Taking Account...

BEA paper suggests a new MNE concept for the SNA

In the global economy and in national economies, multinational enterprises (MNEs) play a unique and important role. As this role continues to evolve, an accurate and complete picture of economically meaningful transactions within MNEs, and consequently among national economies, becomes even more important for economists, policymakers, businesses, and others.

In a recent working paper, Dylan G. Rassier, an economist with the Bureau of Economic Analysis (BEA), proposes improving the *System of National Accounts 2008* (*SNA*) treatment of transactions within MNEs by differentiating between the concept of legal residence, the principle that effectively guides the treatment of MNEs in the *SNA*, and the concept of economic residence in the *SNA's* rest of world accounts.

The *SNA* is a widely followed guide for national statistical agencies that is released under the auspices of the United Nations, the European Commission, the Organisation for Economic Co-operation and Development, the International Monetary Fund and the World Bank Group.

The scope of the residence concept includes transactions conducted within MNEs, which are often structured in ways that involve entities established for purposes other than production and often engage in internal transactions, the paper notes.

These two features present challenges for economic accounting. Under the latter feature, internal transactions are valued using transfer pricing methods that may fail to reflect market outcomes.

However, while such failure inevitably affects economic accounting statistics, any distortions that result from mispriced transactions are presumably limited because transfer prices are subject to strict regulatory scrutiny and enforcement by national tax authorities.

A bigger challenge is accounting for transactions involving MNEs that are structured for purposes other than economic production. Such structuring facilitates the use of artificial locations of inputs and outputs and of debt and equity.

The result is a wedge between the location of production and the location of the underlying factors of production, which affects the accuracy and relevance of core *SNA* measures as well as the interpretability of the measures.

In the case of an entity with little or no physical presence and little or no economic activity, residence in the *SNA* is determined by the economic territory in which the entity is legally incorporated or registered. As a result, the *SNA* rest of world account includes transactions conducted within MNEs regardless of economic substance.

While the use of legal residence was intended to be a pragmatic exception to an otherwise economic concept of residence, it likely leads to distortions throughout the core framework of the *SNA* as MNE activity increases. It has also and has been shown empirically to generate questionable results for some measures in the United States.

Rassier also notes that the economic literature on the formation of MNEs, global guidance on the taxation of MNEs, and economic accounting alternatives to legal residence all lend support to a concept of economic residence in lieu of legal residence.

His paper specifically proposes differentiating *SNA* supplemental measures under the current legal residence concept from *SNA* core measures under an economic residence concept in the rest of world account.

The change will likely be most palpable in *SNA* domestic aggregates such as gross domestic product, disposable income, saving, and net lending/net borrowing, which tend to become less accurate under the legal residence concept.

Overall, the pure concept of economic residence proposed in the paper will yield an improved core framework that is more consistent with the objectives of the *SNA*.

(This summary was prepared by the Survey of Current Business *staff in conjunction with the paper's author.)*