



H A R V A R D | B U S I N E S S | S C H O O L

C. FRITZ FOLEY |

ASSISTANT PROFESSOR

May 10, 2007

David H. Galler
Chief
Direct Investment Division
Bureau of Economic Analysis

Dear Mr. Galler,

I am writing to reply to three letters I have received from you recently, each asking for my views concerning the design of BEA surveys. I have broken out my views into three parts below, each part responding to one of your letters.

Proposed Changes to the BE-12 Survey

In your letter dated April 30, 2007, you asked me to provide you with my comments and suggestions concerning the proposed changes to the benchmark survey of foreign direct investment in the U.S. I support most of the proposed changes, but I have one major objection and a few suggestions.

My biggest objection to the proposed changes relates to the proposal to increase the reporting thresholds. The increase in these thresholds that has occurred over the last ten to fifteen years has dramatically decreased the amount of data firms are required to report and therefore threatens the value of the BEA data. Changes in the requirements concerning which firms must report which data items has also contributed to this decline. I therefore would suggest that the reporting requirements not be changed.

In 1992, all U.S. affiliates with sales, assets or net income with an absolute value in excess of \$1 million filled a complete data form. The proposed changes to the survey would raise this threshold to \$40 million. Proposed requirements for reporting data on the long form data are also far too high. I believe that the long form was only introduced within the last fifteen years—prior to that all companies effectively filed all the information captured on the long form. Since its introduction, thresholds have grown in a way that has significantly reduced the sample of firms that report details of their financial and operating activity.

These changes have the potential to destroy the value and accuracy of many aspects of the BEA data. While BEA may be able to claim that, on a value weighted basis, a large fraction of multinational activity is studied in detail, these changes undermine our understanding of activity in many countries, industries, and types of firms. Multinationals in smaller countries and in industries without significant economies of scale will not be covered well by the BEA data. Certain data items in country/industry cells could also be misleading if there are lots of small affiliates that do not report the item.

Under the proposed changes, it is only possible to track a few data items through time for smaller affiliates, thus limiting the value of research using the firm level data. Researchers will not be able to perform detailed

studies of how changes in the international economic environment and policy changes affect firm operating and financial decisions using large samples if reporting thresholds continue to increase.

It does not make sense to me that BEA should reduce coverage of multinational firms at the same time that information on multinationals is of increasing importance to academics, policy makers, and business leaders. If it has been difficult for BEA to obtain the resources needed to maintain the accuracy and completeness of the data, I wonder if BEA data users could help decision makers understand the value of these data. I am happy to discuss this possibility with you.

I have some other suggestions concerning the proposed changes as well. I would not double the threshold for reporting merchandise trade on the BE-12(LF) form. Although these data have not been widely used by researchers, they are unique, and I believe that researchers will use them extensively in the future. I would suggest leaving this threshold at \$500 thousand.

I would suggest collecting information on capital expenditures in Part I of the short form and on the BE-12 Mini form. Offshoring issues relate not just to where employment is located, but also to where capital is invested, so capturing this item for smaller affiliates is crucial.

I would also suggest collecting information on dividends in Part I of the short form and on the BE-12 Mini form. Dividend repatriations are a significant flow of funds out of and into the U.S. and have been the subject of considerable academic and policy interest over the last two decades. For example, the American Job Creation Act of 2004 temporarily reduced the taxes the U.S. charges on earnings repatriated to the U.S. As debates about how multinational firms should be taxed continue, it will be useful to have information on the dividends paid by U.S. affiliates to inform the debate.

Shipped versus Charged Basis for Trade Data

In your letter dated May 3, 2007, you explain that there is a proposal to report trade data on a charged as opposed to a shipped basis. I do not support this proposal, and I would advise you to continue to collect and report trade data on a shipped basis. I do appreciate that tracking and providing data on a shipped basis is costly for firms and BEA. I think this argument is the strongest one for changing reporting. However, I believe that BEA's trade data are of more value to current research efforts in international economics if they are reported on a shipped as opposed to charged basis. Let me explain my view on this.

Studies of transfer pricing that make use of the BEA data tend to focus on how foreign taxes affect levels of reported income (see Hines and Rice (1994) or Desai, Foley and Hines (2004a)), levels of investment and economic activity, and the use of different factors of production (see Desai, Foley and Hines (2004b)). It would be helpful to have trade data on a charged basis if data on a shipped basis were also collected, or if trade data provided details not just on values but on prices and quantities. This kind of data would allow a researcher to see if firms shift profits to low tax locations. I do not believe that simply knowing where traded goods are charged will allow one to make much headway. Asking for additional details for trade data would create additional burden for reporters, so I do not think it is feasible.

Studies concerning how ownership patterns affect trade and how endowments affect trade rely on having trade data that is reported on a shipped basis. For example, consider Antras (2005). Antras (2005) empirically documents and theoretically explains patterns in the share of intrafirm trade by industry. For his study, Antras must be able to compare levels of intrafirm trade with levels of total trade. He uses the BEA data and relies on the fact that these data and the Census data are both reported on a shipped basis. The literature on the impact of factor endowments on trade also relies on knowing where traded goods are going to and coming from as opposed to who is paying for them.

In short, I believe that trade data are more valuable to researchers if they are collected on a shipped as opposed to charged basis. If reporting burdens are a major concern, I wonder if it would be possible to try to coordinate

data collection efforts with the U.S. Census Bureau and the U.S. Customs Bureau. If it were possible to coordinate data collection efforts, reporting burdens for companies might fall and the accuracy of the data might improve.

Covering Banks in the Annual BE-11 Survey

In your letter dated April 12, 2007, you indicated that BEA intends to cover bank U.S. parents and their bank and nonbank affiliates in future Annual Surveys of U.S. Direct Investment Abroad. I think this is a great idea. I have not seen much academic research that studies the BEA data on multinational banks, and this may in part be a consequence of the fact that data are only available for certain years. I do have a few suggestions on the reporting requirements and the data collection form.

For nonbank affiliates, I wonder why BEA would not ask bank parents to file the same BE-11A, BE-11B, and BE-11C forms subject to the same reporting requirements as other multinational parents. It seems to me that an affiliate in a manufacturing industry with a parent in banking should file the same information as any other affiliate in manufacturing.

If nonbank affiliates filed these forms, this would provide more flexibility to design a BE-11B(BNB) annual survey form specifically for bank affiliates. In the proposed BE-11(BNB) form, I am not sure how a bank would fill out item number 40 which captures information on sales by location since deposit taking entities do not really have sales. For nonbank affiliates, the \$500 million reporting threshold also seems so high that very few of these affiliates will report any data.

Thinking about banking data raises another issue for me. My understanding is that private equity firms are increasingly making international investments that would trigger their being classified as multinational parents. I do not think they would be classified in industry 5221, so I do not think these kinds of firms are affected by the proposed changes concerning bank parents. However, I hope that BEA is capturing their international activity on an annual basis.

Finally, in order to address reporting burdens and to improve the accuracy of the data, I would encourage BEA to try to coordinate their data collection efforts with the efforts of the Federal Reserve Board. I do not know the details of what the Federal Reserve Board does in the sphere of international banking, but I do know that they report data on the foreign activities of U.S. banks, and I wonder if there would be gains from working more closely with officials based there.

In conclusion, thank you for asking my views on these issues. I have a deep respect for all of the hard work that you and others at BEA do to collect and analyze data about our economy. I appreciate the support that BEA has given me in my research, and I hope that you find my suggestions and comments to be helpful.

Sincerely,

C. Fritz Foley

References

P. Antras, "Firms, Contracts, and Trade Structure," *Quarterly Journal of Economics* (2003) 1375-1418.

M.A. Desai, C. F. Foley and J. R. Hines Jr., "The Costs of Shared Ownership: Evidence From International Joint Ventures," *Journal of Financial Economics* (2004a) 323-374.

M.A. Desai, C. F. Foley and J. R. Hines Jr., "Foreign Direct Investment in a World of Multiple Taxes," *Journal of Public Economics* (2004b) 2727-2744.

J. R. Hines Jr., and E. M. Rice, "Fiscal paradise: Foreign tax havens and American business," *Quarterly Journal of Economics* (1994) 109:149-182.

From: Laura.Bloodgood@usitc.gov [mailto:Laura.Bloodgood@usitc.gov]
Sent: Tuesday, May 15, 2007 10:22 AM
To: Galler, David
Cc: Karen.Laney-Cummings@usitc.gov
Subject: Comments on new FDIUS Survey forms

Dear Dave,

Karen Laney-Cummings has passed your requests for comments on to me, as the person in our office who deals most directly with the BEA investment data. It's a pleasure to hear from you after all this time, and I hope you're doing well.

The following comments apply to both your letter of April 12, 2007, seeking comments on the inclusion of bank parents and their affiliates in the annual surveys, and your letter of April 30, 2007, seeking comments on the 2002 benchmark survey.

Regarding the revisions to the BE-11 Annual Survey form, I am particularly pleased to see that you will be including banks and their affiliates in your annual surveys. I agree that the lack of data on bank parents and their affiliates has been a significant gap in existing BEA annual data. However, I would question the high exemption level of \$500 million for bank affiliates, compared to what appears to be an exemption level of \$150 million for non-bank affiliates on the BE-11 instructions enclosed with your letter. I'm concerned that we would be missing important information for smaller institutions. Is it your understanding that the higher exemption level for banks will lead to the same share of overall affiliates reporting? Do you have plans to include bank and their affiliates in the FDIUS annual surveys as well?

Regarding the benchmark survey, I'm quite pleased to see that you will be adding additional information on services transactions and R&D to the surveys. We make extensive use of this information, and we're looking forward to the additional detail. I am particularly pleased to see the additional detail you will be requesting on the activities of banks and bank holding companies, which seem likely to yield significantly greater insight into the these firms' activities.

I am concerned that by raising the exemption criteria, we will be losing valuable information about smaller affiliates. While I understand that there is an issue of the reporting burden on small companies, these companies can be quite an important and dynamic segment of the U.S. economy, and by exempting these affiliates, it is not possible to tell what is missing from the data.

I don't have any serious objections to the other items that will be dropped from the forms.

We appreciate the opportunity to comment on the changes to your survey forms. I look forward to continuing to work with BEA in the future.

Best regards,

Laura

Laura S. Bloodgood, Ph.D.
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From: Pilot, Adrienne T. [mailto:Adrienne_T._Pilot@cea.eop.gov]
Sent: Wednesday, May 16, 2007 1:32 PM
To: matthew.j.slaughter@dartmouth.edu
Cc: Galler, David
Subject: Benchmark Survey of Foreign Direct Investment

Dr. Slaughter,

BEA recently notified CEA of proposed changes to the benchmark survey of foreign direct investment in the US. Comments are due Friday 5/18. Rob Martin reviewed the material provided by BEA, but had no comments; he thought the proposed changes looked reasonable. Although you are no longer with CEA, Steve Braun thought you may be interested in reviewing the proposed changes.

There are no attachments to this email because the material provided by BEA is paper rather than electronic. Copies of the surveys and instructions should be available online. If you would like to review and comment on the proposed changes, I could scan the letter and short paper BEA sent and email it to you, or you could contact BEA directly and request material electronically. You can reach David Galler, BEA's Chief of the Direct Investment Division, at:

David.Galler@bea.gov
202-606-9835

Please do not hesitate to contact me if you have any questions.

Sincerely,

Adrienne Pilot
Director of Statistical Office
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From: Lipsey, Robert <RLipsey@gc.cuny.edu>
To: Galler, David
Sent: Thu May 17 18:02:31 2007
Subject: B-12 Benchmark Survey of FDI in the US

Dear Mr. Galler,

I have looked at the proposed changes in the B-12 form and have a few comments, unfavorable as usual.

With respect to the discontinuance of the collection of merchandise trade by product, I cannot claim that trade by product data have been much used in research, even by me in my two papers dealing with trade. I think the reason is that the trade classification is so broad that it is already difficult to compare with trade data in a useful way. On the other hand, I find it hard to believe that the affiliates find this section impossible to answer, given the broadness of the classification. Someone in the affiliate has had to fill out forms describing exports, at least, in a lot more detail than this. And someone in the affiliate must know the composition of imports at this level. Of course, the ideal solution would be for researchers to be able to match the BEA forms with the Census Bureau's detailed trade data.

I worry more about the dropping of questions on service transactions between U.S. affiliates and their affiliated foreign group and their transfer to the BEA's surveys of cross-border service transactions. The problem with that transfer is that while the totals of these trades will be collected, the relationships with other activities of the same affiliates will be lost. I have found in my studies of service trade of US -owned affiliates that these connections between the service trades of affiliates and the merchandise trade and other activities of the same affiliates are extremely important in understanding service trade. A lot of information would be lost if that connection disappeared from the BEA Benchmark data.

Sincerely,

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May 17, 2007

Mr. David Galler
Chief
U.S. Department of Commerce
Bureau of Economic Analysis
BE-50 (OC)
Shipping and Receiving Section M-100
1441 L. Street, NW
Washington, DC 20005

Dear Mr. Galler:

Thank you for the opportunity to comment on the proposed changes to the BE-12 benchmark survey — BE-12(LF) Long Form, BE-12(SF) Short Form, BE-12 Bank, BE-12 Mini, and BE-12(X) Claim for Exemption. As indicated by Kenneth Lamar in his May 10, 2007 letter to you, we appreciate the opportunity to share our knowledge of information that is currently available in lieu of additional reporting and also provide insights as to data that may be difficult for reporting entities to provide. We've organized our comments as presented in your Attachment A.

Changes in Reporting Criteria

We believe reporting entities will welcome reduced reporting from higher exemption levels. In addition, the creation of the BE-12 Mini form seems to clarify reporting requirements.

Changes that were Recently Introduced in Other BEA Surveys

Where practical, consistency across surveys that must be filed by the same reporting entities, as you have suggested, will likely lead to higher quality data. At a recent meeting with certain major reporting banks, the burden of supplying information related to full versus part-time employees was discussed. We are not familiar with the Standard Occupation Classification and do not know how burdensome this may be for reporting entities to supply data linked to this classification.

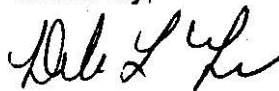
Mr. David Galler
Chief
U.S. Department of Commerce
Bureau of Economic Analysis
May 17, 2007

Other Changes

As mentioned in Mr. Lamar's May 10, 2007 letter, we collect organization structure information that may meet the data needs in some of the suggested changes for the BE-12 Bank and BE-12 Mini forms. These data are publicly available.

Please let us know if you have any questions on the structure data that is publicly available or if you would like us to arrange meetings with trade groups to discuss these report proposals.

Sincerely,



Debra L. Gruber
Statistics Officer
International Reports Department

From: Jeffrey.Kozlowicki@mail.doc.gov [mailto:Jeffrey.Kozlowicki@mail.doc.gov]

Sent: Friday, May 18, 2007 6:22 PM

To: Galler, David

Cc: aaron.brickman@mail.doc.gov; Chris_Rosettie@ita.doc.gov;

Eileen_Hill@ita.doc.gov; Joanne_Tucker@ita.doc.gov

Subject: Commerce OMA comments on BEA benchmark survey design

Dear Mr. Galler:

Thank you for the opportunity to comment on the design of the BEA benchmark survey of foreign direct investment. We appreciate your efforts to revise the BE-12 forms in order to improve collection of important data on investment.

The Office of Multilateral Affairs at the Department of Commerce is particularly interested in statistics on trade in services and we applaud changes to the benchmark forms that will help to identify companies that engage in cross-border services. We would be pleased to work with you however possible towards a fuller understanding of services transactions; please keep us apprised of updates or new initiatives in this area. Thank you.

Sincerely,
Jeff Kozlowicki

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From: Ronald Fecso [mailto:FecsoR@gao.gov]
Sent: Tuesday, May 22, 2007 6:47 PM
To: Galler, David
Subject: Fwd: BE-12 revisions

Once again, thank you for providing GAO with an opportunity to comment on proposed revisions to one of your surveys - the BE-12.

As before, I've called attention to the proposals to various persons and groups within GAO for consideration focusing on any current or anticipated engagements for which the changes might materially impact our work.

In this perspective, we have no objections to the proposed changes.

Thanks again for soliciting our input.
Best wishes for the remaining activities in carrying out the proposed changes.

Regards,

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May 25, 2007

David Galler
Chief, Direct Investment Division
Bureau of Economic Analysis
United States Department of Commerce

Dear David,

Please see my comments below in response to your letter of April 30th regarding proposed changes to the Benchmark Survey of FDIUS. I should start by saying that I've never worked with the IFDI data before – I've only used the USDIA data. I also generally use the Annual Surveys and do not typically make use of the extra data collected in Benchmark years. So I'm considerably less familiar with these surveys. However, some of the issues raised in your letter and the attachment also seem quite relevant to the USDIA data, so I'll comment briefly on them here.

I'll address what I view as the most important issue first – the proposed creation of the BE-12 Mini to be completed by small US affiliates. As I'm sure you know, an interesting feature of US multinationals from the USDIA (and US parent) data is that the distribution of MNC size (as measured by, e.g., a US parent's total number of affiliates, or total foreign sales) tends to be bimodal. There are many small MNCs, and approximately 15% of the population of MNCs are very large firms. Similarly, there are also many small and some very large foreign affiliates of US MNCs. We know very little about how MNCs grow over time and whether, for example, the small MNC affiliates in 1983 have tended to stay small or grow large. These questions have obvious policy implications for both developing countries that are recipients of inward FDI, and for the US and other industrialized countries like Canada that are significant FDI host countries. Answering these questions would mean collecting more reported (not estimated) data on small affiliates, at the very least, in Benchmark Survey years. This would allow us to understand whether and how the small affiliates in the left tail of the distribution eventually grow to become larger affiliates toward the right tail of the distribution.

Understandably, to reduce the reporting burden on firms, the BEA sets size criteria for reporting, hence the proposed creation of the BE-12 Mini. The problem is, the size criteria result in systematically worse data quality (or lack of sufficient reported data altogether) on smaller entities. Thus, it is extremely difficult, using only reported data, to study the growth of MNCs.

I think the idea of having the "Mini" form that small and exempt affiliates complete is excellent. However, I would probably eliminate the tiers in order to gather needed additional data on small affiliates, and I would also suggest adding a few more items.

- 1 – I would put in enough data to allow for the construction of the gross product of small affiliates
- 2 – I would add PPE and PPE expenditure data
- 3 – I would add questions 115 and 126 from the import and export grid in Part II of the Long Form (I would also add these to the Short Form). Note that I would only include the totals – not the trade by

product.

I understand that #3 above might be less realistic, but I don't think that the reporting burden of #1 and #2 would be very difficult, given these are data many affiliates are likely to have fairly easily available. It seems to me that, in general, reporting requirements are onerous only to the extent that entities are being asked for data they might not collect in a similar format themselves. If they're just being asked to fill in questions pertaining to data they already have on hand, I wouldn't think this should pose too much of a burden.

Many of the other proposed changes – particularly the deletions such as discontinuing the collection of merchandise trade by product – do pertain to data affiliates are not likely to have readily available. As indicated in your letter, since these data are not widely used by researchers and are often left blank by firms, so it's hard to argue that BEA should continue to collect them.

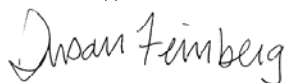
I agree with all the recommendations for changes detailed on page 2, parts II and III of Attachment A. My only concern is the following. I do not know anything about the sampling procedure for the BE-120, BE-125 and BE-185, so I'm not sure whether all of the same entities are being asked to fill out these forms in addition to the relevant BE-12's. If so, then the proposed deletion of the questions pertaining to transactions in services seems reasonable. If not, however, and only a fraction of affiliates that complete the BE-12 are asked to fill out these other surveys, then it might be better to keep these questions in the various BE-12's.

All the proposed changes to the BE-12 Long Form on page 3 of Attachment 2 strike me as reasonable and not likely to compromise the data. Regarding the proposed changes to the BE-12 Short Form at the bottom of page 3 of Attachment 2, I would change item 10 (the first point). I would add items to collect both imports and exports of goods, services and investment income in a grid similar to that in Part II questions 115 and 126 on the Long Form. I agree with all the other recommended changes to the Short Form.

I also agree with the proposed additional items to be added to the BE-12 Mini, as described on page 5. As discussed earlier, I suggest adding to these the 3 additional data items I mentioned above (gross product data, PPE and trade).

Thank you very much for allowing me to comment on these proposed changes to the BE-12's. I hope to use this data someday! I look forward to meeting you over the Summer. Please feel free to contact me again if you have any other questions. I won't be coming in to my New Jersey office very often during the Summer, so my home address is probably better for reaching me. I've noted it below.

Sincerely,



Susan Feinberg

Home address: 4341 Chesapeake Street NW
Washington, DC 20016