DIVISION OF INTERNATIONAL FINANCE
BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Date: September 9, 1999

To: [redacted]

From: Guy Stevens

Subject: Resolution of Disagreements with BEA Concerning 1999 Benchmark Survey of U.S. Direct Investment Abroad

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I have been given assurances that we now have an agreement with BEA concerning our most important reservation with their proposed changes for the new Benchmark Survey of U.S. direct investment abroad. In particular, they have agreed to withdraw their proposal to discontinue collecting data on exports from U.S. multinationals to unrelated foreign entities (questions 119-143 on the 1994 Census). The threat of a negative comment or protest coming from the Fed at the next level of review apparently caused BEA to reconsider its position. We were not the only party objecting to this proposal, however; I am appending the strongly negative comments of Robert Lipsey of the National Bureau of Economic Research. In view of the possibility that this question may come up again in a few years, I am documenting for you and our files where things stand now.

Given the continued availability of the data in question, we have the ability to break down total U.S. exports by country into the four (exhaustive) categories of MNC trade to affiliates and (foreign-owned) non-affiliates, and non-MNC trade to MNC-affiliates and to (foreign-owned) non-affiliates. The first and third categories are collected directly by BEA from our affiliates abroad. The second category is covered by the data in question; moreover, given the availability of these data, one can at least estimate the fourth category, non-MNC exports to non-affiliates, as a residual from total U.S. exports to a given country.

BEA's major reservation about continuing to collect these data is a relevant one. It appears that much of the data is of questionable quality – according to the various internal and other checks they have – and this category has required large amounts of BEA staff time in checking the data and interacting with the companies. Part of the problem is that when firms sell goods to non-affiliates, they often are unaware whether and to what countries the goods might be exported. During our negotiations, I and a number of others thought about alternative ways to collect the data, but could not come up with a viable proposal. I have told the person in charge at BEA, Dave Belli, that we at the Fed would be willing to cooperate with any group that might want to study this problem more systematically.

My letter to BEA and Robert Lipsey's comments are attached.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON D.C. 20551

DIVISION OF INTERNATIONAL FINANCE

June 4, 1999

Ms. Patricia Walker
International Investment Division
Bureau of Economic Analysis
U.S. Department of Commerce
Washington, DC 20230

Dear Pat:

As requested by Dave Belli in his May 11 letter to Bill Helkie, I have been asked by Bill to formulate and convey the comments of the U.S. International Transactions Section on the proposed changes in your next benchmark census of U.S. direct investment abroad. I might note that I have had extensive conversations and input from my colleagues Caroline Freund and Gary Lee, in addition to Bill Helkie.

We all have been impressed by the way you have documented your proposals and have supported them in terms of the estimates of the amount of data that could be lost and your ability to estimate items that would no longer be collected directly. As for all proposals for substantial changes, we do, however, have some reservations about the advisability of certain ones. These include your proposals to discontinue collection of the country breakdown of parent firm exports to non-affiliated enterprises, to reduce the reporting burden for minority-owned affiliates, and to raise the exemption level for the BE-10B long form to $100 million.

First, let me concentrate on what we in the Section – and also in the International Division as a whole – consider to be one your proposals that is most dangerous for the integrity of the data. This is your proposal to discontinue collecting the country detail on exports from the U.S. reporter to "foreigners other than the U.S. Reporter's foreign affiliates." We, along with researchers like Bob Lipsey (and many others), believe that this breakdown by country is important for the continued effort to understand the relationship between multinational production abroad and U.S. trade. Moreover, we dispute your view that such a breakdown has not been fruitfully used in recent research. As for the uses of the country break, it is needed to accurately measure exports to non-affiliated firms in a given country both by U.S. Reporters and by U.S. firms that are not multinationals. An important area of research is whether trade with foreign affiliates and with non-affiliated third parties in a foreign country are both affected by the same variables with the same estimated coefficients. This research can and, to some extent, has thrown light on whether transfer pricing between related entities changes the effect of exchange rates on recorded trade flows. This is just one of the numerous questions where a careful breakdown between U.S. exports to affiliated and non-affiliated entities is essential. An interesting paper where such a breakdown was crucial – in this case data provided by *Swedish* multinationals – is Birgitta Swedenborg's "Determinants and Effects of International Direct Investment: The Swedish Case Revisited." (See her Table 2.) This paper is soon to be published by the NBER in the volume *Topics in Empirical International Research.*

It can even be argued that a *richer* breakdown of trade data by country is needed. In particular, our researchers have found that a breakdown of foreign affiliate exports by major country – exports to other foreign affiliates and to unrelated enterprises – would have been very useful in our analysis of the impact of the recent Asian crisis on U.S. trade. My colleagues and I would be pleased to elaborate on this argument.

Questions of changes in exemption levels and what should be reported by minority-owned, as opposed to majority-owned, affiliates lead always to the balancing of the competing criteria of adequate coverage and reporter burden. As Robert Lipsey indicates in his letter to you, we are somewhat uneasy about some of your judgments that certain data can either be dispensed with or can easily be estimated by BEA from other data that will be provided to you. Your arguments are cogent; however, we would really like to have a meeting with interested parties where (1) you would provide beforehand the detailed calculations that bolster your case (especially regarding adequate country data) and (2) the adequacy of your calculations and the importance of the data that would be lost could be thoroughly discussed. I harken back to the detailed discussions that your advisory panel had with the staff of BEA in the 1970s.

With respect to these questions of exemption levels and the coverage of minority-owned firms, we have the following comments. The proposed change in the exemption levels for banking firms brings up the question of the adequacy of reporting by both BEA and us – the Federal Reserve Board. We were somewhat shocked recently when Robert Lipsey found that the *publically available* Federal Reserve data on foreign banking affiliates did not adequately supplement the BEA data. Second, the proposal to have minority-owned affiliates report only on the BE-10B *short form* seems particularly dangerous in an era where minority-owned affiliates have become much more prevalent; for one thing, such a shift would reduce the detail of the trade data collected from the affiliate (data that, as noted above, can already be argued to be inadequate for certain important purposes). Third, despite the calculations you report, raising the exemption level for the BE-10B long form to $100 million causes a worrisome shift of one-third of your long-form sample to the short form; this leaves only about a third of the total number of 17,000 affiliates reporting on the long form. This result might be fine for large countries, but it could lead to extensive losses of detail for medium-size and smaller countries.

I hope these comments provide useful in the next stage of your effort. We at the Federal Reserve look forward to continuing this dialogue.

Sincerely,

Guy V.G. Stevens
Senior Economist

From: "Robert E. Lipsey" <rlipsey@broadway.GC.cuny.edu> AT internet-gateway on 06/03/99 04:31 PM

To: patricia.walker@bea.DOC.GOV AT internet-gateway@ccMTA
cc: (bcc: Guy Stevens/FRB_IF)

Subject: <no subject>

Dear Ms. Walker,

I received a letter from Dave Belli asking for comments about the proposed changes to the benchmark survey forms. I was out of the country when the letter arrived and I cannot attend the June 10th meeting, but I did want to make some comments although I have not had much time to study the proposals.

? (1) One disturbing feature of the announcement of the proposed changes is that every change was made to please the respondents and no consideration was given to the users of the data. The clientele for these surveys is not the respondents; if it were, there would be no survey. The clientele includes the academic community, Congress, other government agencies, and private business in general, outside of the group who have the task of filling out the forms. These clients might , if asked, suggest improvements or expansions of the surveys, but I see no indication that their views were sought.

If there is strong pressure to reduce the burden on respondents, the way to do it is not to shave a little off the survey each year, but to use some imagination to see if firms could be given the choice of filing some information in forms that duplicate what they are already supplying to other government agencies. That would take some study, but the material filed with the SEC and the Census Bureau comes to mind as a possible substitute for some parent data and, on the inward side, for affiliate data.

The second disturbing feature is the emphasis at every turn on how changes will affect the aggregates. We all want to know worldwide totals of sales, employment, etc., but these are not the materials for analysis of FDI. For that purpose we need data by country and industry to analyze the consequences of FDI and foreign operations for host countries and for the United States. With the present cutoffs and even more with the proposed ones, what will be the share of estimations in the various country and industry cells, and what assumptions are made to fill the cells? This is not mentioned in the proposal and is not 4 shown in the published documents. If BEA has made these calculations, they should be revealed. If not, BEA is flying blind with these changes.

P. 2 What information is in the BE-10A Supplement? The form is not included in the set of documents.

2 I worry about excusing minority-owned affiliates in such a wholesale manner, just because "a number of reporters had difficulty in providing some of the long form detail..."

Couldn't there be a compromise on this? Some of the minority-owned affiliates, such as Japanese auto companies, are very large. And our understanding of US investment in Japan is already compromised by the size of the minority-owned sector there.

P. 3 Why not offer respondents the opportunity to send in their SEC 10K forms (I think that is the right one) to get total sales, assets, and other standard items? Is there a problem with definitions or consolidation rules?

P. 4 The product classification is certainly an improvement in some respects, particularly in machinery. But I don't think a condensed list is necessarily easier to fill out than a longer list. For example, I do not think that separating pharmaceuticals from other chemicals would cost any correspondent time. The same would be true for separating grain exports from other foods and semiconductors from other electrical machinery. These are all categories in which MNCs are important, I think, and involve public policy issues that students of trade and investment would be interested in.

P. 5 I think that eliminating the country breakdown of exports by parents to unaffiliated foreigners would be a very serious mistake. It would cripple efforts to understand effects of foreign operations on exports because presumably some of the impact is on exports to unaffiliated foreigners. I am sure that I have used these figures and that others have also. Export data that are not specific to countries are of much more limited value than country export data.

The CUSIP number must be costless for companies to provide. If BEA is ever to begin a program that brings in outside users, like the Census program, these numbers would become very useful. And I continue to think BEA should have such a program.

P. 6 I think BEA's reporting of bank data has been inadequate. The bank form needs to be different but this is an important industry and it is not adequately covered by anyone else.

I am sorry I did not have more time to think about these matters (you may not regret it) but I am an interested and very long-term user of these data.

Sincerely,   Robert E. Lipsey

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