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Politics of Intra-firm Trade: Corporate Price Planning and the Double Role of the Arm’s Length Principle

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ABSTRACT
Intra-firm trade is an emerging issue. One of its key elements is the international shifting of profits, for example, through transfer pricing that big enterprises use to cross-subsidise their subsidiaries, often to avoid taxes. Accounting rules conceal much of the information about transfer pricing, reproducing secrecy and facilitating the use of administered prices. Given the prevalence of administered price setting, a significant amount of international trade cannot be meaningfully analysed as market transactions. This provokes questions about the validity of market assumptions in research on trade in particular and global capitalism more generally. Our specific contribution focuses on the role of the arm’s length principle and the significance of cross-subsidisation and other forms of corporate planning in intra-firm trade. Under certain conditions, price planning by private corporations should be analysed as political rule within the economic sphere. Since the politics of the world economy is not merely related to governmental intervention, corporations should also be theorised as potentially political entities. Crossing the disciplinary boundaries between political economy and normative political theory, we suggest that the politicisation of intra-firm trade opens possibilities for creating more effective responses to price administration and for creating more democratic ways of governing the global economy.

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Introduction
The societal power of the corporation has become a much-debated topic in many fields from accounting and management studies to economics, tax law, business ethics, and global political economy. Intra-firm trade has been highlighted as an increasingly important phenomenon in this growing body of research (the second section). Our contribution focuses on largely neglected aspects of intra-firm trade: namely, the impacts of the planned intra-firm prices for analyses of the global ‘market’ economy and the opportunities this can create for democratic politics. We argue that the dominant free-market ideology faces an anomaly, as statistics suggest that a significant part of world trade is based on pricing planned in corporate headquarters. Intra-firm trade offers a suitable starting point for understanding the political aspects of the corporate form because of its significance for global corporate-driven capitalism. We argue that understanding the political aspects of the corporation requires revising some key assumptions about the role of markets in global political economy.

In the third section, we continue by arguing that the legitimacy of hierarchic corporate control over significant aspects of society is based on concealing its political dimensions, and suggest that...
the non-market dimension of the firm has far-reaching theoretical and normative implications. Even if scholars have started to pay more attention to intra-firm trade, most analyses of the global economy tend to assume a dichotomy between politics and markets, with corporations neatly belonging to the latter. We suggest that this dichotomy should be questioned in order to understand the politics of intra-firm trade. To conclude, in the fourth section, we discuss the policy lessons of our findings. Our contributions are relevant both for developing concrete policies that would hinder illicit tax avoidance, as well as for creating space for more democratic rules of world trade. The existing reform proposals for international corporate taxation tend to pay insufficient attention to the ideological nature of these rules.

Our analysis draws from previous studies that have revealed that transactions planned in corporate headquarters constitute a significant proportion of global trade. In 1996, the United Nations (UN) estimated that one-third of world trade was conducted within transnational corporations (UNCTAD 1996). In 2004, United Nations Conference for Trade and Development (UNCTAD) assessed that half of the service trade from the United States could be considered intra-firm (UNCTAD 2004). Using 2009 customs data, the Organization for Economic Co-operation and Development (OECD) found that intra-firm trade accounted for 48 per cent of US goods imports and about 30 per cent of US goods exports (Lanz and Miroudot 2011). The authors also pointed out that intra-firm transactions are more common among OECD countries than among emerging economies. In 2009, 58 per cent of U.S. goods imports from OECD countries were intra-firm, while only 29 per cent of US goods imports from Brazil, the Russian Federation, India, Indonesia, China and South Africa (so called BRIICS economies) occurred between related parties.3

There is plenty of direct and indirect evidence that intra-firm prices often differ from market-based prices (see, e.g. Overesch 2006, Webb 2006, Ylönen and Laine 2015). Planning may seem a natural aspect of any strategic action. Intra-firm trade, however, involves planning of a foundational market-economy mechanism, namely prices, which can be adjusted for avoiding taxes or for hiding risk. As many authors have shown (e.g. Picciotto 1992, Overesch 2006, Sikka and Willmott 2010, Christensen 2011, Jenkins and Newell 2013, Keuschnigg and Devereux 2013, Genschel and Rixen 2014, Durst 2016, Fichtner 2016, Mehta and Siu 2016), tax authorities face enormous challenges in monitoring intra-firm trade and enforcing domestic tax laws. It is thus not surprising that aggressive tax avoidance has been highlighted as a key issue in much of the academic research on the intra-firm trade (see, e.g. Sikka and Willmott 2010, Christensen 2011, Pogge and Mehta 2016).

Intra-firm trade deviates from the basic ideals of the market economy, as it takes place between units of the same corporate entity. These non-market aspects of the firm have also been recognised by the mainstream economics and accounting scholarship.4 In economic theory, the transaction costs approach pioneered by Coase (1988) has played a particularly important role in determining why it may make more economic sense to organise production hierarchically within a firm rather than through market transactions.5 One dimension of the social acceptability of hierarchic organisation can be measured by the performance of the bottom line.

**The double role of the arm’s length principle**

How can a ‘free’ market be based on administered and planned prices? Since the legitimacy of the existing framework of world trade is often based on free-market assumptions, the question is also normative. One way to deal with the mismatch between the theory of markets and the reality of price planning is through artificially establishing competitive markets in those parts of the world trade that deviate from the market assumptions. To accomplish this, states have agreed on national and international norms for facilitating market-based transactions within big corporations. As regards the intra-firm trade, the two most important norms are the separate entity principle and the arm’s length principle. The separate entity principle goes back to the early development of the corporate
law in the United States and Britain, as courts and legislators started to view companies belonging to a single enterprise as separate entities in front of the law (e.g. Biondi et al. 2007, Robé 2011, Ireland 2016). This not only facilitated the growth of the modern corporations, but it also enabled corporations to benefit from the differences between states and other territorial jurisdictions.

Championed by the OECD, and to a lesser extent by the UN, the arm’s length principle dictates that whenever two parts of the same corporate entity trade with each other, they should set the prices as if they were at ‘arm’s length’ from each other (Eden 2016). This principle helps combine the anomaly of planned prices with an analytical framework of ‘free’ markets. According to Aspers (2011: 4), markets are ‘constituted by two roles, buyer and seller, each standing on one side of the market, facing the other’. In this structure, the arm’s length principle can function as a mechanism that helps corporations simulate or construct markets in their intra-firm trade. In practice, it is difficult to find evidence that the arm’s length principle would significantly contribute to sustaining genuine, functioning markets within corporations. Instead, as we will argue in more detail below, it plays an important ideological role in legitimising non-market aspects of world trade.

Definitional ambiguities and enforcement difficulties have always restricted the applicability of the arm’s length principle. Its history dates back to the US War Revenue Act of 1917 (Avi-Yonah 1995: 94), the work of the International Chamber of Commerce Conference in the 1920s (OECD 2005: 81), and the League of Nations Model Tax Conventions that prevailed during the first half of the twentieth century (de Ruiter 2012, Vega 2012). Since the early years, corporations have actively tried to shape the arm’s length regime. The development of the US transfer pricing regulation is a telling example, as it was partly a result of active lobbying by large pharmaceutical companies. The 1963 Convention paved the way for the international triumph of the arm’s length principle, which can now be found in most bilateral tax treaties that regulate taxation of transnational corporations (Durst and Culbertson 2003).

The arm’s length principle was initially expressed in relatively general terms, and the lack of detailed rules restricted its application in many countries (Linde 1977: 82 quoted in Vega 2012: 11). When the principle started to be applied in the US courts, the first cases combined a strict application of the arm’s length principle based on market comparables with ad hoc methods that allowed prices that seemed ‘not unreasonable’, or ‘fair and fairly arrived at’ (Avi-Yonah 1995: 100). This ambiguity was accentuated by the early, strict definition of the principle that focused on market comparables. Specifically, the Revenue Act of 1934 stated that the ‘standard to be applied in every case is that of an uncontrolled taxpayer dealing at arm’s length with another uncontrolled taxpayer’ (quoted in Avi-Yonah 1995: 97). Conferences were organised already in the 1940s to tackle these problems (see Palan et al. 2013: 192–3).

As recently as in the early 1970s, tax auditors used uncontrolled comparables only sporadically to test compliance with the arm’s length standard (Durst 2010: 24). In 1972, Rädler tellingly pointed out that ‘reference to the so-called arm’s length rule usually does not lead much further, since to an ever-increasing extent similar or even comparable deliveries or services are carried out only within the one multinational company’. This sporadic approach, however, did not mean that tax authorities were idle. In the United States, tax authorities contested the tax agreements of several multinational corporations from the 1930s onward, but often had to rely on other methods than using comparables. As a consequence, the emphasis shifted from the ideal of ‘uncontrolled taxpayers’ to using other methods to determine acceptable transfer prices.

In the 1960s, the US Treasury Regulation 1.482-2(e) described three methods for determining an arm’s length price in international situations: the comparable uncontrolled price method, the resale price method, and the cost plus method, in that order of priority. Where none of these were applicable, the courts were left free to determine their own ‘fourth methods’ (Avi-Yonah 1995: 107). According to Avi-Yonah, the result was ‘a deliberate decision to retreat from the standard while still paying lip service to it’ (1995:112). The loosening of criteria did not, however, solve the inherent problems of the principle. In 1985, the House Report on House Bill (quoted in Avi-Yonah 1995: 130) noted how
[the] fundamental problem is the fact that the relationship between related parties is different from that of unrelated parties. Observers have noted that multinational companies operate as an economic unit, and not ‘as if’ they were unrelated to their foreign subsidiaries. In addition, a parent corporation that transfers potentially valuable property to its subsidiary is not faced with the same risks as if it were dealing with an unrelated party.

These problems were further addressed in the United States in 1988 in a U.S. Treasury Department white paper on intercompany pricing, and the consequent 1994 revision of the US tax code. The white paper argued that the lack of comparables restricted application of the traditional arm’s length principle. Methods introduced in 1968 had helped keep the system functioning, but the white paper went further in introducing the option of using profit-split methods as well, ‘as long as the results reached were compatible with arm’s length results’ (Avi-Yonah 1995: 135). This was a significant step away from the idealised comparables and market-based prices. Major developments also took place in international forums, as the OECD Council approved the OECD’s Transfer Pricing Guidelines in 1995, initially formulated in 1979. The 1995 Guidelines were an important step toward a more comprehensive normative framework, despite many problems of monitoring and enforcement remaining (OECD 2010: 3, 2013). In line with the US regulations, the OECD guidelines also allowed the use of various methods to determine taxable income where comparable prices could not be found.

While the problems inherent in the transfer pricing regulation are old, they have been accentuated as world trade has grown, characterised by its increasing concentration within large companies and corporate groups that operate across national borders. The recent decades have also seen a massive growth in the services trade, in tandem with a trend by which decentred corporations (Desai 2008) separate their internal wealth chains (Seabrooke and Wigan 2017) from their value chains (Gereffi and Korzeniewicz 1994, Henderson et al. 2002), for example, by centralising the ownership of intangible rights from several group companies to one ‘Intellectual Property company’, often located in a low-tax jurisdiction (see Palazzi 2011: 24). These developments have made it even more difficult to determine the comparable market prices, even though states have begun to monitor the intra-firm trade more rigorously. The arm’s length system is thus highly vulnerable to manipulation. These policy changes have been helping tax authorities and companies to go on with their day-to-day business, but they have distanced the arm’s length principle far from its original purpose. Yet, as we will argue, the principle continues to play an important ideological role.

Most transfer pricing-related profit shifting is conducted with small deviations from the estimated market prices, with major impacts on the geographical distribution of income within large corporations (Seabrooke and Wigan 2017). Companies can, however, also engage in more aggressive forms of planning, enabled by the difficulties states face in enforcing and monitoring their transfer pricing rules. De Boyrie et al. (2007: 474) have described how in November 2005, a set of golf clubs is imported into Nigeria for $4,976, while the US/World median price for the same set of clubs is only $82. During the same month, a gasoline generator is imported into Ghana from the USA at a price of $60,000 that could be purchased at the US/World median price of $63.03.

Ylönen and Laine (2015) demonstrated how the major pulp and paper company Stora Enso was able to handle the invoicing of its pulp trade between Brazil and its internal customers in Europe via a subsidiary in the Netherlands, even though the pulp was shipped via Belgium. The arrangement generated 300 million of euros of profits in the Dutch invoicing centre between 2005 and 2010, with an effective tax rate of 3 per cent. The arrangement was based on the use of low transfer prices in the trade between Brazil and the Netherlands, combined with the use of market-based prices in sales from the Dutch subsidiary to the parent company.

Furthermore, determining the market-based comparable prices can be genuinely difficult for both corporations and states. Corporate secrecy and inadequate statistics make it difficult to estimate market-based prices for many commodities and services. Consequently, corporations are often unable to even roughly estimate the prices their competitors use in their internal trade. Increasing the transparency of country-level financial information through the so-called country-by-country
reporting promoted by many scholars, organisations and tax justice activists could alleviate this problem at least for tax authorities. Unsurprisingly, corporate interest groups have opposed such measures. In its broad version, the country-by-country reporting initiative would make the essential country-level financial information on transnational corporations publicly available at the company’s website. At the moment, these data are scattered across national company registers whose level of openness and accessibility varies greatly (see Murphy 2009, 2016). Greater transparency would help tax authorities and the public to understand the tax avoidance arrangements, but it would not solve the underlying problems of the arm’s length principle.

Consequently, we argue that the arm’s length principle plays a double role. On the one hand, it is an instrument to establish markets within hierarchical corporate structures. There is enough evidence to suggest that the arm’s length principle is a failure in market creation, demonstrated by the slow but steady shift of transfer pricing rules from the search for comparables to other pricing methods. Michael Durst, former director of the Advance Pricing Agreement Program of the US Internal Revenue Service, has aptly noted that ‘despite many efforts at reform around the world during the 40 years or so in which the current system has played an important international role, governments have never been able to administer the system effectively’. What is more, he saw little prospect of getting the system to function in the future ‘no matter how hard one seeks to reform it’ (Durst 2010: 247).

There exists, however, a role in which the arm’s length principle has been more successful. We suggest that the principle also helps maintain non-market planning operations within corporations. The principle offers a basis for assuming that markets exist in places where their presence is difficult to verify in practice but ideologically important to simulate in theory. In this sense, it clearly plays an ideological role. This role of the arm’s length principle can be compared to another body-part metaphor, the invisible hand. As in the human body, each part has a function that sustains the whole. The invisible hand, albeit mentioned only in passing by Adam Smith in *The Wealth of Nations* ([1776] 2003: 572; see also Rothschild 1994, Watson 2005), has been constantly evoked to support the claim that market economy contributes to the overall public good.

Scholars have debated both societal and academic roles of the invisible hand from various viewpoints for decades (Rothschild 1994, Aydinonat 2008: 81–92). In world trade, the arm’s length principle arguably plays an even more fundamental role, because it can be evoked to resolve the prior question of whether a market economy actually exists. Even if it is sometimes recognised that its flaws and ambiguities favour corporate interests (see Webb 2006: 110–11), the ideological role of the arm’s length principle has not received the critical examination it deserves. These monitoring and enforcement problems imply that the arm’s length principle has been a failure only if we judge by its ability to create markets where they do not exist. The same difficulties, however, can be considered important elements in the success of the principle in justifying the non-market aspects of intra-firm trade, so that they seem compatible with the normative foundations of the market economy. Its success is not perfect, as demonstrated by the insufficient OECD-driven attempts to ‘fix’ the arm’s length principle with its Base Erosion Profit Shifting (BEPS) project (OECD 2013); the increasing calls for unitary taxation; and the growing public attention to these issues. By focusing on these aspects of world trade, we hope to contribute to further understanding of the politics of price planning in big corporations.

**What does it mean to analyse corporations as systems of planning?**

**The political planning of intra-firm trade**

According to Aspers (2011: 4), a key feature of the market is that its ‘actors – individuals and firms – compete with each other’. In addition, Lazonick (1991: 59) has noted how the ‘definitional social characteristic of a market is the impersonal relation between buyer and seller’. Both characterise markets as dominated by independent, rival firms. In the intra-firm trade, the buyer and seller are,
however, part of the same decision-making structure. Therefore, the relationship is far from ‘imper-
sonal’, and not ‘competitive’ in the standard market-economy sense. The veil of corporate secrecy
protects intra-firm transactions, whereas the market ideal assumes that relevant information is avail-
able to all key participants. This reasoning suggests that a significant part of world trade could hardly
be characterised as a market economy. There is evidence that corporate planning conducted through
cross-subsidisation and administered prices is so widespread that characterising real-world global
capitalism as a market economy is misleading.

Even if the simplistic market assumptions about world trade are non-realistic, planning the intra-
firm trade surely also involves market considerations. If the intra-firm price of a particular good or
service deviates from ‘going market price’, thus violating the arm’s length principle, the overall
price planning of the company still needs to respond to various external pressures that include unde-
niable market elements. This does not, however, invalidate our hypothesis of big corporations as
centralised planning entities. After all, states need to take market considerations into account in
their economic planning as well. For example, trade treaties include elements that induce states to
imitate markets by transforming government functions into state-owned companies (Schneiderman
2000). The prices used in this trade are also supposed to reflect market-based prices, but determining
the latter is often impossible. Even in cases where governments are strongly conditioned by such
rules and market signals, few would argue that this would turn them into non-political entities.

This establishes our first argument for questioning any strict demarcations between markets and poli-
tics in corporate sphere, as being conditioned by markets and being political are not mutually exclu-
sive conditions. Nevertheless, we still need to address the question of how to best define the
relationship between politics and markets in the non-market setting of intra-firm trade. Toward
this end, it is useful to address also terminological issues.

In the academic literature, the difficulty of determining ‘true’ transfer prices has been discussed
using terms such as ‘misuse of transfer pricing’ (as in Lakhal 2006: 545), ‘abusive transfer pricing’
(as in Lesage et al. 2010: 156), ‘distortion of transfer prices’ (Fuest and Riedel 2010: 5), ‘abnormal
prices’ (Fuest and Riedel 2010: 7), ‘enlarged import prices’ (Fuest and Riedel 2010: 17), and ‘over-
and under-invoiced prices’ (Eden 2003: 11). Most of these terms point to an intentional agency
that directly impacts price formation in intra-firm trade. Even if the value-laden nature of these
terms is often forgotten, the choice of ethically loaded terms such as ‘abusive’ is at least potentially
politicising, as it suggests that there is something else at play than the market mechanism. On the
other hand, terms such as ‘enlarged’ or ‘distorted’ prices implicitly suggest that it is possible to
define market-based prices. As argued earlier, this is often not the case.

The term ‘profit shifting’ avoids this assumption but lacks the ethical tone. Used already in the
1960s by Kaldor (1963: 20), it has recently become a popular concept, not least because of the
OECD’s Base Erosion Profit Shifting project (2013). In addition, ‘profit shifting’ has featured in many
other publications (e.g. Development Working Group 2011, FitzGerald 2012). One way to define
profit shifting is to see it as ‘strategic actions taken by firms that result in profits being reported in
a tax favorable jurisdiction’ (Cederwall 2015). Related to this, the OECD understands base erosion
and profit shifting as ‘shifting profits away from the jurisdictions where the activities creating
those profits take place or by exploiting gaps in the interaction of domestic tax rules where corporate
income is not taxed at all’ (2015: 42). However, there are two further concepts that succeed in high-
lighting the planning aspect of intra-firm trade, namely cross-subsidisation and administration of
prices.

To recap the argument so far, we made the case that states and large corporations have more in
common than prevalent dichotomies of trade research often assume. States increasingly operate
under market-based assumptions. Even more importantly, non-market-based economic planning is
more prevalent in large corporations than many political-economy analytical frameworks assume.
Hence, there is a case to be made to analyse large corporations without the economistic assumptions
that associate planning only with state intervention. Both large corporations and states participate in
planning the markets and marketing their plans. There are obvious differences between them,
including the territorial boundaries that delimit the potential for state action, the greater role of states as creators of binding normative frameworks, and the ability of states to declare a state of exception (Schmitt 1927, Agamben 2005). However, both governments and corporations can be rule-makers as well as rule-takers, although often in different venues and processes. At times, corporations can make their own rules directly in private regulative bodies. On other occasions, corporations influence the rules indirectly through economic planning.

Given that the ‘political’ sphere of states and the ‘economic’ sphere of corporations are more intertwined than is commonly understood, we need to ask a further question: could corporations also be conceived as political entities? We will focus on this question in the next section, arguing that the theoretical question also has practical implications. States often claim to base their legitimacy on democratic consent, whereas corporations are typically shielded from the validity sphere of democratic norms. Even though advancing better norms for international taxation can be successful within the existing conceptual frameworks, understanding corporations as political entities can also be used in arguments for more democratic international tax governance. We contribute to this important task by exploring how a realist analysis of intra-firm trade provides one avenue for this kind of politicisation.

**Corporations as political entities: some normative issues**

Among the multitude of debates in political theory about what it means to call an entity ‘political’, Unger’s two basic definitions of ‘politics’ (1987: 145–6) provide a helpful starting point. For him, the narrow sense of politics can be called ‘conflict over the mastery and uses of governmental power’. To analyse other than governmental politics of practices and spaces, it is more useful to rely on Unger’s broader definition of politics as ‘struggle over the resources and arrangements that set the basic terms of our practical and passionate relations’. According to Unger (1987: 145–6), the most important of these arrangements is ‘the formative institutional and imaginative context of social life’. Politics in the narrow sense represents a special case of the politics in the broader sense.

The widely acknowledged role of non-governmental actors in the ‘private’ governance of the contemporary global economy alone would favour endorsing the ‘broad’ definition. However, our primary focus is not on decision-making bodies, as the term ‘private governance’ is sometimes understood in the literature. Rather, we maintain that intra-firm planning can have major impacts on taxation, regulation, and the financial transparency of corporations. Consequently, corporations can consciously affect these ‘resources and arrangements’ by intra-firm planning. Therefore, state-centred definitions of the political nature of such planning are insufficient. Limiting the analysis of corporate power only to the influence on state actions can render other significant areas of corporate power invisible.

Before focusing in more detail on the political nature of the intra-firm planning in corporations, we should ask why bother. Is it simply a matter of definitional taste whether one considers corporate activities such as intra-firm trade to be political, or whether the term ‘political’ should be reserved for the activities of governments, as in the more narrow definition of Unger? The standard use of terms such as ‘economic planning’ and ‘political intervention in the market’ associates these activities with state governments. In addition to paving way for more efficient policy responses, the realisation that corporations practise planning and intervene politically in the markets without direct mediation by states opens up new ways to reflect on the legitimacy of many aspects of the corporate sphere. In particular, understanding corporations as potentially political entities raises questions about their democratic legitimacy. These questions, apart from their practical implications, also help expand the boundaries of political economy research toward normative political theory.

Another justification for studying corporations as political entities can be found in the basic tenet of science as an endeavour intended to increase our capacity to explain and understand reality, in this case the anomalies described in the previous sections. Within mainstream economics, there have
been influential attempts to dismiss the importance of realist assumptions in scientific research, most famously in the often-cited article by Friedman (1953). While acknowledging that non-realist simplifications may sometimes be needed in science, we suggest that the mismatch between free-market assumptions and the non-market realities of intra-firm trade has become of such a magnitude that the assumptions violate the basic tenets of scientific research.

The relative absence of these questions in the scholarship on corporations at least partially results from the division of labour between academic disciplines. Scholars in economics, accounting, management, and related fields may simply think that analysing issues of democratic legitimacy is for political scientists. Most of the well-established approaches in the fields of management and economics tend to pay little attention to the historical development of their own disciplines, and even less so to others. In political studies, questions of intra-firm trade are generally considered issues of international political economy. Research in international political economy, on the other hand, is often conducted as if it was about interactions between political and economic entities that are represented respectively by states and markets. Understanding the political role of corporations and their economic planning requires transgressing the depoliticised conceptions of the economic as a separate sphere. The concept of planning enables us to analyse corporations as political entities.

One of the main assumptions that help legitimise and reproduce corporate power is the idea we discussed in the second section, namely that democratic norms are only valid within the political sphere and not within the economic sphere (Teivainen 2002). If academic research establishes that important aspects of corporate action in fact form part of the political sphere, as we believe any serious analysis of intra-firm trade suggests, we have a case for asking political questions that may seem uncomfortable for the current power relations. Politicising an entity that has traditionally been considered apolitical reveals its potentially democratisable nature. As we will argue in the next section, this can be important, for example, when designing ways of governance of unitary taxation of large corporations.

Both political economy and radical activism have a long tradition of politicising economic issues. The tax-related issues of intra-firm trade have, however, remained without much public attention until recently. Less than a decade ago, Webb (2006: 109) noted the ‘virtual absence’ of non-governmental critical activism on international corporate taxation. Since then, the situation has changed, as evidenced by the appearance of tax-related scandals in the media and the visibility of tax-themed NGOs such as Global Financial Integrity and the Tax Justice Network (Seabrooke and Wigan 2016, Dallyn, in press).

Until recently, discussions on corporate social responsibility (CSR) were characterised by an almost total absence of corporate finance and tax functions (Ylönen and Laine 2015). Both the public and corporate framing of corporate responsibility leaned heavily toward the social and environmental aspects of the corporation (e.g. Golob and Bartlett 2007: 3). In the past two decades, growing public attention to tax planning has resulted in calls to discuss tax policies ‘in the boardroom’ (KPMG 2006). In accounting studies, Gray and Laughlin maintained only a few years ago that ‘taxation remains [here], as it does throughout much of accounting research, something of an un-explored desert’ (2012: 237). This situation has been changing since the financial crisis of 2007–2009, but tax issues are still rarely discussed in detail in corporate responsibility reports (Soederberg 2010, Lee 2015). Corporations tend to dislike the emergence of tax-related aspects of intra-firm planning in the corporate responsibility agenda. One of the mechanisms to avoid it is through highlighting the various kinds of mandatory taxes they already pay, giving little meaningful information on the intra-firm dimensions of tax planning (Ylönen and Laine 2015).

In other words, there is an ongoing discursive struggle on how to frame corporate tax planning in a situation where critical debate on corporate taxation ‘is out and there’s no going back’ (KPMG 2006: 4). Moreover, the narrow framing of the voluntary tax footprint reports suggests that corporations would rather remain silent on political aspects of corporate taxes and tax planning. It is thus evident that the doctrine of economic neutrality characterises both corporate and scholarly discussion on tax planning (Swedberg 1986, Teivainen 2002). The corporate responsibility discourse has
partially challenged this doctrine by integrating conscious choice and social consequences into the responsibility debate.

In this context, mildly moralising terms such as over- or underpricing tend to suggest that the anomaly of wrongly priced products can be corrected by either hoping or assuming that corporations will conform to arm's length prices. While ‘profit shifting’ can be seen as a more neutral substitute that avoids such assumptions, we believe that ‘administered prices’ and ‘cross-subsidisation’ can be particularly useful concepts in analysing corporate power. In the 1970s, Barnet and Müller defined cross-subsidisation as ‘the use of power and resources developed in one “profit center” to start or to expand another’ (1974: 255), maintaining that the ‘widespread use of transfer pricing so central to the cross-subsidisation strategies of the global corporation is designed, as we have seen, to create what amounts to a private economy’ (277).

While we find the concept of a ‘private economy’ ambiguous, the idea of cross-subsidisation captures two important dimensions of intra-firm transactions: subsidising specific parts of a business unit for market-related reasons (e.g. setting up a new business or outbidding competitors) and setting non-market transfer prices in order to gain tax related or other advantages. Cross-subsidisation includes various forms of planning that deviate from the arm’s length principle, from non-market transfer pricing to debt-related arrangements. The goals vary from lower tax rates to avoiding regulation, or concealing risks.

Cross-subsidisation entails that the prices used in intra-firm trade may be ‘administered’ in ways that violate market principles. Means and Berle argued already in the 1930s in their seminal study of the modern corporation (Berle and Means 1934: xxxiv) that, contrary to the mainstream market theory, corporations are able to ‘administer’ their prices. According to Means (quoted in Auerbach 1962), an ‘administered price’ is ‘a price set by someone, usually a producer or seller, and kept constant for a period of time and for a series of transactions’, as distinguished from a ‘market’ price, which ‘fluctuates on the basis of supply and demand as these forces are felt in the market’.14

Our framework resonates also with the idea of large corporations as enterprise entities. Drawing partly on early evolutionary economists, Yuri Biondi and others have argued in recent years that while the group companies of multinational enterprises are treated as individual legal entities in jurisdictions where they operate, in reality these large corporations plan their activities as unified enterprise entities. According to Biondi and others, many of the difficulties in taxation and regulation of large corporations result from this mismatch between their legal treatment and their internal operational logic (Biondi et al. 2007, Biondi 2013). In a way, the enterprise entity approach and our framework complement each other, as they illuminate different aspects of corporate planning and its effects.

Our framework can also help deepen the understanding of concepts such as ‘illicit financial flows’. Baker (2005: 23) has used the terms ‘dirty money’ and illicit money interchangeably, defining the former as money ‘that is illegally earned, illegally transferred, or illegally utilised’. Consequently, the term ‘illicit financial flows’ has become widely applied in the development and tax policy communities. From the planning viewpoint, illicit flows can include various degrees of lawlessness conducted by the administering of prices. In the case of states, we have become accustomed to attaching labels such as endemic corruption or rule by the mafia to situations where one group in society is constantly bending the laws. However, we maintain that the strict separation of market and politics hampers our ability to see the similarities between the use of power in these two realms when we address similar situations in the corporate realm. Finally, it should be noted that from a normative perspective analysing corporations as potentially political entities can also have ambiguous implications, as it can lead also into situations where corporations are granted political rights without any responsibilities of political accountability.

To recap, we started by presenting the case that much of world trade takes place under conditions that the market-based lexicon captures poorly. We argued that the intra-firm trade could be analysed using the concepts of corporate planning, administration of prices, and cross-subsidisation. We also maintained that this planning and cross-subsidisation can give corporations power to affect the ‘resources and arrangements’ in states and societies where they operate, relying on Unger’s broad
definition of politics. Consequently, we believe that there are grounds to analyse not only states but also corporations as political actors.

This does not mean that all corporate planning, price administration, and cross-subsidisation could be considered equally political. Even though many individual, isolated decisions collectively affect the resources and arrangements in societies, not all these decisions should therefore be subjected to political norms such as democratic accountability. For example, one could think of a large corporation that operates in a small state and forms a significant part of the economic activities within that state’s jurisdiction. There are significant reasons to consider the corporation as political if it uses its planning power to conceal significant risks or to deprive the state of the revenues it is legally entitled to. The precise borderlines between markets, planning, and political planning clearly require further research.

Another point of interest is how easily corporations can circumvent national tax laws. While there are many countries where companies can violate environmental or labour legislation, it is difficult to think of an area where it is so common to break the spirit of the law as in tax payments. States are often incapable of effectively implementing the corporate tax laws that are supposed to condition the ‘resources and arrangements’ of corporate affairs. Meanwhile, there are occasions on which corporations can use the commercialised sovereignty (Palan 2003) of tax havens to circumvent tax laws in other countries. Even more importantly, corporations can circumvent national tax laws or other regulations by cross-subsidising their subsidiaries in low-tax and high secrecy jurisdictions.

**From the arm’s length principle to unitary taxation?**

Today, the efficiency of the arm’s length principle is debated more than ever (e.g. Eden 2016). The principle has failed in its declared goal of establishing markets within large companies. The principle, however, also has another, much less discussed ideological role that helps legitimise international corporate tax governance. We argued above that this legitimising role could be compared to discussions on the concept of ‘invisible hand’. We pointed out that while there is a huge body of critical discussion on the invisible hand, there has hardly been any discussion on the normative implications of the arm’s length principle. Consequently, we call for scholarly attention to these aspects. Relying on Unger’s broader definition of politics as ‘struggle over the resources and arrangements that set the basic terms of our practical and passionate relations’, we also argued that in order to understand corporate planning, it is important to focus on how it constitutes a political dimension in corporate affairs.

The first step in recognising the double role of the arm’s length principle is realising that the idea of using market-based comparable prices in intra-firm transactions has never been a success. The de facto rules of intra-firm trade have allowed using other mechanisms than comparable pricing at least since the 1960s. From the 1990s onwards, the applications of the arm’s length principle have moved even further from the market. While the use of comparable prices is still the first pricing method in the transfer pricing guidelines, it has long been overshadowed by other pricing mechanisms such as the cost plus method and the resale price method.

We acknowledge the work of many scholars who have analysed these issues (e.g. Avi-Yonah 1995, Durst and Culbertson 2003, Biondi et al. 2007, Ireland 2016) and the emerging discussion on the planning aspects of transnational corporations (Pistor 2014, May 2015). Nevertheless, the arm’s length principle is often discussed with an assumption that it is possible, at least in theory, to identify market-based prices. Bandyopadhyay (2012: 111) suggests that preferred price should be a ‘fair one, that is, a price that would be charged between the parent and subsidiary companies, as if they are “unrelated companies”’. This fairness is often not achieved, he continues, since ‘companies often manipulate the transfer price to escape taxes’. Essentially, this formulation can create the impression that it is generally possible to determine comparable prices but that they are currently subject to manipulation.
Similarly, Keuschnigg and Devereux (2013) maintain that ‘tax authorities typically apply the arm’s length principle in corporate taxation and use comparable market prices to “correctly” assess the value of intra-company trade and royalty income of multinationals’. As a third example, Jenkins and Newell (2013: 390) recommend that companies should ‘commit to using arm’s length pricing in all transactions with related parties as recommended by the OECD Guidelines on Multinational Enterprises’. They then note that it is not ‘always easy to establish arm’s length prices for all transactions’, but point out that there are regularly updated principles laid out in the OECD Guidelines that guide this process. One of our main arguments is that a fine-tuning of these principles is unlikely to result in market-based transfer prices, as the arm’s length principle is inconsistent with the ways corporations plan their internal transactions. Therefore, we call for careful attention to the double role of the principle and its implications for markets.

Understanding the ambiguities in current transfer pricing regulations and their various methods helps demystify intra-firm trade and opens up discussions on both more efficient alternatives and on their more democratic governance. Regarding the former, we believe that recognising the role of artificial formulas and estimations in currently existing intra-firm pricing is useful for discussing unitary taxation (e.g. Cockfield 2004, Avi-Yonah and Benshalom 2011, Avi-Yonah 2016, Picciotto 2016). Under unitary taxation, the global taxable income of corporations would be divided by a method called formulary apportionment between the jurisdictions where the company has genuine operations (Avi-Yonah et al. 2009). This is not a new idea, as the United States applies formulary apportionment between its states. Neither would the arrangement have to be global – it would also be possible for a smaller group of countries to pave the way. The arm’s length principle and formulary apportionment are not mutually exclusive systems but more like two ends of a continuum (Avi-Yonah 1995). The key issue is, therefore, to tackle the ideological assumption that it is possible to create markets within firms. As soon as we abandon this presumption, it will become easier to conduct meaningful analytical debates on what kinds of formula we should use for dividing the part of the added value created by corporations that belongs to the states.

Real unitary taxation would help the task of addressing corporations as centrally coordinated entities (Biondi 2013). It would take some of corporate planning out of private hands and make it an issue of global governance by adopting an internationally agreed formula to divide the taxable income from transnational corporations between the states where they operate. This would strengthen economic planning by states over corporations, as each state would get a share of corporate tax revenues based on a formula derived from the company’s accounts. In less state-centric possible futures, other actors could also participate in norm building or receive corporate tax incomes. Understanding large corporations as global planning entities gives weight for demanding global or regional (e.g. an EU-level) decision-making of their tax matters, possibly through channelling parts of the revenues into regional or global funding mechanisms.

The discussions of unitary taxation have evolved rapidly in recent years. In September 2013, the G20 group stated in its St. Petersburg summit declaration that ‘profits should be taxed where economic activities deriving the profits are performed and where value is created’ (G20 2013: 12). While this was not an outright endorsement of unitary taxation, it gave more weight to similar demands. The international efforts to tackle corporate cross-subsidisation have centred around the OECD’s BEPS initiative complemented by initiatives of the EU and the OECD (Eccleston and Smith 2016). It is evident, however, that these initiatives fall short of fixing the underlying problems.

The more opportunities corporations have for shaping the ‘resources and arrangements’ of the places where they operate, the more vulnerable they may also become to demands to bring their operations under more public scrutiny and accountability. Unitary taxation would diminish the current opportunities for corporate tax planning and expand the sphere of public planning. Although in itself this would not necessarily lead to a significantly more democratic system of global tax governance, it could provide new opportunities for establishing state-led or otherwise democratic alternatives to corporate power. Among other things, the policy responses depend on how well the corporate planning power we have described in this article is understood.
Concluding remarks

Depending on the formula and its application, unitary taxation could significantly diminish corporate non-market planning. The most likely short-term impact would be an increase in the overall planning power of states, but only as a result of international negotiations. The discrepancies in power between states would most likely affect the outcome of the formula, favouring some states over others. By reaching an agreement on the formula, states could significantly restrict the scope of ‘tax wars’ between nations (Christensen and Shaxson 2016), as states would delegate some of their planning power on corporate taxation to the international bodies. Effectively, with formulary apportionment, much of the current corporate planning related to intra-firm transfer pricing could be rendered useless.

On the other hand, partial solutions to the problems of transfer pricing may lead to ideological biases not unlike the double role of the arm’s length principle. This has already been evident in the significant expansion of advance pricing agreement (APA) programmes in various countries. APAs are essentially tools that companies use to negotiate transfer prices before applying them. Companies give up some of their planning power in exchange for reducing possible tax litigation risk. Moreover, as the LuxLeaks scandal of 2014 demonstrated, the APAs can also be used for aggressive tax planning and in order to avoid taxes in other countries. While by no means a panacea, multilateral negotiations for genuine unitary taxation could be an effective way of dealing with the issues of corporate planning that we have explored in this article.

A crucial question for any alternatives is the direction the recent public interest will take. Should the public interest in tax governance issues wane, the political momentum will most likely suffer as well. We hope this article can participate in opening new ways to connect the often-technical debates on intra-firm trade with more fundamental normative questions. In particular, we hope our focus on the mismatch between the market assumptions of the arm’s length principle and the reality of non-market planning in intra-firm trade can contribute to increasing public attention and political pressure. If the academics, policy-makers, and social movements are not aware of the normative implications of the terms they use, they run the risk of letting these normative aspects guide their messages and analyses. A more realist conceptual understanding of the non-market elements of world trade can be helpful also for putting democratic norms into practice.

Notes

1. An early version of this article won the 2015 Amartya Sen Prize in a contest organised by Yale University, together with Global Financial Integrity and Academics Stand Against Poverty.
2. Some key contributions in business ethics studies are Doyle et al. (2009), Huseynov and Klamm (2012), Muller and Kolk (2015), Preuss (2010, 2012), and Weyzig (2013). In political economy, see, e.g. Christensen (2011), Christensen and Murphy (2004), Dietsch and Rixen (2016), Jenkins and Newell (2013), Leaman and Waris (2013), May (2015), Otusanya (2011), Palan et al. (2013), Pogge and Mehta (2016), Rixen (2011), Seabrooke and Wigan (2017), and Webb (2006). For discussions in economics, see, e.g. Clauxing (2003), Desai and Dharmapala (2006), and Haufler and Schjelderup (2000). In accounting, see, e.g. Hasseldine and Morris (2013), Sikka (2013, in press), and Sikka and Willmot (2010). In legal scholarship, see, e.g. Avi-Yonah (1995), Durst and Culbertson (2003), Eden (2016), Ireland (2016), and Picciotto (2016).
3. In its 2002 Economic Outlook, the OECD also gave an important estimate that “Across all OECD countries ... intra-industry trade in more sophisticated products such as chemicals or machinery and transport equipment is typically around 60 or 70 per cent, whereas for manufactured goods involving simpler transformation processes, such as food products, it is typically around 40 per cent or less” (OECD 2002: 161). In the same year, the OECD Observer magazine also also stated that approximately 60 per cent of the world trade is intra-firm (Neighbour 2002).
4. Horngren et al. (2012: 773) note in their widely used textbook of managerial accounting that ‘top management uses transfer prices (1) to focus managers’ attention on the performance of their own subunits and (2) to plan and coordinate the actions of different subunits to maximise the company’s income as a whole’, also noting that ‘managers of different subunits often have very different preferences about how transfer prices should be set’.
5. Many of the key benefits of hierarchically organised operations supposed by the transaction cost theory, such as lower transaction costs and economic efficiency, are based on assumption that companies do not operate internally according to market mechanisms (Avi-Yonah 1995: 148).

6. The concept of ‘arm’s length’ is also used in many other contexts, meaning ‘avoiding intimacy or close contact’ according to the Oxford Dictionary of English Idioms. In political economy, it is sometimes applied when discussing such matters as borrowing (Agarwal and Hauswald 2008) or international production networks (Kimura 2006), but the concept also appears in studies of arts funding (Madden 2009).

7. This should not be confused with corporate taxation in trade conducted within the United States, where the tax revenue belonging to individual states is determined using formulary approach. See, e.g. Clauing (2014).

8. Intellectual property rights can also be exploited in many other ways. See, e.g. Dharmapala (2008), Graham and Tucker (2006), Grubert (2003), and Rixen (2011).

9. Recently, a growing body of statistical research has emerged on this issue. In their article focusing on the 2011 financial accounts of S&P 500 companies, Heckemeyer and Overesch (2013) estimated that 72 per cent of their profit shifting took place using non-financial (e.g. typically transfer-pricing-related) channels. For a review of other relevant research, see, e.g. European Commission (2015).

10. As, for example, providing reliable information on performance of different geographical and business segments interests not only tax authorities, but also investors (Horngren et al. 2012).

11. However, it is interesting to note that responsibility aspects of taxation are mentioned in Howard Bowen’s foundational CSR book Social Responsibilities of the Businessman (1953: 207).

12. The tax footprints often focus on the indirect taxes paid by the corporations with little or no attention to the importance of tax planning.

13. There is a danger that it may be interpreted as a closed but market-based system (in contrast to the planning system that regularly violates market principles), even though Barnett and Müller probably did not mean this.

14. Elsewhere, Means argued that ‘market’ prices are to be found only in agricultural commodities and some raw materials, whereas most industrial prices, many retail prices, and most wage rates are ‘administered’ (quoted in Auerbach 1962: 144). In the US Senate antitrust hearings of 1957–1961, Means also maintained that “administered” prices should be of special concern to the Subcommittee because the greater the concentration, the less the restraint upon pricing discretion imposed by market forces and the greater the possibility of the abuse of discretion’ (quoted in Auerbach 1962: 144).

15. On transnational democratic non-state politics, see Teivainen and Trommer (2017).

16. The LuxLeaks scandal centred on a massive leak of APAs from Luxemburg drafted by the Big 4 auditing firm and published by the members of ICIJ, the International Consortium for Investigative Journalists.

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