# The Economics of Transfer Pricing

Edited by

### Lorraine Eden

Professor of Management and Gina and Anthony Bahr Professor in Business Texas A&M University, College Station, Texas, USA

THE INTERNATIONAL LIBRARY OF CRITICAL WRITINGS IN ECONOMICS

An Elgar Research Collection

Cheltenham, UK • Northampton, MA, USA

© Lorraine Eden 2019. For copyright of individual articles, please refer to the Acknowledgements.

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system, or transmitted in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise without the prior permission of the publisher.

Published by Edward Elgar Publishing Limited The Lypiatts 15 Lansdown Road Cheltenham Glos GL50 2JA UK

Edward Elgar Publishing, Inc. William Pratt House 9 Dewey Court Northampton Massachusetts 01060 USA

A catalogue record for this book is available from the British Library

Library of Congress Control Number: 2018960948



ISBN 978 1 84064 832 4 Printed and bound in Great Britain by TJ International Ltd, Padstow

## Contents

Acknowledge Introduction	: Th	ne economics of transfer pricing: looking back, thinking forward	х
	Lo	orraine Eden	xiv
PART I	THE	EARLY WORK: DIVISIONALIZED TRANSFER PRICING	
	1.	Paul W. Cook, Jr. (1955), 'Decentralization and the Transfer-Price Problem', Journal of Business, XXVIII (2), April, 87–94	2
	2.	Jack Hirshleifer (1956), 'On the Economics of Transfer Pricing', Journal of Business, <b>29</b> (3), July, 172–84	10
	3.	Jack Hirshleifer (1957), 'Economics of the Divisionalized Firm', Journal of Business, <b>30</b> (2), April, 96–108	23
	4.	J.R. Gould (1964), 'Internal Pricing in Firms When There Are Costs of Using an Outside Market', <i>Journal of Business</i> , <b>37</b> (1), January,	20
		61–7	36
PART II	GOV	<b>VERNMENTS AND TRANSFER PRICING</b>	
	Α	Government Regulation	
	5.	Thomas Horst (1971), 'The Theory of the Multinational Firm:	
		Optimal Behavior under Different Tariff and Tax Rates', <i>Journal of</i> <i>Political Economy</i> , <b>79</b> (5), September–October, 1059–72	44
	6.	L.W. Copithorne (1971), 'International Corporate Transfer Prices and Government Policy', <i>Canadian Journal of Economics</i> , <b>IV</b> (3),	
	7.	August, 324–41 E.J.R. Booth and Oscar W. Jensen (1977), 'Transfer Prices in the Global Corporation under Internal and External Constraints',	58
	8.	Canadian Journal of Economics, X (3), August, 434–46 Lorraine A.B. Eden (1978), 'Vertically Integrated Multinationals: A	76
		Microeconomic Analysis', Canadian Journal of Economics, XI (3), August, 534–46	89
	9.	Takao Itagaki (1979), 'Theory of the Multinational Firm: An Analysis of Effects of Government Policies', <i>International</i>	
	10	Economic Review, 20 (2), June, 437-48	102
	10.	Eric W. Bond (1980), 'Optimal Transfer Pricing when Tax Rates Differ', Southern Economic Journal, 47 (1), July, 191–200	114

11.	Homi Katrak (1981), 'Multi-National Firms' Exports and Host Country Commercial Policy', <i>Economic Journal</i> , <b>91</b> (362), June,	
12.	454–65 Larry Samuelson (1982), 'The Multinational Firm with Arm's Length Transfer Price Limits', <i>Journal of International Economics</i> ,	124
13.	13 (3–4), November, 365–74 Lorraine Eden (1983), 'Transfer Pricing Policies under Tariff	136
	Barriers', Canadian Journal of Economics, XVI (4), November, 669–85	146
14.	W. Erwin Diewert (1985), 'Transfer Pricing and Economic Efficiency', in Alan M. Rugman and Lorraine Eden (eds),	
15.	Multinationals and Transfer Pricing, Chapter 3, London, UK and New York, NY, USA: St. Martin's Press, 47–81, references Lorraine Eden (1985), 'The Microeconomics of Transfer Pricing', in Alan M. Rugman and Lorraine Eden (eds), Multinationals and	163
16.	<i>Transfer Pricing</i> , Chapter 2, London, UK and New York, NY, USA: St. Martin's Press, 13–46, references Chander Kant (1988), 'Endogenous Transfer Pricing and the Effects	200
	of Uncertain Regulation', <i>Journal of International Economics</i> , <b>24</b> (1–2), February, 147–57	236
17.	Chander Kant (1990), 'Multinational Firms and Government Revenues', <i>Journal of Public Economics</i> , <b>42</b> , July, 135–47	247
18.	Lorraine Eden (1998), 'Taxing Multinationals in Theory', in Lorraine Eden (ed.), <i>Taxing Multinationals: Transfer Pricing and</i> <i>Corporate Income Taxation in North America</i> , Toronto: University	
19.	of Toronto Press, 279–319, notes, references Guttorm Schjelderup and Alfons J. Weichenrieder (1999), 'Trade,	260
20.	Multinationals, and Transfer Pricing Regulations', <i>Canadian</i> Journal of Economics, <b>32</b> (3), May, 817–34 Christian Keuschnigg and Michael P. Devereux (2013), 'The Arm's	307
20.	Length Principle and Distortions to Multinational Firm Organization', <i>Journal of International Economics</i> , <b>89</b> , 432–40	325
В	Bargaining Models	
21.	Jan Svejnar and Stephen C. Smith (1984), 'The Economics of Joint	
22.	Ventures in Less Developed Countries', <i>Quarterly Journal of</i> <i>Economics</i> , <b>99</b> (1), February, 149–67 Thomas J. Prusa (1990), 'An Incentive Compatible Approach to the	335
22.	Transfer Pricing Problem', <i>Journal of International Economics</i> , <b>28</b> (1–2), February, 155–72	354
23.	Thomas A. Gresik and Douglas R. Nelson (1994), 'Incentive Compatible Regulation of a Foreign-Owned Subsidiary', <i>Journal of</i>	
	International Economics, 36 (3-4), May, 309-31	372

24.	Ramy Elitzur and Jack Mintz (1996), 'Transfer Pricing Rules and Corporate Tax Competition', <i>Journal of Public Economics</i> , <b>60</b> , 401–22	395
25.	Andreas Haufler and Guttorm Schjelderup (2000), 'Corporate Tax Systems and Cross Country Profit Shifting', <i>Oxford Economic</i>	
	Papers, <b>52</b> (2), April, 306–25	417
26.	Pascalis Raimondos-Møller and Kimberley Scharf (2002), 'Transfer Pricing Rules and Competing Governments', <i>Oxford Economic</i>	
	Papers, 54 (2), April, 230–46	437
27.	Hans Jarle Kind, Karen Helene Midelfart and Guttorm Schjelderup (2005), 'Corporate Tax Systems, Multinational Enterprises, and	
	Economic Integration', Journal of International Economics, 65 (2), March, 507–21	454
28.	Susana Peralta, Xavier Wauthy and Tanguy van Ypersele (2006), 'Should Countries Control International Profit Shifting?', Journal	
	of International Economics, 68 (1), January, 24-37	469

### PART III MARKETS AND TRANSFER PRICING

#### **A** Market Distortions

29.	Raveendra N. Batra and Josef Hadar (1979), 'Theory of the	
	Multinational Firm: Fixed versus Floating Exchange Rates', Oxford	
	Economic Papers, 31 (2), July, 258–69	484
30.	Takao Itagaki (1981), 'The Theory of the Multinational Firm under	
	Exchange Rate Uncertainty', Canadian Journal of Economics,	
	<b>XIV</b> (2), May, 276–97	496
31.	Guttorm Schjelderup and Lars Sørgard (1997), 'Transfer Pricing as	
	a Strategic Device for Decentralized Multinationals', International	
	Tax and Public Finance, 4 (3), July, 277–90	518
32.	Laixun Zhao (2000), 'Decentralization and Transfer Pricing under	
	Oligopoly', Southern Economic Journal, 67 (2), October, 414-26	532
В	Product Characteristics: Intangibles and Non-Renewable	
В	Product Characteristics: Intangibles and Non-Renewable Resources	
	Resources	
<b>B</b> 33.	Resources George F. Kopits (1976), 'Intra-Firm Royalties Crossing Frontiers	
	Resources George F. Kopits (1976), 'Intra-Firm Royalties Crossing Frontiers and Transfer-Pricing Behaviour', <i>Economic Journal</i> , <b>86</b> (344),	
	Resources George F. Kopits (1976), 'Intra-Firm Royalties Crossing Frontiers and Transfer-Pricing Behaviour', <i>Economic Journal</i> , <b>86</b> (344), December, 791–805	546
	Resources George F. Kopits (1976), 'Intra-Firm Royalties Crossing Frontiers and Transfer-Pricing Behaviour', <i>Economic Journal</i> , <b>86</b> (344), December, 791–805 Larry Samuelson (1985), 'Transfer Pricing in Exhaustible Resource	546
33.	Resources George F. Kopits (1976), 'Intra-Firm Royalties Crossing Frontiers and Transfer-Pricing Behaviour', <i>Economic Journal</i> , <b>86</b> (344), December, 791–805 Larry Samuelson (1985), 'Transfer Pricing in Exhaustible Resource Markets', in Alan M. Rugman and Lorraine Eden (eds),	546
33.	Resources George F. Kopits (1976), 'Intra-Firm Royalties Crossing Frontiers and Transfer-Pricing Behaviour', <i>Economic Journal</i> , <b>86</b> (344), December, 791–805 Larry Samuelson (1985), 'Transfer Pricing in Exhaustible Resource	546
33.	Resources George F. Kopits (1976), 'Intra-Firm Royalties Crossing Frontiers and Transfer-Pricing Behaviour', <i>Economic Journal</i> , <b>86</b> (344), December, 791–805 Larry Samuelson (1985), 'Transfer Pricing in Exhaustible Resource Markets', in Alan M. Rugman and Lorraine Eden (eds),	546

	35. 36.	Harry Grubert (2003), 'Intangible Income, Intercompany Transactions, Income Shifting, and the Choice of Location', <i>National Tax Journal</i> , <b>LVI</b> (1), Part 2, March, 221–42 Matthias Dischinger and Nadine Riedel (2011), 'Corporate Taxes and the Location of Intangible Assets within Multinational Firms', <i>Journal of Public Economics</i> , <b>95</b> (7–8), August, 691–707	581 603		
PART IV		EMPIRICAL ESTIMATES OF TRANSFER PRICE MANIPULATION			
	Α	Income Shifting Estimates			
	37.	Marion B. Stewart (1986), 'U.S. Tax Policy, Intrafirm Transfers, and the Allocative Efficiency of Transnational Corporations',			
	38.	Public Finance/Finances Publiques, XXXXI, 350–71 Harry Grubert and John Mutti (1991), 'Taxes, Tariffs and Transfer Pricing in Multinational Corporate Decision Making', <i>Review of</i>	621		
	39.	<i>Economics and Statistics</i> , <b>73</b> (2), May, 285–93 John Jacob (1996), 'Taxes and Transfer Pricing: Income Shifting and the Volume of Intrafirm Transfers', <i>Journal of Accounting</i>	643		
	40.	Research, <b>34</b> (2), Autumn, 301–12 Eric J. Bartelsman and Roel M.W.J. Beetsma (2003), 'Why Pay More? Corporate Tax Avoidance Through Transfer Pricing in OECD Countries', <i>Journal of Public Economics</i> , <b>87</b> (9–10),	652		
	41.	September, 2225–52 Lorraine Eden, Luis F. Juarez Valdez and Dan Li (2005), 'Talk Softly but Carry a Big Stick: Transfer Pricing Penalties and the Market Valuation of Japanese Multinationals in the United States',	664		
	42.	Journal of International Business Studies, <b>36</b> , 398–414 Céline Azémar and Gregory Corcos (2009), 'Multinational Firms' Heterogeneity in Tax Responsiveness: The Role of Transfer Pricing', World Economy, <b>32</b> , 1291–318	692 709		
	B	Transfer Mispricing Estimates			
	43.	Sanjaya Lall (1973), 'Transfer-Pricing by Multinational Manufacturing Firms', Oxford Bulletin of Economics and Statistics, <b>35</b> (3), August, 173–95	738		

44. Anita M. Benvignati (1985), 'An Empirical Investigation of International Transfer Pricing by US Manufacturing Firms', in Alan M. Rugman and Lorraine Eden (eds), *Multinationals and Transfer Pricing*, Chapter 10, London, UK and New York, NY, USA: St. Martin's Press, 193–211, references
761

viii

Jean-Thomas Bernard and Robert J. Weiner (1990), 'Multinational	
Corporations, Transfer Prices, and Taxes: Evidence from the U.S.	
Petroleum Industry', in Assaf Razin and Joel Slemrod (eds),	
Taxation in the Global Economy, Chicago, USA: University of	
Chicago Press, 123–54	781
Deborah L. Swenson (2001), 'Tax Reforms and Evidence of	
Transfer Pricing', National Tax Journal, LIV (1), 7-25	813
Kimberly A. Clausing (2003), 'Tax-Motivated Transfer Pricing and	
US Intrafirm Trade Prices', Journal of Public Economics, 87,	
2207–23	832
Lorraine Eden and Peter Rodriguez (2004), 'How Weak are the	
Signals? International Price Indices and Multinational Enterprises',	
Journal of International Business Studies, 35 (1), 61–74	849
Agnes W.Y. Lo, Raymond M.K. Wong and Michael Firth (2010),	
'Can Corporate Governance Deter Management from Manipulating	
Earnings? Evidence from Related-Party Sales Transactions in	
China', Journal of Corporate Finance, 16 (2), April, 225-35	863
Michael J. Ferrantino, Xuepeng Liu and Zhi Wang (2012), 'Evasion	
Behaviors of Exporters and Importers: Evidence from the U.S	
China Trade Data Discrepancy', Journal of International	
Economics, 86 (1), January, 141-57	874
	Corporations, Transfer Prices, and Taxes: Evidence from the U.S. Petroleum Industry', in Assaf Razin and Joel Slemrod (eds), <i>Taxation in the Global Economy</i> , Chicago, USA: University of Chicago Press, 123–54 Deborah L. Swenson (2001), 'Tax Reforms and Evidence of Transfer Pricing', <i>National Tax Journal</i> , LIV (1), 7–25 Kimberly A. Clausing (2003), 'Tax-Motivated Transfer Pricing and US Intrafirm Trade Prices', <i>Journal of Public Economics</i> , <b>87</b> , 2207–23 Lorraine Eden and Peter Rodriguez (2004), 'How Weak are the Signals? International Price Indices and Multinational Enterprises', <i>Journal of International Business Studies</i> , <b>35</b> (1), 61–74 Agnes W.Y. Lo, Raymond M.K. Wong and Michael Firth (2010), 'Can Corporate Governance Deter Management from Manipulating Earnings? Evidence from Related-Party Sales Transactions in China', <i>Journal of Corporate Finance</i> , <b>16</b> (2), April, 225–35 Michael J. Ferrantino, Xuepeng Liu and Zhi Wang (2012), 'Evasion Behaviors of Exporters and Importers: Evidence from the U.S.– China Trade Data Discrepancy', <i>Journal of International</i>