.2	0.2	0.2	0.2
All other							
FCDC	0.3	0.4	0.5	0.4	0.5	0.5	0.4
AOC	0.7	0.8	0.7	0.9	1.5	1.0	0.9
Effective world-wide tax rate on total assets							
Manufacturing							
FCDC	1.2	1.4	0.7	0.4	0.7	0.8	0.9
AOC	1.9	2.1	1.8	1.6	1.8	2.1	1.9
Wholesale & retail trade							
FCDC	1.6	2.2	1.8	1.3	1.1	0.8	1.5
AOC	1.4	1.4	1.4	1.6	1.5	1.3	1.4
Finance, insurance & real estate							
FCDC	0.1	0.1	0.2	0.1	0.2	0.2	0.2
AOC	0.1	0.1	0.2	0.2	0.2	0.2	0.2
All other							
FCDC	0.3	0.4	0.5	0.4	0.5	0.5	0.4
AOC	0.7	0.8	0.7	0.9	1.5	1.0	0.9

TABLE 12 (continued)

COMPARISON OF EFFECTIVE INCOME TAX RATES BY MAJOR INDUSTRY USING TOTAL ASSETS, TOTAL RECEIPTS, AND NET WORTH[a]

	1983	1984	1985	1986	1987	1988	Average
Effective U.S. tax rate on net worth							
Manufacturing							
FCDC	2.8	2.9	1.5	0.9	1.5	2.1	1.9
AOC	2.6	3.0	2.4	2.5	3.2	3.7	2.9
Wholesale & retail trade							
FCDC	5.6	8.0	7.3	5.5	4.7	4.3	5.9
AOC	4.1	4.2	4.7	5.3	5.1	4.6	4.7
Finance, insurance & real estate							
FCDC	0.7	0.7	0.8	0.8	1.3	1.5	1.0
AOC	0.7	0.8	0.9	1.0	1.0	1.0	0.9
All other							
FCDC	0.9	1.1	1.2	1.1	1.3	1.1	1.1
AOC	1.8	2.2	1.9	2.5	4.1	3.0	2.6
Effective world-wide tax rate on net worth							
Manufacturing							
FCDC	3.6	3.5	2.0	1.1	1.8	2.3	2.4
AOC	4.4	4.8	4.4	4.2	4.8	5.7	4.7
Wholesale & retail trade							
FCDC	5.7	8.3	7.4	5.7	4.8	4.4	6.0
AOC	4.2	4.3	4.9	5.5	5.4	5.0	4.9
Finance, insurance & real estate							
FCDC	0.9	0.8	1.0	0.9	1.4	1.6	1.1
AOC	0.9	0.9	1.0	1.1	1.1	1.1	1.0
All other							
FCDC	1.2	1.8	1.5	1.8	1.6	1.8	1.6
AOC	2.0	2.5	2.1	2.6	4.2	3.2	2.8

TABLE 12 (continued)

COMPARISON OF EFFECTIVE INCOME TAX RATES BY MAJOR INDUSTRY USING TOTAL ASSETS, TOTAL RECEIPTS, AND NET WORTH[a]

	1983	1984	1985	1986	1987	1988	Average
Effective U.S. tax rate on total receipts							
Manufacturing							
FCDC	1.3	1.3	0.7	0.5	0.8	0.9	0.9
AOC	1.0	1.1	0.9	1.0	1.2	1.4	1.1
Wholesale & retail trade							
FCDC	0.6	0.8	0.7	0.6	0.5	0.4	0.6
AOC	0.5	0.6	0.6	0.7	0.6	0.6	0.6
Finance, insurance & real estate							
FCDC	0.6	0.5	0.7	0.7	1.0	1.2	0.8
AOC	0.6	0.7	0.9	1.1	1.1	1.1	0.9
All other							
FCDC	0.5	0.6	0.7	0.7	0.8	0.8	0.7
AOC	0.7	0.9	0.8	1.0	1.7	1.3	1.7
Effective world-wide tax rate on total receipts							
Manufacturing							
FCDC	1.6	1.6	0.9	0.6	1.0	1.0	1.1
AOC	1.7	1.8	1.7	1.7	1.8	2.2	1.8
Wholesale & retail trade							
FCDC	0.6	0.9	0.7	0.6	0.5	0.4	0.6
AOC	0.7	0.6	0.6	0.7	0.7	0.6	0.6
Finance, insurance & real estate							
FCDC	0.7	0.6	0.9	0.8	1.1	1.3	0.9
AOC	0.8	0.8	1.0	1.3	1.2	1.2	1.1
All other							
FCDC	0.7	1.0	0.9	1.1	1.0	1.3	1.0
AOC	0.8	1.0	0.9	1.1	1.8	1.3	1.1

[a]Effective world-wide tax rate assumes foreign tax credits claimed equal foreign taxes paid. To the extent firms have excess credits the world-wide effective tax rate may be understated.

Characteristics of Selected Major Industry Groups

There are a number of major industry groups where FCDCs are particularly important. Four manufacturing groups and two trade groups are particularly important. While the following discussion of IRS statistics on these six groups provides a better understanding of underlying trends, it is important to recognize that sampling variability may reduce the reliability of these data.

Major Groups in the FCDC Manufacturing Sector

Four FCDC manufacturing groups are particularly significant: petroleum and coal; chemicals; food products; and electrical and electronic equipment. The petroleum group had the greatest assets in 1988, and the chemical group had the greatest net worth. Table 13 provides statistics on the number of returns filed, total assets, net worth, total receipts, net income, and tax liability for each group over the 1984 through 1988 period.

Petroleum. Following the 1985-1986 collapse in oil prices, the number of FCDCs filing returns fell from 366 firms in 1986 to only 35 firms in 1988. Most of this decline was in relatively small firms as assets and net worth did not show the same percentage decline. Total assets and net worth declined in 1988; however, total receipts and net income increased significantly.

Chemicals. The FCDC chemical industry grew strongly throughout the 6-year period. Tax liability grew significantly from $0.2 billion in 1986 to $0.5 billion in 1987, and $0.7 billion in 1988. The chemical industry had 38 percent of the net income earned in the manufacturing sector in 1988.

Food Products. The FCDC food and kindred products industry showed significant declines during 1988 in the number of returns, assets, net worth, and net income. In contrast, total receipts and tax liability increased. The 1988 results were, however, significantly above results for years before 1987 indicating that 1987 may have been an unusually good year.

Electrical Equipment. FCDCs show continuing increases in assets, net worth, and receipts over the period. The substantial decline in the number of returns in 1987 may be the result of sampling variability, although some parts of the electronics industry had a particularly difficult period in the mid-1980s.

TABLE 13

SELECTED INFORMATION ON FCDC MAJOR MANUFACTURING GROUPS

(Dollar amounts in Billions)

	1984	1985	1986	1987	1988
Petroleum					
Number of returns	106	225	366	95	35
Total assets	89.0	91.0	92.4	102.0	98.3
Net worth	32.6	33.5	36.3	40.4	31.6
Total receipts	53.3	51.6	40.8	53.5	61.7
Net income	4.2	2.4	-2.2	0.2	1.2
U.S. tax liability	1.3	0.4	*	0.3	0.4
Chemicals					
Number of returns	205	169	207	274	312
Total assets	26.1	32.6	51.0	73.5	84.3
Net worth	11.2	12.4	18.3	28.2	33.3
Total receipts	27.8	31.0	40.6	55.1	62.0
Net income	0.6	0.4	0.6	2.8	3.2
U.S. tax liability	0.3	0.3	0.2	0.5	0.7
Food products					
Number of returns	167	135	205	349	244
Total assets	21.2	28.4	27.6	49.6	40.1
Net worth	9.1	9.3	9.7	23.8	13.7
Total receipts	13.7	19.3	17.6	25.1	31.1
Net income	*	0.2	0.3	1.0	0.8
U.S. tax liability	0.1	*	*	0.2	0.3
Electrical equipment					
Number of returns	693	787	971	356	751
Total assets	10.1	11.2	22.0	26.4	32.7
Net worth	3.6	4.0	8.5	10.9	11.9
Total receipts	14.1	15.2	24.4	28.2	36.8
Net income	0.3	*	0.2	0.1	0.2
U.S. tax liability	0.2	0.1	0.1	0.2	0.2

* Less than $50 million.

Comparison of FCDC and AOC Effective Tax Rates

Insufficient data are available for 1988 to allow us to compute AOC effective tax rates for the four major manufacturing groups.[14] Data are, however, available for 1987. Table 14 shows 1987 FCDC and AOC effective tax rates on total assets, total receipts, and net worth for FCDCs and AOCs.

FCDC effective tax rates are consistently below -- or at best equal to -- AOC rates. In two instances the effective tax rates are equal. The petroleum industry's effective U.S. tax rate on total receipts is 0.6 percent for both FCDCs and AOCs. FCDC and AOC food products industry effective world-wide tax rates on total receipts are equal at 1.4 percent.

[14] AOC data require the availability of information on S-corporations. S-corporation data are typically only published by industrial sector. We were able to obtain an unpublished, detailed industry tabulation on S-corporations for 1987.

TABLE 14

COMPARISON OF 1987 EFFECTIVE INCOME TAX RATES FOR MANUFACTURING MAJOR INDUSTRY GROUPS USING NET WORTH, TOTAL ASSETS, AND TOTAL RECEIPTS[a]

	Petroleum	Chemicals	Food	Electrical	All Other Manufacturing
Effective U.S. tax rate on total assets					
FCDC	0.3	0.7	0.4	0.6	0.7
AOC	0.4	1.9	1.7	0.8	1.3
Effective U.S. tax rate on total receipts					
FCDC	0.6	1.0	0.8	0.6	0.8
AOC	0.6	2.0	1.1	1.0	1.2
Effective U.S. tax rate on net worth					
FCDC	0.8	1.9	0.9	1.6	2.0
AOC	0.9	4.1	4.4	2.3	3.9
Effective world-wide tax rate on total assets					
FCDC	0.3	1.1	0.7	0.7	0.8
AOC	1.7	3.0	2.2	1.0	1.8
Effective world-wide tax rate on total receipts					
FCDC	0.6	1.5	1.4	0.7	0.9
AOC	2.4	3.2	1.4	1.3	1.6
Effective world-wide tax rate on net worth					
FCDC	0.8	2.9	1.4	1.8	2.2
AOC	3.9	6.3	5.7	2.9	5.1

[a] The effective world-wide tax rate computation assumes that reported foreign tax credits claimed are equal to foreign taxes paid. To the extent firms are in an excess credit position the world-wide effective tax rate may be understated.

Major Groups in the FCDC Wholesale and Retail Trade Sector

Data on FCDC wholesale trade and retail trade groups can be shown separately. Table 15 provides the number of returns filed, total assets, net worth, total receipts, net income, and tax liability for each group.

Wholesale trade. The size of the FCDC wholesale trade group -- as measured by returns, assets, net worth and total receipts -- has grown in each year except 1986. Industry net income and tax liability dropped in 1986, and by 1988 neither had recovered to pre-1986 levels.

Retail trade. Total assets, net worth, and total receipts all increased significantly and continuously throughout the 1984 through 1988 period. The number of returns fluctuated significantly, which may be partially related to sampling variability. Net income and tax liability have also fluctuated. While the trend in net income is difficult to determine, tax liability seems generally to have increased in 1987 and 1988 when compared with earlier years.

TABLE 15

SELECTED INFORMATION ON FCDC MAJOR WHOLESALE AND RETAIL TRADE GROUPS
(Dollar amounts in Billions)

	1984	1985	1986	1987	1988
Wholesale					
Number of returns	11,364	11,592	10,630	12,250	13,257
Total assets	70.2	75.7	82.8	103.5	122.6
Net worth	18.2	18.8	17.6	22.6	25.1
Total receipts	181.7	196.8	190.9	252.2	282.6
Net income	2.5	2.4	1.3	0.7	1.8
U.S. tax liability	1.6	1.5	1.1	1.0	1.1
Retail[a]					
Number of returns	2,826	1,988	2,711	4,214	2,643
Total assets	10.0	12.5	21.1	27.0	40.0
Net worth	2.8	3.2	5.7	6.5	5.7
Total receipts	20.3	30.6	37.1	53.0	64.1
Net income	-0.1	*	*	0.2	-0.1
U.S. tax liability	0.1	0.1	0.1	0.4	0.2

[a] Retail group data have been derived by subtracting wholesale figures from the total for the wholesale and retail industry. This assumes the small "unallocable" trade group should be counted as retail activity.
* Between -$50 million and $50 million.

Comparison of Effective Tax Rates with AOCs

Effective tax rates for 1987 measured on the three different bases -- total assets, net worth, and total receipts -- are shown in Table 16 for the wholesale trade and retail trade groups. These comparisons show that effective tax rates were consistently lower for FCDC wholesalers than for the AOC wholesalers. By contrast, FCDC retailers tended to pay the same or higher effective tax rates as AOC retailers in 1987.

TABLE 16

COMPARISON OF 1987 EFFECTIVE INCOME TAX RATES FOR MAJOR WHOLESALE AND RETAIL TRADE GROUPS USING NET WORTH, TOTAL ASSETS, AND TOTAL RECEIPTS[a]

	Wholesale Trade	Retail Trade[b]
Effective U.S. tax rate on total assets		
FCDC	1.0	1.4
AOC	1.4	1.5
Effective U.S. tax rate on total receipts		
FCDC	0.4	0.7
AOC	0.6	0.7
Effective U.S. tax rate on net worth		
FCDC	4.4	5.9
AOC	5.6	5.1
Effective world-wide tax rate on total assets		
FCDC	1.0	1.4
AOC	1.4	1.5
Effective world-wide tax rate on total receipts		
FCDC	0.4	0.7
AOC	0.6	0.7
Effective world-wide tax rate on net worth		
FCDC	4.4	5.9
AOC	5.7	5.3

[a]The effective world-wide tax rate computation assumes that reported foreign tax credits claimed are equal to foreign taxes paid. To the extent firms are in an excess credit position the world-wide effective tax rate may be understated.
[b]The effective rates for the retail trade group are calculated using the same data calculated for Table 15.

IV. TRENDS IN FCDC TAX LIABILITY

IRS data may be used to analyze trends in FCDC tax liability by focusing on the level of taxes paid and on effective tax rates. FCDCs tax liability declined in 1985 and 1986, and increased significantly in 1987 and 1988 (see Table 6). By comparison, AOC tax liability increased throughout the period, although the gain in 1986 was negligible. Our review of effective tax rates shows that FCDC rates are closer to AOC effective rates when averaged over the 6-year period. However, FCDC rates were generally higher in the earlier part of the period, dipped to a low point in 1986, and moved back up in 1987 and 1988. This section discusses these trends in more detail.

Our 1990 report discussed possible reasons for declines in net income, tax liability, and effective tax rates in 1986. These reasons included: (a) start-up costs resulting from the substantial growth in foreign investment in the U.S., (b) high levels of debt used to acquire existing businesses, and (c) high intercompany charges for goods and services. The report also suggested that shifting exchange rates might provide some explanation for lower 1986 results. These effects will be discussed in more detail; however, access to company-by company tax return data, as used in the Treasury report, is necessary for a more complete understanding.

Much of the data discussed in this section is from tax returns filed for 1987. As previously discussed, a more detailed industry comparison between AOCs and FCDCs requires the elimination of S-corporation data that are only publicly available for 1987 returns.

FCDC tax burdens may be particularly affected by rapid growth. As shown in Table 17, total FCDC assets have increased much more rapidly than AOC assets over the 1986 through 1988 period. FCDC growth rates exceed AOC growth rates in each year in almost all industries. The FCDC finance, insurance, and real estate sector grew the most rapidly at an average annual rate of almost 30 percent.

TABLE 17

COMPARISON OF FCDC AND AOC ASSET GROWTH RATES BY INDUSTRY

	1986	1987	1988	1986-88 Average
All industries				
FCDC	28.2	14.1	25.0	22.4
AOC	9.8	6.4	6.3	7.5
Manufacturing				
FCDC	15.5	25.4	15.3	18.7
AOC	10.3	2.2	7.4	6.6
Wholesale & retail trade				
FCDC	17.9	25.6	24.5	22.7
AOC	4.1	0.4	4.7	3.1
Finance, insurance & real estate				
FCDC	51.1	0.4	37.0	29.5
AOC	12.1	9.7	6.1	9.3
All other industries				
FCDC	7.4	21.3	16.2	15.0
AOC	3.5	2.1	6.4	4.0

Impact of Start-up Costs

Rapid asset growth will likely result in higher start-up costs. These costs can be manifested in several ways. Rapid growth in direct investment could result in high depreciation deductions relative to sales. Growth through acquisitions of existing firms could lead to large amortization deductions where intangible assets are acquired. High levels of debt may be incurred for use in either direct investment or growth through acquisition. Because each industry will have somewhat different mixes of assets and expenses, these attributes are best explored at a more detailed level.

FCDC deductions for depreciation, amortization, and interest are very large relative to net income. In 1987, total FCDC net income was $5.6 billion. Depreciation deductions were $19.6 billion, amortization deductions were $1.9 billion, and interest deductions were $35.6 billion. Relatively small changes in these deductions would have a large impact on net income.

Large depreciation deductions generally do not appear to have caused FCDCs' low ratios of net income to total receipts. Table 18 shows FCDC depreciation deductions as a percentage of total receipts are 18.5 percent below the deductions of AOCs. The most noticeable difference is that FCDC finance, insurance, and real estate firms have depreciation deductions more than 200 percent greater than AOC firms. This may be the result of a different industry mix between FCDCs and AOCs within this industrial sector.

TABLE 18

1987 DEPRECIATION DEDUCTIONS AS A PERCENTAGE OF TOTAL RECEIPTS

	FCDC	AOC	FCDC -AOC	Percent Difference
All Industries	2.85%	3.50%	-0.65%	-18.5%
Manufacturing	4.08	3.94	0.14	3.6
Petroleum	6.54	4.17	2.37	57.0
Chemicals	4.00	3.74	0.26	7.1
Food products	2.42	2.71	-0.30	-11.0
Electrical equipment	3.61	5.03	-1.42	-28.2
Other manufacturing	3.37	3.99	-0.62	-15.5
Wholesale & retail trade	1.13	1.51	-0.38	-25.4
Wholesale trade	0.99	1.11	-0.12	-11.0
Retail trade[a]	1.78	1.84	-0.06	-3.3
Finance, insurance & real estate	4.06	0.02	4.04	208.8
All other industries	5.16	6.38	-1.22	-19.2

[a] Retail figures are derived by subtracting wholesale trade from wholesale and retail trade combined.

The differences between FCDC and AOC amortization deductions are greater in percentage terms; however, because these deductions are a small fraction of total receipts they are unlikely to have a large impact on net income. FCDC deductions are 58.5 percent higher than AOC deductions. The largest differences are in the chemicals; other manufacturing; retail trade; and finance, insurance, and real estate categories.

TABLE 19

1987 AMORTIZATION DEDUCTIONS
AS A PERCENTAGE OF TOTAL RECEIPTS

	FCDC	AOC	FCDC -AOC	Percent Difference
All Industries	0.28%	0.18%	0.10%	58.5%
Manufacturing	0.39	0.18	0.21	116.3
Petroleum	0.20	0.20	-0.00	-1.5
Chemicals	0.51	0.18	0.33	177.7
Food	0.39	0.22	0.17	79.6
Electrical equipment	0.24	0.18	0.07	36.4
Other manufacturing	0.47	0.17	0.30	175.6
Wholesale & retail trade	0.08	0.08	-0.00	-0.8
Wholesale trade	0.06	0.05	0.01	9.5
Retail trade	0.17	0.10	0.16	160.0
Finance, insurance & real estate	0.57	0.00	0.57	273.7
All other industries	0.59	0.27	0.32	122.3

High Level of Net Interest Expense

Table 20 shows net interest expense (total interest expense less total interest income) as a percentage of total receipts for 1987. FCDCs have positive net interest expense, while AOCs have negative net interest expense. Overall, 1987 FCDC net interest payments are 2.4 percentage points higher than AOC payments. The greatest different is in the finance, insurance, and real estate sector where AOC net interest expense as a percent of total receipts is close to zero, but FCDC net interest is a negative 6.21 percent. Negative net interest expense for all AOCs is largely the result of financial institutions earning net interest income from making loans to customers.

High interest payments resulting from debt issued to finance acquisitions may substantially reduce FCDC net income. Because interest expense on debt used to finance acquisitions cannot be separated from debt used for other purposes, it is not possible to determine the cause of high FCDC net interest expense.

It is possible that some of this interest expense may be related to earnings stripping activity. To the extent some corporations did distribute income to foreign parents or affiliates as deductible interest expense rather than as taxable dividends this practice was essentially disallowed in the Omnibus Budget Reconciliation Act of 1989. It is, however, unlikely that earnings stripping activity accounted for a large share of total FCDC interest expense.

Because FCDC net interest expense as a share of total receipts is 2.4 percentage points higher than AOC net interest expense, it may have a large impact on FCDC net income. If, for example, FCDC interest deductions were reduced by 2.4 percent of total receipts to make them comparable to AOC interest deductions, FCDC net income would increase by $16.5 billion.

TABLE 20

1987 NET INTEREST EXPENSE AS A PERCENTAGE OF TOTAL RECEIPTS

	FCDC	AOC	FCDC -AOC	Percent Difference
All Industries	1.07%	-1.33%	2.40%	-180.4%
Manufacturing	2.58	1.60	0.97	60.6
Petroleum	3.05	1.76	1.29	73.6
Chemicals	2.97	1.41	1.56	111.2
Food	3.30	1.56	1.74	111.6
Electrical equipment	1.11	2.47	-1.36	-55.0
Other manufacturing	2.34	1.49	0.85	57.5
Wholesale & retail trade	0.96	0.78	0.18	23.6
Wholesale trade	0.83	0.57	0.26	46.0
Retail trade	1.58	0.95	0.63	66.3
Finance, insurance & real estate	-6.21	-14.29	8.08	-56.5
All other industries	2.49	2.75	-0.26	-9.5

The combined effect of differences between FCDCs and AOCs for these three categories of deductions could potentially increase FCDC net income by $12.7 billion (-$4.5 billion from depreciation, +$0.7 billion from amortization, and +$16.5 billion from interest). While we are not able to specifically relate these expenses to the higher rate of asset growth of FCDCs, this

effect may offer one explanation for the relatively low amounts of net income reported by FCDCs.

If lower levels of FCDC net income are attributable to start-up expenses and we allow for the higher FCDC growth rate by adjusting these expenses, we find FCDC relative net income is similar to AOC net income. That is, by increasing FCDC net income from $5.6 billion to $18.3 billion -- by this $12.7 billion adjustment, FCDC net income in 1987 would be 1.9 percent of total assets, which is quite close to the 2.1 percent figure for AOCs.

Intercompany Charges for Goods and Services

A third possible reason for the lower net income and tax liability of FCDCs is that FCDCs may have paid higher prices for goods bought from foreign parents and affiliates, thereby reducing FCDC profitability and tax liability. A detailed analysis of this question is beyond the scope of available IRS data. However, if such higher prices were paid, they should appear in the "Cost of Sales and Operations" deduction, and FCDC gross profit margins[15] should be smaller than AOC profit margins.

As shown in Table 21, FCDC costs of sales were generally higher than AOC costs of sales, as a fraction of total receipts. At the industrial sector level, however, this pattern varies.

Manufacturing. From 1983 to 1985, costs of sales as a share of receipts were lower for FCDCs than for AOCs, but the differences were small. In 1986, this relationship reversed, but again, the difference was small. In 1987, FCDC and AOC costs of sales shares were virtually identical, and in 1988 FCDCs were again larger. Over the entire period there was virtually no difference between FCDCs and AOCs.

Wholesale and retail trade. FCDC costs of sales as a share of receipts is consistently about 10 percentage points higher than AOC costs of sales.

Finance, insurance, and real estate. The FCDC ratio is consistently above the AOC ratio over the period; however, the difference is gradually narrowing. The gap was .145 in 1983, but only .066 in 1988. FCDC and AOC firms within this industry tend to differ widely. For example, a large share of foreign-owned banks are organized as branches which are not included in these data. This different industry mix could significantly affect the cost of sales / total receipts ratio.

Table 22 provides additional industry detail for the manufacturing and trade sectors. The relationships for the total and the major industrial sectors are slightly different from those in

[15] Gross profit is the excess of business receipts over the cost of sales and operations. The gross profit margin is simply gross profit per dollar of receipts.

Table 21 because the Table 22 amounts use cost of sales divided by business receipts rather than by total receipts.

- Of the major FCDC manufacturing groups in 1987, only the chemical industry had a cost of sales / business receipts ratio below the corresponding AOC ratio. With the exception of the electrical equipment industry the differences for each industry were relatively small.

- The difference between FCDC and AOC cost of sales / business receipts ratios for retail trade is small. Wholesale trade, however, shows somewhat larger differences with the FCDC ratio 6.5 percentage points above the AOC ratio.

These comparisons do not demonstrate that FCDCs pay excessive prices for their intercompany purchases -- especially in the wholesale trade sector -- but they do leave the question of transfer pricing open for further investigation. IRS statistical data, however, cannot resolve this issue. Intercompany pricing issues can only be fairly addressed through a careful examination of specific company data. Direct comparisons of foreign-owned firms with other companies that are truly comparable are needed to resolve transfer-pricing controversies.

There may be a number of reasons why FCDCs have higher ratios of costs of sales to receipts. For example, FCDCs in the wholesale trade group may typically be little more than U.S. sales offices for their parents, with relatively few employees, assets, and other expenses. AOC wholesalers, on the other hand, are more likely to be independent businesses.

This distinction is, in part, the result of the way in which industries are identified. The industry code is assigned to the activity that generates the largest amount of receipts within the consolidated group. Wholesale trade AOC tax returns are filed by companies where wholesale trade is the dominant activity of the consolidated group, while FCDC wholesalers may be wholly-owned subsidiaries of foreign manufacturing parents. Because FCDCs are not consolidated with the foreign parent's tax return, only the wholesaling activity is identified on the U.S. tax return. In contrast, wholesaling activities included in the consolidated tax return of U.S. manufacturers are included in the manufacturing sector data. To the extent substantive differences in the nature of the business activity are responsible for different relationships between the cost of sales and receipts, FCDC wholesalers could have adequate operating profit even if their gross profit margins are low.

TABLE 21

COMPARISON OF FCDC AND AOC COSTS OF SALES AS A SHARE OF TOTAL RECEIPTS BY MAJOR INDUSTRY

	1983	1984	1985	1986	1987	1988	Average
Total							
FCDC	.696	.699	.696	.683	.701	.693	.695
AOC	.597	.587	.571	.556	.563	.553	.571
Manufacturing							
FCDC	.627	.620	.627	.644	.649	.657	.637
AOC	.659	.650	.635	.618	.645	.624	.639
Wholesale & retail trade							
FCDC	.860	.850	.848	.830	.839	.832	.843
AOC	.761	.753	.745	.735	.735	.731	.743
Finance, insurance & real estate							
FCDC	.331	.381	.283	.337	.366	.350	.341
AOC	.186	.200	.198	.231	.291	.284	.232
All other							
FCDC	.590	.607	.611	.570	.563	.547	.581
AOC	.532	.525	.514	.489	.475	.480	.503

TABLE 22

1987 COSTS OF SALES AND OPERATIONS
AS A PERCENT OF BUSINESS RECEIPTS
BY MAJOR INDUSTRAIL SECTOR AND GROUP

	FCDC	AOC
All Industries	76.1	65.3
Manufacturing	69.4	68.9
Petroleum	74.5	73.7
Chemicals	57.2	60.8
Food	71.3	70.0
Electrical equipment	70.8	64.4
All other manufacturing	72.3	69.6
Wholesale & retail trade	85.8	75.8
Wholesale trade	88.7	82.2
Retail trade	71.7	70.7
Finance, insurance & real estate	63.0	58.0
All other industries	61.3	50.8

Impact of Exchange Rates

The volatility of exchange rates appears to affect the cost of sales comparison between FCDCs and AOCs. When FCDCs purchase goods with foreign currencies, their cost of sales will rise when the dollar falls in value, and will decrease when the dollar rises in value. A firm's net income or loss will depend upon the extent and the speed with which cost increases can be passed on to the ultimate customer.

In 1986 the value of the dollar fell dramatically relative to other major currencies. The average annual value of the dollar relative to the Yen, fell by 29 percent; it fell by 26 percent relative to the German Mark; and by 12 percent relative to the U.K. Pound. On a trade-weighted basis the value of the dollar fell by 22 percent in 1986.[16] A further significant decline occurred in 1987, when the trade-weighted value of the dollar fell nearly 14 percent.

[16] Economic Report of the President, 1992, p. 420.

The magnitude of these reductions in the value of the dollar likely prevented some firms from fully passing their higher costs through to customers. As a result, cost of sales as a fraction of total receipts may have increased, and gross profit per dollar of receipts may have declined, driving down FCDC net income and tax liability. While exchange rates do fluctuate over time, the change that occurred in 1986 was particularly large.[17]

In reviewing available IRS data, there appears to be a relationship between the trade-weighted value of the dollar and FCDCs' performance, although the relationship does vary both by year and by industry.[18]

The relationship between exchange rates and profitability is measured by comparing gross profit margins with the trade-weighted value of the dollar. The gross profit margin equals the excess of total receipts over the cost of sales, divided by total receipts. This measure excludes the effects of interest, depreciation, and all the other costs of operating the business. To the extent FCDCs purchase a substantial part of what they sell from foreign sources, the gross profit margin should reflect the impact of exchange rates on profitability.

Exchange rates are measured using the trade-weighted value of the dollar. The value of the dollar is measured against major foreign currencies and then weighted by the volume of trade between the U.S. and these countries. The Board of Governors of the Federal Reserve System prepares these data and converts them into an index with a base year of 1973.

Figure 9 shows a comparison of the gross profit margin for the FCDC manufacturing sector with the exchange rate index over the 1983 through 1988 period. The relationship appears to be quite strong with annual changes in the gross profit margin closely tracking the change in the value of the dollar. This result may explain a significant share of the decline in net income and tax liability reported by the FCDC manufacturing sector in 1986.

The relationship between profitability and exchange rates is not as strong in the FCDC finance, insurance, and real estate sector. As shown in Figure 10, over the 6-year period, the relationship diverged in 1984 and 1988. Nevertheless, it is clear that gross profit margins generally tend to track exchange rates over the period. This relationship may have contributed the low net income reported in 1986 and 1987, although it does not explain the increase in net income reported in 1988.

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[17] The following series shows the annual percentage change in the average trade-weighted value of the dollar over the 1983 through 1991 period:

	1983	1984	1985	1986	1987	1988	1989	1990	1991
Percent change	7.5	10.3	3.5	-21.5	-13.6	-4.3	6.4	-9.6	0.8

[18] The strongest relationship appears when a 2-year moving average of the trade-weighted exchange rate is calculated, and then lagged one year.

Figure 9:
Relationship between Gross Margin and Exchange Rates: FCDC Manufacturing

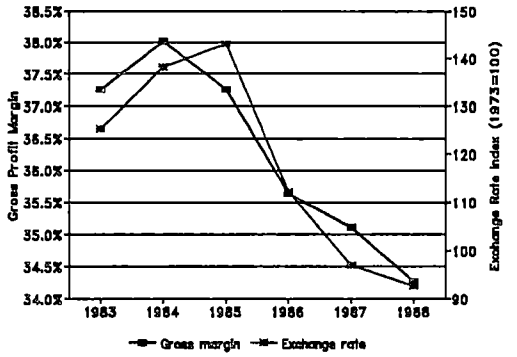
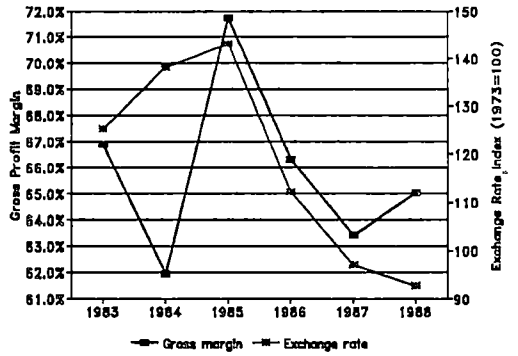
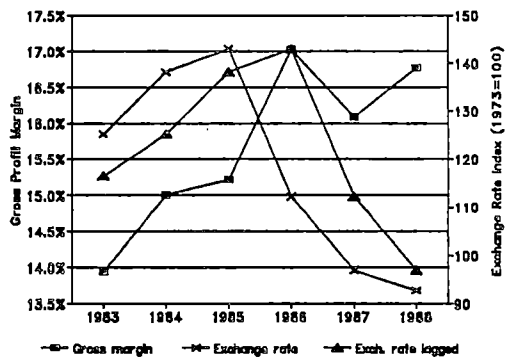


Figure 10:
Relationship between Gross Margin and Exchange Rates: FCDC Finance



Profitability in the FCDC wholesale and retail trade sector shows a weaker relationship with exchange rates. There is a general similarity between the trend in gross profit margins and exchange rates, but it is neither as clear or as consistent as in other sectors. This is somewhat surprising because wholesale and retail trade is the FCDC sector most likely to be affected by changes in the exchange rate with many of these firms importing goods for resale. Of the three sectors, trade has the highest proportion of imports to costs of sales, making costs of sales more sensitive to exchange rate movements.

Figure 11:
Relationship between Gross Margin and Exchange Rates: Trade



As shown in Figure 11, the relationship is somewhat stronger if a 1-year lag is used. It appears to take a year, on average, for exchange rate shifts to have the anticipated effects on the trade sector's cost of sales. Such a lag is appropriate to the extent the trade sector tends to use longer-term contracts that lock in prices when arranging purchases from foreign suppliers.

This means the severe depreciation of the dollar in 1986 did not adversely affect wholesale and retail trade gross profit margins until 1987. Even though there may be a general relationship between exchange rates and gross profit margins in the trade sector, this relationship does not explain why the FCDC wholesale and retail trade sector had lower net income and paid less tax in 1986.

Overall, it is clear that exchange rates do affect FCDC gross profit margins -- although to differing degrees in different industries. Other costs of operating the business also impact the net income of FCDCs, but exchange rates provide a partial explanation for significant year-to-year fluctuations in profitability and tax liability.

V. CONCLUSIONS

The most recent Internal Revenue Service data on taxes paid by FCDCs raise a number of complex issues that cannot be fully resolved by these data. Certain measures show FCDCs to be paying a reasonable amount of federal income tax, while other measures indicate that some FCDCs may be paying less than their "fair share" of taxes. FCDC effective tax rates tend to be roughly comparable to AOC effective rates when averaged over the last 6 years, yet most measures based of pretax profitability show surprisingly low rates of return.

Some concepts have the potential to be misleading. For example, comparing FCDC and AOC pretax rates of return without recognizing differences in the mix of industries and in the means of financing investments are not likely to be accurate and may be misinformative. To recognize these limitations we have explored alternative concepts, such as measures of the pretax return to both lenders and equityholders, that show more similar pretax returns. We have also focused on comparisons within industries.

Even when using measures that are conceptually more accurate, we still find that pretax returns are somewhat lower for FCDCs than AOCs. Average effective tax rates over the period studied, depending on the tax base chosen, range from being essentially the same as AOC effective rates, to somewhat below AOC rates. In exploring the reasons for these results we have identified a number of possible explanations, including those related to the rapid growth in FCDC investment in the U.S., intercompany transfer pricing, and the impact of foreign exchange rates.

IRS statistical data are very useful in gaining an understanding of relative tax burdens; however, they cannot fully answer the more fundamental policy questions. These issues require a more complete understanding the structural differences between FCDCs and AOCs. These structural differences lessen the comparability of the data and complicate the analysis. For example, FCDC wholesale trade subsidiaries often perform materially different functions from AOC wholesale trade companies. Because income tax returns do not include any detailed description of the functions or activities a company performs, IRS statistical data cannot be assumed to provide information on the comparability of different companies, even within the same industry.

In conclusion, we find analyses of pretax returns and effective tax rates are useful in developing a perspective on relative profitability and tax burdens; however, these data should be only one element of the policy analysis. A more complete picture of these issues requires more accurate measures of the true comparability of the firms being analyzed.

MYTHS ABOUT THE TAXES PAID BY FOREIGN-OWNED COMPANIES

Myth #1: Foreign-owned companies are not paying their fair share of taxes.

FACT: ***According to IRS Statistics of Income (SOI), foreign-owned companies paid federal income taxes at essentially the same rates as domestically-owned companies.***

The most recent IRS data for the period 1983-1988 reveal that the average effective tax rate as a percentage of net worth for foreign owned companies was 2.1 percent. The average, effective tax rate for domestically-owned companies for the same period was 2.2 percent. These percentages are calculated by dividing the total federal income taxes paid by each group by the net worth of all the companies in the group (including those companies which did not pay any taxes because they had no income for the year). The year by year effective tax rates on net worth are as follows:

YEAR-BY-YEAR COMPARISONS FOR EFFECTIVE TAX RATES BASED UPON NET WORTH		
Year	**Foreign-owned Companies**	**All Other U.S. Companies**
1988	2.0 percent	2.4 percent
1987	1.8 percent	2.5 percent
1986	1.4 percent	2.1 percent
1985	2.0 percent	1.9 percent
1984	2.9 percent	2.2 percent
1983	2.5 percent	2.0 percent

Comparing effective tax rates using total assets instead of net worth over the same time period reveals that the foreign-owned and domestically owned companies paid identical effective tax rates of 0.6 percent. Calculating an effective tax rate based upon total receipts (i.e., total taxes paid divided by total receipts), foreign-owned corporations paid a slightly lower average rate of 0.7 percent, while other U.S. corporations paid an average effective tax rate of 0.9 percent. Comparing effective tax rates based upon assets or total receipts is less accurate because such comparisons do not take into consideration the differences in the level of debt of the companies. Tax rates based upon net worth are considered a more accurate comparison.

Myth #2: In 1986, foreign-owned companies doing business in the U.S. were entitled to a tax refund (i.e., a "negative tax liability") of $1 billion.

FACT: ***Foreign-owned companies had net losses of $1.5 billion in 1986 but paid, nevertheless, $3 billion in federal income taxes.*** Even though many foreign-owned companies lost money in 1986, there were enough foreign-owned companies with income to pay $3 billion in taxes. The most recent available IRS Statistics of Income (SOI) data show that foreign-owned companies have paid the following aggregate amounts of federal income tax for each of the years listed.

AGGREGATE FEDERAL INCOME TAX LIABILITY
OF FOREIGN-OWNED COMPANIES

1988 - $5.8 billion

1987 - $4.6 billion

1986 - $3.0 billion

1985 - $3.6 billion

1984 - $4.5 billion

1983 - $1.8 billion

The 1986 net loss figure has been misstated consistently in the press and in some political speeches as a "negative tax liability" or refund of moneys from the U.S.

government. As can be seen from the following table of SOI data listing the total income of foreign-owned companies, 1986 was the only year in recent IRS statistics in which the foreign-owned companies as a group incurred a net loss.

AGGREGATE NET INCOME
OF FOREIGN-OWNED COMPANIES

1988 - $11.2 billion

1987 - $5.6 billion

1986 - ($1.5 billion)

1985 - $3.0 billion

1984 - $4.5 billion

1983 - $1.8 billion

Myth #3: Foreign-owned companies are avoiding paying taxes by using a "scheme" called "transfer pricing" to reduce their income in the U.S.

FACT: ***Transfer pricing is not a tax avoidance "scheme" or device. The term "transfer pricing" refers to the price for a product, service, or intangible that a corporation charges to an affiliated corporation. All multinational companies, domestic and foreign, must establish transfer prices for international transactions.***

Income tax rates of major industrial nations are similar or, in many cases, higher than U.S. income tax rates. Income of a multinational enterprise that is not reported in one nation must be reported in another. Transfer pricing determines the portion of income arising from an international transaction that is taxed by each nation involved in the transaction. Unless one of the concerned jurisdictions is a "tax haven," i.e., one with markedly lower tax rates, there is little advantage to shifting income artificially from one jurisdiction to another. It should be noted, for example, that both Japan and Germany have higher corporate income tax rates than the U.S.

Since members of a multinational group are located in different nations, the tax authorities of each nation concerned are extremely anxious to ensure that the

transfer price is "arm's length" -- that is, the same price at which the seller would have sold the same product to an unrelated buyer.

If, for example, a U.S.-owned company manufactures computers in the U.S. and sells them to its foreign subsidiary to market abroad, both the parent and its subsidiary may recognize some portion of the total profit from the final sale to consumers. The portion that is reportable in each country is determined by the "transfer price" between parent and subsidiary. If that price is high, the subsidiary has less profit, but the parent has more. If the price is low, the parent has less profit but the subsidiary has more. The total income from the computer sales will be taxed, but the split between U.S. and the foreign country may depend on the transfer price. All tax authorities have the power to challenge transfer prices and regularly do so, frequently disagreeing with one another as to the correct income split. These disagreements must be resolved among the taxing authorities themselves in proceedings referred to as "competent authority".

Myth #4: Additional laws are needed to enforce transfer pricing regulations and prevent abuse.

Fact: ***In 1989 and 1990, Congress passed legislation to foster compliance with transfer pricing rules.*** New reporting and record-keeping legislation was enacted, providing much additional information from foreign-owned companies and imposing penalties on companies that fail to comply. Enforcement tools given to the IRS include a designated summons procedure (for those companies that refuse to provide requested information in the hope that the statute of limitations will expire) and expedited availability of outside experts.

In April 1992 testimony before a House Ways & Means Subcommittee, IRS Commissioner Shirley Peterson stated that "... the legislation [passed in 1989 and 1990] is responsive to the problems identified in 1990 and is increasing compliance..." At the same hearing, Alan J. Wilensky, Deputy Assistant Secretary (Tax Policy) of the U.S. Treasury Department, "... urg[ed] that these new measures be given adequate time to work before introduction of major new initiatives ...."

Myth #5: Foreign-owned companies manipulate transfer prices to report lower U.S. taxable income than domestically-owned companies.

FACT: ***While foreign-owned companies have generally earned lower rates of return on their assets, sales, and net worth than domestically-owned companies, the disparity does not result from transfer pricing abuse.***

Both the IRS Commissioner and the Deputy Assistant Secretary of the Treasury recently explained the difference in levels of profitability for foreign-owned firms in testimony before the Oversight Subcommittee of the House Committee on Ways and Means on April 9, 1992. According to their testimony, "as much as 50 percent of the differential" in profitability between foreign-owned and domestically-owned companies is explained by nontax factors such as start up costs or currency fluctuations. Over the period 1985-1988, foreign investment in the U.S. increased three times faster than domestic investment. This high growth rate, coupled with historic cost accounting methods used throughout the U.S., distorted comparisons between the two groups. Older investments show a higher rate of return than new ones which are valued at closer to current market value. In addition, start-up losses of the new investments decreased the actual rates of return.

The IRS Commissioner went on to state that there is "no certainty that the remainder (of the difference in rates of return) is due to transfer pricing abuse or that the comparison of measures of profitability is valid in this aggregate form."

Myth #6: There is $30 billion in taxes going uncollected annually from foreign-owned companies who are inflating their transfer prices and reporting too little profit in the U.S.

FACT: ***This is a total fabrication that has no foundation in fact and is not supported by the U.S. Treasury.***

The IRS Commissioner specifically discussed this $30 billion myth in her testimony on April 9, 1992 and stated unequivocally that such an estimate could not be substantiated. She further stated that if the unexplained differential in the profitability of foreign-owned companies, described above, were due wholly to transfer pricing abuse (and she specifically states that there is no certainty that this is the case) the "tax gap" would be "about $3 billion," not $30 billion. The Commissioner went on to state that although transfer pricing problems do exist,

they are not presently quantifiable and the problems exist equally for foreign-owned and U.S.-based multinational companies.

Myth #7: Foreign-owned companies which sell large amounts of popular products, such as automobiles and electronics, should pay more taxes.

FACT: ***All U.S. corporations pay taxes based upon their net taxable income, i.e., their profits. A company that has large sales and many assets is not automatically profitable.*** An example is the "Big Three" U.S. automobile companies which apparently have not reported taxable profits for years. It is entirely wrong to assume that any company, foreign or domestic, should pay income taxes based upon a percentage of its sales or assets irrespective of profits. This concept is that of a "wealth tax" practiced in only a few countries, notably India, which have a small gross national product in comparison to government expenditures. It is not a formula that will promote prosperity. The $30 billion myth discussed above is the result of assumptions that foreign-owned companies should be reporting income based upon a certain percentage of their assets or receipts. In testimony before a House Ways & Means Subcommittee, IRS Commissioner Peterson noted that 59 percent of U.S.-owned companies report no taxable income.