Chapter 2 The Background to the Rate of Return Gap between USDIA and FDIUS

This chapter discusses the background why rate of return of USDIA has been consistently higher than that of FDIUS. The chapter consists of the following. Section 1 examines an argument that rate of return of USDIA (operations in foreign countries) should be higher than that of FDIUS as the former should reflect additional country risk premium that should be added on top of rate of return of FDIUS. Section 2, shedding light from a different angle, examines another argument that rate gap between USDIA and FDIUS reflects the difference of the investment motivations between the two. Following the examinations of these fundamental aspects, Section 3 analyzes cost factors that are presumably impacting rate of return of USDIA and FDIUS. Section 4 overviews key ratios of USDIA including rate of return by industry. Section 5 examines holding company that plays key role in USDIA. Section 6 discusses whether or not FDIUS's low rate of return is attributable to their under-reporting profit to reduce U.S. corporate tax.

1. Country Risk and Rate of Return Gap between USDIA and FDIUS

As shown in Table 1-8, rate of return of USDIA has consistently exceeded that of FDIUS. On reconsidering the matter, however, it appears very logical that the former is higher than the latter. The reason is that, given other conditions be equal, the rate of return expected of USDIA (operations in foreign countries) should be determined at a higher level than that of FDIUS (operations in the U.S.), as the former should include risk premium that would compensate the difference of the country risk between the U.S. (supposed to be the safest country in terms of country risk) and other locations. We analyze below in this section such risk premium, i.e., a margin spread that should be included in USDIA rate of return in addition to return on investment in the U.S.

It would be conceivable that risk premium associated with USDIA can be estimated by using, for example, the data on theoretical default probabilities that are provided as proprietary products by major rating agencies to their clients.

As an example of using such data, a report produced in technical paper series of Congressional Budget Office (CBO) entitled "*Return on Cross-Boarder Investment: Why Does U.S. Investment Do Better?*" by Juannh H. Hung and Angelo Mascaro (December 2004) and its summary version dated November 30, 2005 estimated weighted risk factor based on the country ratings by Standard & Poor's. According to the CBO papers, they first convert letter ratings to number ratings by assigning the D rating (in default) the value zero, adding 1 to each ascending letter rating, and ending with assigning the value 21 to the highest rating, AAA. Then they apply a non-linear relationship between Standard & Poor's sovereign ratings and default probabilities to the sovereign risk rating of each host country to derive a numerical estimate of the riskiness of direct investment in the country. The CBO papers, however, disclose no key data such as non-linear relationship between Standard & Poor's sovereign ratings and default probabilities. The overall sovereign risk of outward direct investment is then the foreign direct investment weighted average of those numerical estimates of (default-probability-adjusted) riskiness of host countries. That average is converted back to the implied numerical equivalent of sovereign rating, and then to the implied letter rating. The CBO papers show that the sovereign risk rating of the risk of outward direct investment calculated as such is 14 (equivalent to BBB+). In calculating the risk, the papers indicate that share of U.S. direct investment position by each region and the average rating assigned to each region are as follows: Canada (11%, "AAA"); Latin America and other Western Hemisphere (17%, "BB+"); Europe (54 %, "AA+"); Asia and Pacific (16%, "A-"); Africa (1%, "BBB-"); Middle East (1%, "BBB+").

We herein below estimate the level of risk factor based on similar conceptual framework but using information available in public data source so that we can disclose computation process. More specifically, we calculated below risk factor by using the exposure fee of the Export-Import Bank of the United States (USEXIM) that is applicable to export insurance or export credit.

- Outlines of USEXIM'S exposure fee applicable to medium and long-term loan
  - The country category is determined by the OECD guidelines. Countries are classified between 1 and 7, with Category 1 being at the lowest risk and Category 7 at the highest risk. Exposure fee applicable to countries classified in Category 1 is set at the lowest level and Category 7 at the highest level.

- Applicable exposure fee levels are set in compliance with the minimum standard by the OECD guidelines.
- Applicable exposure fees are offered for a model case with disbursement period of 12 months or less, grace period of six moths, and semi-annual installments.
- Applicable exposure fee increases in accordance with the period until the final maturity.
- Applicable exposure fee is set on the condition that it is fully paid at upfront. Should the borrower desire such exposure fee is to be financed and to pay the fee in arrear (e.g. to pay exposure fee on top of loan interest on outstanding loan balance), the exposure fee is re-calculated at a level of percent per annum of which present value is equivalent to the fee amount to be paid at upfront.
- Percent of cover is up to 100%.
- Non-sovereign risk (transaction risk) is also covered with additional fee. Such risk increment is five-staged, reflecting financial conditions of the applicant corporations.

➢ Risk premium of USDIA to be calculated hereunder covers sovereign risk only. Other risks such as commercial risk associated with operating business by U.S. companies in foreign countries including those risks inherent to foreign markets (e.g. port strike, stability of power supply) are excluded

➢ In calculating applicable USEXIM exposure fee, the following conditions are assumed for a standard hypothetical medium-term loan.

- Loan disbursement period: 12 months
- Semi-annual installments over 7 years after 6 month-grace period, hence the weighted average life of the loan should be calculated as 4 years.
- Percent of coverage: 100%

➢ Exposure fee applicable to each country category based on the above assumptions should be calculated as follows (flat fee on an upfront basis).

- Category 1 (1.18%), Category 2 (2.21%), Category 3 (3.72%), Category 4 (5.62%), Category 5 (7.97%), Category 6 (10.45%), and Category 7 (13.50%)

➢ The above exposure fees on an upfront basis shall be converted into fees payable semi-annually in arrear on outstanding credit balance as follows.

- Category 1 (0.32% p.a.), Category 2 (0.61% p.a.), Category 3 (1.04% p.a.), Category 4 (1.61% p.a.), Category 5 (2.34% p.a.), Category 6 (3.16% p.a.), and Category 7 (4.22% p.a.)

Weighted risk premium of USDIA shall be calculated below by multiplying the above risk premium by USDIA position by area as of 2004 end (Table 2-1).

Table 2-1 USDIA Position by Area, Country Category, and Applicable Risk Premium

Area	USDIA position (US$ million)	USEXIM country category	Risk exposure fee	Weighted risk premium
Canada	216,571	1	0.32%	699.74
Austria	5,278	1	0.32%	17.05
Belgium	27,761	1	0.32%	89.7
Czech Republic	2,188	2	0.61%	13.38
Denmark	6,618	1	0.32%	21.38
Finland	2,071	1	0.32%	6.69
France	58,927	1	0.32%	190.39
Germany	79,579	1	0.32%	257.12
Greece	1,255	1	0.32%	4.05
Hungary	3,285	2	0.61%	20.09
Ireland	73,153	1	0.32%	236.36
Italy	33,378	1	0.32%	107.84
Luxembourg	74,902	1	0.32%	242.01
The Netherlands	201,918	1	0.32%	652.40
Norway	9,104	1	0.32%	29.42
Poland	6,059	2	0.61%	37.06
Portugal	3,151	1	0.32%	10.18
Russia	2,231	4	1.61%	35.95
Spain	45,251	1	0.32%	146.21
Sweden	36,399	1	0.32%	117.61
Switzerland	100,727	1	0.32%	325.45
Turkey	2,225	5	2.34%	52.15
The U.K	302,523	1	0.32%	977.45
Argentina	11,629	7	4.22%	491.15
Brazil	33,267	5	2.34%	779.65
Chile	10,196	2	0.61%	62.36
Colombia	2,987	5	2.34%	70.00
Ecuador	814	7	4.22%	491.15
Peru	3,934	4	1.61%	779.65
Venezuela	8,493	6	3.16%	62.36
Costa Rica	1,093	3	1.04%	11.48
Honduras	339	7	4.22%	14.32
Mexico	66,554	2	0.62%	407.04
Panama	5,886	4	1.61%	94.56
Barbados	1,369	3	1.04%	14.31
Bermuda	91,265	1	0.32%	294.88
Dominican Republic	1,041	6	3.16%	32.87
United Kingdom Islands	63,066	n.a.	n.a.	n.a.
Egypt	4,240	4	1.61%	68.33
Nigeria	955	7	4.22%	40.33
South Africa	4,966	3	1.04%	51.92
Israel	6,790	3	1.04%	71.00
Saudi Arabia	3,835	3	1.04%	40.10
UAE	2,368	2	0.61%	14.48
Australia	(D)	1	0.32%	n.a.
China	15,430	2	0.61%	94.37
Hong Kong	43,743	2	0.61%	267.53
India	6,203	3	1.04%	64.86
Indonesia	(D)	5	2.34%	n.a.
Japan	80,246	1	0.32%	259.27
Korea, Republic of	17,332	1	0.32%	56.00
Malaysia	8,690	2	0.61%	53.10
New Zealand	4,481	1	0.32%	14.48
Philippines	6,338	5	2.34%	148.54
Singapore	56,.900	1	0.32%	183.84
Taiwan	(D)	1	0.32%	n.a.
Thailand	7,747	3	1.04%	81.00
Total excl. (D)	1,801,304			8,437.45
Weighted risk premium			**0.47%**	
Weighted risk premium = 8,437.45 devided by 1,801,304				

The weighted risk premium that has been calculated in accordance with the above steps based on USDIA position as of 2004-end is 0.47%. In other words, applicable risk premium, (additional risk on top of business risk associated with operations in the U.S.) that should be included in rate of return on USDIA has been calculated at 0.47%. However, the following should be noted regarding the number calculated as above:

- The 0.47% is a theoretical premium applicable to risk assets of USEXIM as a debt provider, not as an equity provider. Given the fact that foreign direct investment, being equity contribution, should be in the most subordinated position in all claims to the relevant USDIA affiliate, the risk premium to be expected by equity providers should be higher than that by debt providers.
- The number calculated as above is based on a hypothetical medium-term loan (with disbursement period of one year, semi-annual installments over seven years, and average loan life of four years) within the framework of the USEXIM's official program of credit enhancement that is offered in compliance with the OECD guidelines on minimum benchmark fees. Accordingly, country risk perception held by private sector should be higher than the level of above exposure fee. In this sense, the number calculated as above should be treated as a minimum country risk premium for risk assets.
- The calculated number covers only country risk like political risk, and excludes any other additional commercial risks inherent to foreign countries such as port strike and instability of power supply. It should be noted, however, commercial risk is basically not compatible with unified quantitative approach, as such risks differ by industry.
- Substantial part of USDIA positions are those of holding companies in the Netherlands, Luxembourg, Switzerland, Bermudas, etc. that are classified as Category 1 countries. Given that such holding companies make investment in countries classified as Category 2 or below, the number calculated as above should be understated.

The CBO paper mentioned earlier, based on the analysis that the weighted rating of USDIA is equivalent to BBB+, discusses further in its paper as follows. The benchmark spread of long-term corporate bonds rated BBB, one notch lower than BBB+ versus those rated AAA averaged 136 basis points over the past 5 years (1999-2003). Such difference should be included in the rate gap between USDIA (AAA) return and FDISU (BBB+) return. The CBO summery paper dated November 30, 2005, based on the data for 10 years rather than the 5 years above, calculates such spread at approximately 0.8%. We note, however, that, CBO paper simply applies the spread between corporate bonds (being senior debt) to foreign direct investment (being most subordinated claim) without caveat. The paper might as well have made certain reservation in this regard.

The numbers 0.47% and 0.8% are theoretically expected risk premiums, which mean that such risk premiums should not be necessarily detected ex post facto. In fact, the rate of return of USDIA in Japan and Canada, the country classification being at Category 1 for both, stood at as high as 11.1% and 15.3% respectively in 2004 while that of Argentina (Category 7) and Brazil (Category 5) stood at 9.1% and 8.6% respectively in the same year.

2. Rate of Return Gap between USDIA and FDIUS and Their Motivations for Investment

There are considerable differences, as we discuss below, between USDIA (the aggregate consisting of foreign affiliates of U.S. companies) and FDIUS (the aggregate consisting of U.S. affiliates of foreign companies) with respect to each of their motivations to make investment in international market.

The typical motivation of USDIA to make investment abroad should be as follows. An U.S. that delivers its goods or services to certain foreign market compares which operation would be more profitable (i) to deliver its goods or services to the market from the U.S. head office or (ii) to deliver such goods or services through foreign affiliate. In the event that the operation (ii) is determined to be more profitable than the operation (i), the U.S. company should choose to cover the foreign market by its affiliate abroad[2]. Furthermore, the U.S. company should select the location of such

[2] Typical cases are such sectors as manufacturing and wholesale. In the case of retail sector like Wal-Mart Shop, Inc., their business models are quite different from those of typical USDIA cases in that the targeted market needs to be

affiliate after it has carefully analyzed various conditions (resources endowments, transportation cost, incentive programs, infrastructure, taxes, technology levels, market size, economic growth, etc.) of potential host countries. USDIA is deemed as the aggregate of the operations in foreign countries that have been selected after these careful screenings[3].

What is the likely process in the case of the motivation of FDIUS? Admittedly, there are FDIUS cases in which foreign companies decided to cover the U.S. market from their foreign affiliates for profitability consideration and selected the U.S. as a location of such foreign affiliates to cover the U.S. market after they carefully analyzed various conditions of potential host countries in the same way as the typical case of USDIA. However, there are a number of FDIUS cases in which foreign companies decided to cover the U.S. market from their U.S. affiliates with such motivations as counter-responses to trade frictions. There are also many FDIUS cases motivated by foreign companies' business judgment that they need to have direct presence in the U.S. market, the world largest economy in the world, to keep up with industry trends including market directions and new technologies. In most of these FDIUS cases, profitability of the operation has not been the top priority matter, at least in the short run. There are also many cases in which foreign companies, from the outset, had no intention to select other locations than the U.S. for obvious reason. The difference of the motivation between USDIA and FDIUS in making investment abroad as discussed above should be reflected in investment return ratio gap between the two.[4]

3. Cost Factor Comparison among USDIA, U.S. Parent Companies of USDIA, and FDIUS

This section examines cost factors that affect rate of return of USDIA, U.S. parent companies of USDIA and FDIUS.

Table 2-2 compares the ordinary profit to sales ratio in respect of USDIA, U.S. parent company of USDIA, and FDIUS.[5] Ordinary profit is herein defined as the profit before corporate tax minus (or plus) capital gain (or capital loss) to neutralize the difference of the tax rates in the U.S. and foreign countries as well as non-recurrent factors[6]. With regard to the ordinary profit of U.S. parent company of USDIA, receipts of dividends from USDIA affiliates are subtracted.

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covered only by franchise located in that targeted market except those operated by catalogue shopping. Accordingly, the operations of USDIA of retail sector are not necessarily more profitable than those in the U.S. market. In the case of Wal-Mar Shop Inc., the ratio of earnings before interest and taxes (EBIT) to sales for fiscal January 2005 is 5.3% as against 6.7% of U.S. operations. The ratios for fiscal January 2004 are 6.7% and 5.0% respectively.
USDIA position of retail sector stood at US$35.1 billion on a historical-cost basis as of 2004-end (classified in "other industries" sector in Table 1-4), which represents 2.0% of total USDIA position of US$2,064 billion.

[3] Some U.S. companies choose to continue concentrating their manufacturing and R&D activities in the U.S. while their foreign affiliates are engaged mainly in marketing, sales, engineering, maintenance services, and other customer support services. In the case of Applied Materials, Inc., the world largest supplier of manufacturing systems of semiconductor, its sales of overseas markets represents 79% of the company's total sales while 82% of its total fixed assets such as equipment, factories, warehouses, R&D facilities are located in the U.S.

[4] This view was also expressed by an executive officer at a global industry company we interviewed. He indicated that: (i) the U.S. market is generally considered to be the most severe business environment with most demanding shareholders, strict legal system, highest transparency requirement, and fierce competition; (ii) as such, it is generally expected that USDIA operations in less severe environment generate higher return than those in the U.S. market; and (iii) in contrast to USDIA operations in overseas markets, it is not an easy job for FDIUS operations to generate the same level of return in the tough U.S. market as U.S. companies do in their own market.

[5] Table 2-2 does not include data of depository institutions, but includes those of other financial institutions.

[6] Numbers in the table are for entire affiliate, without being prorated in accordance with equity holding.

Table 2-2 Ordinary Profit to Sales Ratio
USDIA, U.S. Parent Companies of USDIA, and FDIUS (1999-2003)

(US$ billion)

		1999	2000	2001	2002	2003
USDIA	Sales	2,218.9	2,507.4	2,524.5	2,515.6	2,905.9
	Ordinary profit (OP)	203.4	253.5	243.6	286.0	405.4
	OP to sales ratio	9.2%	10.1%	9.7%	11.4%	14.0%
Parent companies of USDIA	Sales	5,975.5	6,695.2	6,800.8	6,337.8	6,606.7
	Ordinary profit (OP)	408.6	445.6	271.9	306.7	412.8
	OP to sales ratio	6.8%	6.7%	4.0%	4.8%	6.3%
FDIUS	Sales	2,044.4	2,334.7	2,327.1	2,031.0	2,136.6
	Ordinary profit (OP)	43.5	46.7	-2.0	22.0	49.5
	OP to sales ratio	2.1%	2.0%	0.0%	1.1%	2.3%

(Compiled from the Department of Commerce data)

The above table clearly indicates the ordinary profit to sales ratio of USDIA has consistently far exceeded that of U.S. parent companies of USDIA. It also indicates rate of return of FDIUS have been not only by far lower than that of USDIA, but also substantially lower than that of U.S. parent companies of USDIA. The following sections examine cost factors that are presumably impacting profitability of each operation of USDIA, parent companies of USDIA and FDIUS.

(1) Comparison of Labor Cost to Sales Ratio

Table 2-3 compares the labor cost to sales ratio of USDIA, U.S. parent company of USDIA, and FDIUS. The data does not include depository institutions.

Table 2-3 Labor Cost to Sales Ratio of USDIA, U.S. Parent Companies of USDIA, and FDIUS (1999-2003)

(US$ billion)

		1999	2000	2001	2002	2003
USDIA	Sales	2,611.8	2,905.5	2,945.9	2,945.7	3,383.0
	Labor cost (LC)	295.3	310.8	309.7	311.4	343.0
	LC to sales ratio	11.3%	10.7%	10.5%	10.6%	10.1%
Parent companies of USDIA	Sales	5,975.5	6,695.2	6,800.8	6,337.8	6,606.7
	Labor cost (LC)	1,103.9	1,176.3	1,151.4	1,140.9	1,177.4
	LC to sales ratio	18.5%	17.6%	16.9%	18.0%	17.8%
FDIUS	Sales	2,044.4	2,334.7	2,327.1	2,216.5	2,340.2
	Labor cost (LC)	292.7	332.2	344.7	341.9	344.6
	LC to sales ratio	14.3%	14.2%	14.8%%	15.4%	14.7%

(Compiled from the Department of Commerce data)

- The ratio of U.S. parent companies of USDIA during the period averages at 17.8% where as that of USDIA at 10.6%, and that of FDIUS at 14.7%.
- The ratio of USDIA at 10.6% reflects labor cost at host countries of USDIA which should be at a substantially lower level than the U.S.
- Although the ratio of FDIUS has been slightly lower than that of U.S. parent companies of USDIA, it has been substantially higher than that of the USDIA, reflecting the level of labor cost in the U.S.
- The difference of the ratios between USDIA and FDIUS averages at 4.1% points during the period. This obviously affects rate of return of USDIA and FDIUS.

(2) Comparison of Debt to Total Assets Ratio

Table 2-4 compares debt to total assets ratio of USDIA, U.S. parent companies of USDIA, and FDIUS for the period from 1999 to 2003. The data exclude the numbers of depository institutions.

Table 2-4 Debt to Total Assets Ratio of USDIA, U.S. Parent Companies of USDIA, and FDIUS (1999-2003)

(US$ billion)

		1999	2000	2001	2002	2003
USDIA	Total assets	4,056.4	4,745.3	5,254.5	6,126.2	7,468.7
	Debt	2,608.9	2,932.0	3,179.6	3,634.3	4,354.8
	Debt ratio	64.3%	61.8%	60.5%	59.3%	58.3%
Parent companies of USDIA	Total assets	11,688.4	13,086.4	13,946.6	14,713.0	15,911.1
	Debt	8,772.9	9,729.9	10,389.3	11,336.4	12,080.7
	Debt ratio	75.1%	74.4%	74.5%	77.1%	75.9%
FDIUS	Total assets	3,637.3	4,216.3	4,760.6	4,573.1	5,093.5
	Debt	3,011.5	3,427.2	3,878.7	3,693.1	4,104.7
	Debt ratio	82.8%	81.3%	81.5%	80.8%	80.6%

(Compiled from the Department of Commerce data)

- The debt to total assets ratio of USDIA has been substantially lower than those of U.S. parent companies of USDIA, and FDIUS. USDIA is by far in a better position in terms of financial cost with its stronger balance sheet compared with U.S. parent companies and FDIUS. The ratio of USDIA is in an improving trend.
- The ratio of FDIUS has been exceeding the level of U.S. parent of USDIA by approximately 5% points, which disadvantages FDIUS in terms of financial cost compared with U.S. companies. Although the ratio of FDIUS is also in an improving trend, its pace is slower than USDIA, and gap between the two is widening.

We have examined in the above that the debt to total assets ratio of USDIA has been substantially lower than not only that of FDIUS but also that of U.S. parent companies of USDIA, thus advantaging USDIA in terms of financial cost with its strong balance sheet position. What, then, enabled USDIA to have such strong balance sheet? Or, what, then, put FDIUS in such poor financial position compared to USDIA? We will address this question in the following sections.

All affiliates, irrespective of foreign affiliates of USDIA or U.S. affiliates of FDIUS, are subject to corporate tax of its host country in respect of its profit for a reporting period. After-tax profit (net profit) is then available for (i) distribution of dividend to parent company or payment of interest to group companies, or (ii) retaining profit for reinvestment by the affiliate. Tax payment and dividend /interest payment are cash-out from the relevant affiliate while the remaining net profit is retained as cost-free funds for the relevant affiliate. The following two sections examine any difference between USDIA and FDIUS in respect of cash-out situation. We examine first the difference of tax payment between the two. We then examine how USDIA or FDIUS disposes its after-tax profit.

(3) Comparison of Corporate Tax for USDIA and FDIUS by Host Country

Table 2-5 presents the corporate tax amount paid by USDIA and FDIUS (both excluding depository institutions) to respective tax jurisdiction and the net profit amount (including capital gain/loss). The data are on a basis of entire affiliate (i.e., not prorated in accordance with equity holding). The tax amount is net of any refund. Net profit is net of net loss.

Table 2-5 Corporate Tax Paid by USDIA and FDIUS, and After-Tax Profit of USDIA and FDIUS (1983-2003)

(US$ million for (1) and (2))

	USDIA			FDIUS		
	(1) Corporate tax paid	(2) Net profit	(2) / (1)	(1) Corporate tax paid	(2) Net profit	(2) / (1)
1983	30,122	30,600	1.02	6,600	5,584	0.84
1984	33,587	36,747	1.09	8,670	9,605	1.11
1985	33,105	36,634	1.11	8,295	11,234	1.35
1986	24,454	40,779	1.67	7,434	2,458	0.33
1987	27,928	52,246	1.87	9,793	7,820	0.8
1988	30,842	66,399	2.15	10,625	12,049	1.13
1989	33,291	72,142	2.17	9,958	9,286	0.93
1990	31,693	73,254	2.31	10,352	-4,535	-0.43
1991	26,877	65,990	2.46	9,240	-11,018	-1.19
1992	26,686	62,948	2.36	8,271	-21,331	-2.58
1993	24,316	66,570	2.74	8,697	-4,354	-0.5
1994	29,277	81,095	2.77	14,984	8,132	0.54
1995	38,801	108,862	2.81	18,052	15,493	0.86
1996	45,192	118,918	2.63	24,284	24,379	1
1997	47,580	140,512	2.95	25,873	40,924	1.62
1998	40,536	134,531	3.31	26,325	33,312	1.27
1999	45,068	162,759	3.61	27,655	26,576	0.96
2000	59,801	199,864	3.34	34,800	34,593	0.99
2001	55,214	177,317	3.21	18,911	-44,894	-2.37
2002	50,916	212,564	4.17	18,166	-54,973	-3.03
2003	60,708	336,153	5.54	26,131	30,580	1.17
Total	795,994	2,276,884	Average 2.63 (not weighted)	333,116	130,920	Average 0.22 (not weighted)

(Compiled from the Department of Commerce data)

- In the early 1980s, both USDIA and FDIUS recorded net profit of approximately 1 after paying corporate tax of 1 respectively.
- However, USDIA started recording net profit exceeding 2 after paying corporate tax of 1 from the late 1980s. Such net profit to corporate tax ratio of USDIA increased to 2.5-3.0 in the mid 1990s, and exceeded 5 in 2003.
- In contrast to USDIA, the comparable ratio of FDIUS has changed little since in the 1980s with the ratio at around 1.
- The higher the ratio, the more tax effective (more tax saving). The ratio of USDIA started increasing from the late 1980s, and accelerated its increment in the 1990s, which is exactly the same timing that setting up holding companies started to proliferate.
- If we look at the numbers on an accumulated basis for the period from 1983 to 2003, USDIA paid to host countries for a total amount of corporate tax of US$796.0 billion while it recorded a total amount of net profit of US$2,276.9 billion. The comparable numbers of FDIUS are a total amount of corporate tax of US$333.1 billion paid to U.S. tax authorities and a total amount of net profit of US$130.9 billion (on the basis of net profit and net loss being netted out) and US$267.7 billion (on the basis of net loss being excluded).
- The above indicates that the portion of cash-out in the form of corporate tax of USDIA is small in relation to USDIA's pre-tax profit with an accumulated net profit to corporate tax ratio of 2.9. In contrast to USDIA, the portion of cash-out in the form of corporate tax of FDIUS is extremely large in relation to FDIUS's pre-tax profit. In fact, FDIUS's net profit amount did not reach the amount paid for corporate tax. In FDIUS, as we discuss later in the section on profitability by industry, performance of business operations vary greatly among industries, with good performers (e.g. motor vehicle by Japanese manufacturers in the U.S.) paying a large amount of corporate tax while poor performers (e.g. communication industry) causing to squeezing the aggregate amount of FDIUS's net profit, thus reducing FDIUS's net profit to corporate tax ratio.

Notwithstanding the above, the reason for the marked difference of the ratio between USDIA and FDIUS is unusual smallness of corporate tax amount paid in the tax jurisdictions where holding companies are located. We will discuss USDIA holding companies in more detail.

(4) Comparison of Disposition of Profit

Table 2-6 presents the breakdown of the disposition of profit of USDIA and FDIUS for the period from 1992-2003. The profit hereunder is defined as follows: profit = distributed dividends + reinvested earnings + paid-out interest (net). Therefore, the profit here is totally different form the net profit referred to in section (3) above. Also please note that the data in this section are on a prorated basis, and include depository institutions.

Table 2-6 Comparison of Disposition of Profit of USDIA and FDIUS (1992-2003)

(US$ million)

	USDIA					FDIUS				
	Profit	Distributed dividend	Reinvested earnings[7]		Interest Paid (Net)	Profit	Distributed dividend	Reinvested earnings [8]		Interest Paid (Net)
			Reinvested earnings	of which revaluation				Reinvested earnings	of which revaluation	
1992	51,912	34,441	16,287	-7	1,184	317	6,930	-13,389	-1,286	6,775
1993	61,579	28,390	31,492	1,252	1,697	5,250	8,478	-9,317	631	6,090
1994	67,702	31,065	34,718	1,672	1,919	22,621	7,394	7,594	-618	7,633
1995	88,882	31,955	54,470	2,103	2,457	31,418	9,825	13,290	-612	8,303
1996	98,890	37,629	57,885	2,252	3,377	32,132	12,024	12,187	-1,873	7,921
1997	109,407	42,726	64,310	7,307	2,371	45,674	13,606	22,524	2,701	9,545
1998	102,846	41,419	58,651	11,185	2,775	43,441	19,638	12,789	4,415	11,015
1999	118,802	45,492	69,640	12,390	3,670	56,098	17,390	23,155	4,364	15,555
2000	149,240	45,984	99,691	13,180	3,566	68,009	24,744	23,651	6,539	19,614
2001	125,996	42,253	79,668	13,863	4,076	23,401	20,405	-19,697	6,361	22,694
2002	142,933	43,453	94,152	18,095	5,328	49,458	19,575	6,755	9,603	23,128
2003	187,522	40,363	141,106	21,914	6,053	68,657	38,265	12,048	10,118	18,345
Total	1,305,711	465,170	802,070	105,206	38,473	446,476	198,274	91,590	40,343	156,618
Share	100.0%	35.6%	61.4%	8.1%	2.9%	100.0%	44.4%	20.5%	9.0%	35.0%

（Compiled from the U.S. Department of Commerce data）

- USDIA allocated US$802.1 billion (61.4%) to reinvestment out of its total cumulative profit of US$1,350.7 billion while it allocated US$465.2 billion (35.6%) to dividend distribution and US$38.5 billion (2.9%) to interest payment. The cash-out from USDIA during the period amounts to 38.5% of cumulative profit.
- In contrast to USDIA, FDIUS allocated US$198.3 billion (44.4%) to dividend distribution and US$156.2 billion (35.0%) to interest payment out of its total cumulative profit of FDIUS while it allocated US$91.6 billion (20.5%) to reinvestment. The cash-out from FDIUS during the period amounts to 79.5% of cumulative profit.
- Cumulative reinvestment amount of US$802.1 billion up to 2003 consists of US$105.3 billion attributable to revaluation profit and remaining US$696.8 billion. The latter portion is deemed as cost-free funds for USDIA as it is retained with USDIA on cash value basis. If we assume the marginal funding cost of US dollar at 5-6% p.a., the opportunity gain for USDIA would be calculated around US$35-40 billion, which should be equal to 1.75% -2% p.a. on USDIA position of US$2 trillion as of 2003-end.

Active reinvestment by USDIA foreign affiliates has been induced mainly by the U.S. tax law which allows tax deferral on certain foreign income. Under the law, income from USDIA generally is not subject to tax until the income is repatriated. As long as the income is retained with USDIA and reinvested abroad, U.S. tax is not applicable.

[7] Retained invested earnings are prorated retained earnings of the relevant affiliate in accordance with the percentage of equity holding

[8] In the event that an affiliate recorded net loss for a reporting period or distributed dividends in excess of net profit for a reporting period, such net loss or excess portion shall be recorded as negative reinvestment.

The American Jobs Creation Act enacted in October 2004 contains a provision to allow a temporary tax holiday for dividend repatriation. U.S. firms may elect a one-year window in 2004 or 2005 during which they may deduct 85% of extraordinary cash dividends received from controlled foreign corporations. This effectively taxes those dividends at 5.25%, or 35% of 15%. Depending on the magnitude of the repatriation, it would negatively impact USDIA foreign affiliates' financial cost. While the size of the repatriation has yet to be known, it needs to be closely followed up.

4. Ratio Comparison by Industry

USDIA generally performs better than FDIUS on all industries basis. However, as we discuss later, the performance of each industry segment varies significantly. We overview the data for all industries first, followed by each major industry segment. Depository institutions are examined at the end of this section as the data base is different from other industry segments.

Table 2-7 Major Ratios Comparison (All Industries) (2003)

(US$ million)

	ROA	Equity to total asset ratio	Profit to sales ratio	Labor cost to sales ratio	Net profit	Total assets
USDIA	4.50%	41.70%	11.60%	10.20%	336,153	7,468,713
Parent companies of USDIA	2.70%	24.10%	6.50%	17.80%	432,407	15,911,129
FDIUS	0.60%	19.40%	1.40%	14.90%	30,580	5,093,531

(Compiled from the Department of Commerce data)

- Operation size of USDIA in terms of total assets is almost one half of U.S. parent companies of USDIA.
- Operation size of FDIUS in terms of total assets is nearly 70% of USDIA. However, net profit of FDIUS is less than one tenth of USDIA. Ordinary profit[9] of FDIUS for US$49.5 billion is also one tenth of USDIA's US$405.4 billion.

Table 2-8 Major Ratios Comparison (Mining and Utilities) (2003)

(US$ million)

		ROA	Equity to total asset ratio	Profit to sales ratio	Labor cost to sales ratio	Net profit	Total assets
Mining	USDIA	7.5%	41.8%	20.1%	5.3%	23,073	309,421
	Parent companies of USDIA	3.2%	45.5%	10.9%	20.5%	6,257	193,645
	FDIUS	1.0%	32.9%	3.0%	23.7%	554	56,816
Utilities	USDIA	2.3%	30.7%	6.0%	5.2%	2,290	98,234
	Parent companies of USDIA	-0.3%	21.1%	-0.7%	11.4%	-1792	706,655
	FDIUS	0.8%	33.6%	2.0%	7.1%	741	89,932

(Compiled from the Department of Commerce data)

- Reflecting the U.S.'s unparalleled overseas operation scale in natural resources development area, USDIA (mining) overwhelms U.S. parent companies and FDIUS by total assets.
- Operation size of USDIA and FDIUS of utilities segment is small compared with that of U.S. parent companies of USDIA.
- FDIUS (utilities), mainly consisting of electric power generation by the U.K. and Canada, has been outperformed by USDIA, but it has been performing steadily compared with U.S. parent companies of USDIA. The ROA and net profit to sales ratio of USDIA, though the level themselves are quite low because of the nature of the industry, are much better than those of FDIUS.
- USDIA (mining) recorded ordinary profit of US$41,884 million while FDIUS US$778 million.

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[9] Ordinary profit is defined as the profit before corporate tax minus (or plus) capital gain (or capital loss) to neutralize the difference of the tax rates in the U.S. and foreign countries as well as non-recurrent factors. With regard to the ordinary profit of U.S. parent company of USDIA, receipts of dividends from USDIA affiliates are subtracted.

Ordinary profit to sales ratio of USDIA (mining) is 36.5% while that of FDIUS (mining) is 4.2%. The gap between the two is more conspicuous in the ratio. USDIA (utilities) recorded ordinary profit of US$3,759 million while FDIUS (utilities) US$1,704 million. Ordinary profit to sales ratio of USDIA (utilities) is 9.8% and that of FDIUS (utilities) 4.6%.

Table 2-9 Comparison of Major Ratios (All Manufacturing) (2003)

(US$ million)

	ROA	Equity to total asset ratio	Profit to sales ratio	Labor cost to sales ratio	Net profit	Total assets
USDIA	5.3%	45.2%	5.1%	10.5%	69,213	1,301,666
Parent companies of USDIA	3.9%	32.5%	5.9%	17.6%	177,395	4,602,585
FDIUS	0.6%	28.6%	0.7%	17.7%	6,046	1,035,133

(Compiled from the Department of Commerce data)

- The ratios are more or less the same as "all industries", as "all manufacturing" covers a wide variety of industry segments.
- USDIA recorded ordinary profit of US$85,201 million while FDIUS US$15,301 million. Ordinary profit to sales ratio of USDIA is 6.3% and that of FDIUS 1.8%.

We examine below manufacturing sector by each industry segment.

Table 2-10 Comparison of Major Ratios (Food and Beverages & Tobacco) (2003)

(US$ million)

		ROA	Equity to total asset ratio	Profit to sales ratio	Labor cost to sales ratio	Net profit	Total assets
Food	USDIA	6.5%	45.0%	5.3%	9.7%	5,441	83,966
	Parent companies of USDIA	6.5%	34.7%	6.7%	13.9%	17,214	265,423
	FDIUS	-0.2%	19.6%	-0.2%	13.7%	-98	46,672
Beverages & Tobacco	USDIA	11.8%	55.2%	13.1%	7.0%	6,532	55,210
	Parent companies of USDIA	10.5%	31.1%	18.8%	16.3%	17,584	167,840
	FDIUS	-4.5%	21.1%	-5.5%	14.3%	-1,236	27,426

(Compiled from the Department of Commerce data)

- There is no significant gap between USDIA and FDIUS in terms of the size of total assets for both food and beverages & tobacco industries. However, USDIA recorded substantial amount of net profit for the both industry segments while FDIUS recorded net loss for the both segments.
- The above ratios straightly reflect the established strength of U.S. companies represented by Coca Cola, etc. in this segment both in domestic and international markets.
- USDIA (food) recorded ordinary profit of US$7,293 million while FDIUS (food) US$87 million. Ordinary profit to sales ratio of USDIA (food) is 7.1% and that of FDIUS (food) 0.2%.
- USDIA (beverages & tobacco) recorded ordinary profit of US$7,991 million while FDIUS (beverage & tobacco) US$330 million. Ordinary profit to sales ratio of USDIA (beverage & tobacco) is 16.0% and that of FDIUS (beverage and tobacco) 1.5%.

Table 2-11 Comparison of Major Ratios (Chemicals) (2003)

(US$ million)

		ROA	Equity to total asset ratio	Profit to sales ratio	Labor cost to sales ratio	Net profit	Total assets
Chemicals	USDIA	7.6%	50.6%	10.9%	11.0%	28,011	369,757
	Parent companies of USDIA	5.9%	40.3%	9.6%	19.5%	39,117	664,700
	FDIUS	2.9%	36.9%	4.3%	19.6%	6,899	235,676
of which Pharmaceuticals	USDIA	10.8%	53.5%	18.1%	11.2%	19,263	178,750
	Parent companies of USDIA	8.3%	47.2%	14.7%	20.4%	27,986	335,650
	FDIUS	2.6%	36.1%	3.9%	24.7%	2,937	112,631
Soap, cleaning compounds, etc	USDIA	9.5%	36.2%	9.7%	11.9%	3,196	33,539
	Parent companies of USDIA	9.9%	44.0%	13.1%	16.2%	7,178	72,890
	FDIUS	10.1%	45.0%	25.2%	15.7%	4,568	45,057

(Compiled from the Department of Commerce data)

- USDIA and U.S. parent companies of USDIA maintain higher profitability in this segment compared with other manufacturing sectors.
- Profitability of USDIA and U.S. parent companies of pharmaceuticals and medicines segment is extremely high. USDIA excels and achieves better ratios including profitability than U.S. parent companies.
- Profitability of FDIUS of soap, cleaning, and toilet preparations exceeds USDIA and U.S. parent companies with higher ROA and net profit to sales ratio. It is due partly to capital gain of US$2,608 million being included in FDIUS, but, as is touched upon later, ordinary profit to sales ratio of FDIUS of this segment is higher than that of USDIA. Major investors in this segment are France and Germany. This is one of the few industry segments along with motor vehicles in which FDIUS exceeds USDIA performance.
- USDIA (chemicals) recorded ordinary profit of US$31,846 million while FDIUS (chemicals) US$7,220 million. Ordinary profit to sales ratio of FDIUS (chemicals) is 12.4% and that of FDIUS (chemicals) 4.5%.
- USDIA (pharmaceuticals and medicines) recorded ordinary profit of US$21,718 million while FDIUS (pharmaceuticals and medicines) US$5,639 million. Ordinary profit to sales ratio of USDIA is 20.4%, and that of FDIUS 7.5%. It is of note that labor cost to sales ratio of USDIA is less than half of that of FDIUS while the latter exceeds that of U.S. parent companies of USDIA. This is a typical case in which foreign companies that are required to maintain their presence in the U.S. market in this segment are paying higher cost.
- USDIA (soap, cleaning, and toilet preparations) recorded ordinary profit of US$3,562 million while FDIUS (soap, cleaning, and toilet preparations) US$2,203 million. Ordinary profit to sales ratio of USDIA is 10.8% and that of FDIUS 12.1%.

Table 2-12 Comparison of Major Ratios (Primary and Fabricated Metals) (2003)

(US$ million)

	ROA	Equity to total asset ratio	Profit to sales ratio	Labor cost to sales ratio	Net profit	Total assets
USDIA	3.7%	49.6%	5.5%	17.0%	8,036	70,165
Parent companies of USDIA	2.9%	34.3%	3.2%	23.1%	4,464	153,861
FDIUS	-1.4%	26.8%	-1.3%	19.9%	-609	44,551

(Compiled from the Department of Commerce data)

- While FDIUS has been suffering from poor performance since 2000, USDIA is in a steady trend.
- USDIA recorded ordinary profit of US$3,132 million while FDIUS recorded US$389 million. Ordinary profit to sales ratio of USDIA is 2.1% and that of FDIUS 0.8%.

Table 2-13 Comparison of Major Ratios (Machinery and Transportation equipment) (2003)

(US$ million)

		ROA	Equity to total asset ratio	Profit to sales ratio	Labor cost to sales ratio	Net profit	Total assets
Machinery	USDIA	5.0%	49.5%	4.9%	16.9%	3,305	66,266
	Parent companies of USDIA	3.1%	25.7%	8.3%	20.4%	20,216	651,491
	FDIUS	-0.3%	38.4%	-0.4%	26.0%	-278	99,454
Motor vehicles, parts	USDIA	1.4%	29.1%	1.0%	10.9%	2,730	192,194
	Parent companies of USDIA	0.9%	9.5%	1.6%	12.6%	8,468	983,600
	FDIUS	1.6%	18.7%	1.8%	11.4%	3,251	205,620

(Compiled from the Department of Commerce data)

- While FDIUS (machinery) has suffered from weak business recently, USDIA (machinery) has been performing strongly.
- The ratios indicate FDIUS (motor vehicles) size and its strong performance, with total assets and net profit being 20% and 38% respectively of U.S. parent companies of USDIA. FDIUS (motor vehicles) exceeds USDIA in terms of total assets and net profit. This is one the few segments along with aforementioned soap, cleaning, and toilet preparations in which FDIUS outperforms USDIA.

- The ratios of USDIA (motor vehicles) and U.A. parent companies are not in good shape. Their ROA and net profit to sales ratio are lower than those of FDIUS (motor vehicles).
- The strong performance of FDIUS (motor vehicles) is due primarily to U.S. affiliates of Japanese companies, whose net profits amounts to US$2,014 million, representing 62% of total net profit of FDIUS (motor vehicle) of US$3,251 million. ROA of Japanese companies is not available as the size of their total assets is not disclosed. Net profit to sales ratio of Japanese FDIUS (motor vehicle) is calculated at 3.1% based on the sales of US$64,346 million, being 44% of the sales of USDIA (motor vehicles) of US$146,384 million, which compares advantageously to USDIA's 1.0% and U.S. parent companies' 1.6%. If Japanese portion is subtracted from FDIUS (motor vehicle), the ratio drops to 1.5%, which is slightly lower than U.S. parent companies.
- USDIA (machinery) recorded ordinary profit of US$3,914 million while FDIUS net loss of US$144 million. USDIA (motor vehicles & parts) recorded ordinary profit of US$3,077 million while FDIUS (motor vehicles & parts) US$3,588 million. Ordinary profit to sales ratio of USDIA (motor vehicles and parts) is 1.1% and that of FDIUS (motor vehicles and parts) 2.0%.
- It is noted that equity to total assets ratio of U.S. parent companies (motor vehicles & parts) is unusually low. The ratio which stood at an ordinary level of 25.1% in 1985 declined to 15.1% (1995), 14.2% (2000), 10.9% (2001), and 6.8% (2002). It stood at 9.5% in 2003.

Table 2-14 Comparison of Major Ratios (Computers and electric products) (2003)

(US$ million)

	ROA	Equity to total asset ratio	Profit to sales ratio	Labor cost to sales ratio	Net profit	Total assets
USDIA	4.8%	45.7%	3.8%	7.8%	7,888	165,132
Parent companies of USDIA	1.2%	57.0%	2.0%	23.6%	6,121	501,432
FDIUS	-4.6%	26.7%	-4.6%	19.8%	-4,221	92,661

(Compiled from the Department of Commerce data)

- FDIUS has suffered from weak business in 2001-2003 due to IT bubble burst. The recovery started in 2004 in this segment.
- There are significant gap among USDIA, U.S. parent companies and FDIUS in their profitability. It is of note that the gap between USDIA and U.S. parent companies detected in labor cost to sales ratio. Relocation of manufacturing plants to strategic cites (e.g., Ireland) should be one of the factors supporting USDIA's strong profitability.

Table 2-15 Comparison of Major Ratios (Wholesale trade) (2003)

(US$ million)

	ROA	Equity to total asset ratio	Profit to sales ratio	Labor cost to sales ratio	Net profit	Total assets
USDIA	6.8%	39.5%	4.6%	5.5%	33,706	499,072
Parent companies of USDIA	5.0%	36.9%	3.4%	8.1%	21,029	418,287
FDIUS	3.7%	33.5%	2.6%	5.8%	16,711	453,529

(Compiled from the Department of Commerce data)

While the ratios of USDIA, U.S. parent companies and FDIUS vary within a relatively narrow range compared with other industry sectors, FDIUS still lags behind USDIA in ROA and net profit to sales ratio. The background to this difference is due to FDIUS's weak profitability in other goods than petroleum and petroleum products (e.g. professional and commercial equipment and supplies, motor vehicles, other durable goods, electrical goods, other nondurable goods). Major ratios of USDIA and FDIUS in the sectors other than petroleum and petroleum products are as follows. The comparative data on U.S. companies are not available.

(US$ million)

	ROA	Equity to total asset ratio	Profit to sales ratio	Labor cost to sales ratio	Net profit	Total assets
USDIA	7.1%	41.0%	5.3%	6.6%	31,990	450,470
FDIUS	2.7%	32.2%	1.9%	7.5%	8,354	305,054

(Compiled from the Department of Commerce data)

- USDIA recorded ordinary profit of US$35,452 million while FDIUS US$17,691 million. Ordinary profit to sales ratio of USDIA is 4.8% and that of FDIUS 2.8%.

Table 2-16 Comparison of Major Ratios (Information) (2003)

(US$ million)

		ROA	Equity to total asset ratio	Profit to sales ratio	Labor cost to sales ratio	Net profit	Total assets
Information	USDIA	1.0%	27.6%	1.6%	15.6%	1,575	156,522
	Parent companies of USDIA	5.0%	45.0%	12.8%	22.1%	69,176	1,384,250
	FDIUS	-1.5%	39.2%	-5.0%	21.5%	-4,076	265,832
of which Broadcasting & telecommunications	USDIA	-5.6%	6.0%	-12.8%	11.8%	-4,086	72,388
	Parent companies of USDIA	5.0%	41.8%	13.4%	20.5%	46,606	939,673
	FDIUS	-6.2%	33.3%	-18.9%	13.9%	-3,668	59,317
Others	USDIA	6.7%	46.2%	8.4%	17.4%	5,661	84,134
	Parent companies of USDIA	5.0%	51.6%	11.7%	24.7%	22,570	444,577
	FDIUS	-0.2%	40.9%	-0.7%	23.9%	-408	206,515

(Compiled from the Department of Commerce data)

- Information sector includes telecommunication (telephone, internet, etc.), broadcasting, publishing (software publishers), motion pictures, sound recording, etc. The performance of telecommunication and broadcasting sector varies greatly from other sectors.
- ROA and net profit to sales ratio of USDIA (information) are substantially lower than those of U.S. parent companies due to huge loss incurred by telecommunication sector in overseas market. Equity to total assets ratio of USDIA is unusually low.
- In contrast to telecommunication sector, other segments of USDIA (information) are performing strongly.
- FDIUS (information) recorded losses not only in communication sector but also in other sectors with total net loss of US$4.1 billion.
- USDIA (information) recorded ordinary profit of US$4.9 billion while FDIUS (information) recorded loss of US$323 million. Ordinary profit to sales ratio of USDIA (information) is 5.0% and that of FDIUS (information) –0.4%. USDIA (communication and broadcasting) recorded ordinary profit of –US$2,959 million while FDIUS (communication and broadcasting) –US$2,235 million. USDIA (other information) recorded ordinary profit of US$7,865 million while FDIUS (other information) US$1,912 million. Ordinary profit to sales ratio of USDIA (other information) is 11.7% and that of FDIUS (other information) 3.3%.

Table 2-17 Comparison of Major Ratios (Finance except Depository Institutions and Insurance) (2003)

(US$ million)

	ROA	Equity to total asset ratio	Profit to sales ratio	Labor cost to sales ratio	Net profit	Total assets
USDIA	1.4%	21.2%	17.5%	10.5%	40,141	2,813,684
Parent companies of USDIA	1.2%	10.9%	10.6%	15.4%	90,038	7,311,031
FDIUS	0.2%	6.3%	3.9%	19.0%	6,328	2,710,029

(Compiled from the Department of Commerce data)

- Finance (except depository institutions) and insurance sector includes securities, nondepository credit intermediation, funds, trust, insurance carriers and related activities.
- ROA level of this sector is lower than that of other industry sectors as this sector is basically asset based business.
- USDIA and FDIUS are almost the same on total assets. However, the size of owners' equity

(though not shown in the table) differs greatly with USDIA being US$597.2 billion and FDIUS being US$171.7 billion.

- USDIA recorded ordinary profit of US$37,025 million while FDIUS US$6,262 million. Ordinary profit to sales ratio of USDIA is 16.1% and that of FDIUS 3.9%.

Table 2-18 Comparison of Major Ratio (Professional, Scientific and Technical Services) (2003)

(US$ million)

	ROA	Equity to total asset ratio	Profit to sales ratio	Labor cost to sales ratio	Net profit	Total assets
USDIA	4.3%	34.3%	7.3%	28.8%	6,613	152,724
Parent companies of USDIA	8.8%	46.6%	11.6%	37.4%	22,505	255,720
FDIUS	1.0%	44.9%	1.2%	26.7%	609	62,246

(Compiled from the Department of Commerce data)

- Professional, scientific and technical services include computer systems design and engineering, consulting, advertising, legal services, accounting tax services, typical business segments that are most developed in the U.S. market.
- With this background, profitability of U.S. parent companies far exceeds those of USDIA and FDIUS.
- Net profit to sales ratio of FDIUS is far below that of USDIA or U.S. parent companies. USDIA recorded ordinary profit of US$7,160 million and FDIU US$3,607 million. Ordinary profit to sales ratio of USDIA is 7.9% and that of FDIUS 7.1%, indicating FDIUS net profit being reduced by relatively large amount of U.S. corporate tax paid by FDIUS.

Table 2-19 Comparison of Major Ratios (Other Industries) (2003)

(US$ million)

	ROA	Equity to total asset ratio	Profit to sales ratio	Labor cost to sales ratio	Net profit	Total assets
USDIA	7.5%	69.0%	63.1%	16.0%	159,543	2,137,370
Parent companies of USDIA	4.6%	39.4%	4.3%	21.5%	47,781	1,038,955
FDIUS	0.9%	45.0%	1.4%	21.9%	3,668	420,015

(Compiled from the Department of Commerce data)

- “Other industries” included in USDIA and U.S. parent companies data are slightly different from those included in FDIUS data. The former includes agriculture, forestry, construction, retail trade, transportation, real estate, rental, leasing, hotel, restaurant, management of nonblank companies (e.g. holding company), etc. The latter does not includes retail trade, rental and leasing which the former includes. On the contrary, the latter includes mining and utilities which the former does not.
- FDIUS data in Table 2-19 is reformatted to the same base as “other industries” defined for USDIA and U.S. parent companies.
- The reason why USDIA shows aberrant levels in all ratios compared with U.S. parent companies and FDIUS is that “other industries” include holding companies abroad the main function of which is to channel investment to other entities abroad. As we discuss in the following section, USDIA (holding company) profit as percentage of total is substantial.

As mentioned at the outset of this section, data on depository institutions are unavailable on the base described above. In order to compare profitability of USDIA and FDIUS by industry including depository institutions, we examine below profit (net of withholding tax) to investment position (on a historical basis) ratio for the period from 2001 to 2004.

General trend of profitability of industries other than depository institutions is more or less the same as what we examined using the ratios such as ROA in the section above. However, there are some industry sectors in which the gap of rate of return between USDIA and FDIUS changed in 2004. This will be addressed in Chapter 3. The section below discusses mainly on depository institutions segment that was excluded from earlier analysis.

Table 2-20 Comparison of Profitability by Industry (2001-2004)

		2001	2002	2003	2004	Average
All Industries	USDIA	7.9%	8.1%	10.1%	10.9%	9.3%
	FDIUS	0.3%	2.6%	4.3%	6.3%	3.4%
Mining	USDIA	12.2%	11.1%	13.3%	17.9%	13.6%
	FDIUS	0.1%	0.3%	4.5%	9.4%	3.6%
Utilities	USDIA	8.7%	8.1%	8.5%	10.2%	8.9%
	FDIUS	3.3%	3.2%	4.7%	3.4%	3.7%
Manufacturing	USDIA	8.2%	7.9%	10.1%	12.0%	9.6%
	FDIUS	0.9%	4.0%	4.6%	7.3%	4.2%
of which Food	USDIA	11.6%	12.8%	14.6%	12.9%	13.0%
	FDIUS	3.3%	4.9%	0.0%	9.7%	4.5%
Chemicals	USDIA	9.2%	10.7%	12.1%	13.5%	11.4%
	FDIUS	1.6%	6.4%	6.6%	6.3%	5.2%
Metals	USDIA	6.5%	5.4%	8.0%	10.6%	7.6%
	FDIUS	-1.2%	0.0%	2.9%	12.8%	3.6%
Machinery	USDIA	6.6%	10.7%	11.3%	12.6%	10.3%
	FDIUS	-2.6%	1.2%	-1.2%	2.9%	0.1%
Computers, etc.	USDIA	7.3%	2.8%	9.2%	10.9%	7.6%
	FDIUS	-7.6%	-5.4%	-0.6%	5.6%	-2.0%
Electric products	USDIA	6.8%	5.3%	5.7%	11.5%	7.3%
	FDIUS	5.0%	9.6%	-0.2%	5.9%	5.1%
Transportation equipment	USDIA	4.8%	2.3%	5.0%	9.4%	5.4%
	FDIUS	3.2%	6.6%	7.3%	8.0%	6.3%
of which	USDIA	2.3%	-3.2%	-1.2%	7.3%	1.3%
Motor vehicles and parts	FDIUS	3.9%	7.4%	8.7%	10.8%	7.7%
Wholesale trade	USDIA	13.3%	11.9%	16.1%	18.7%	15.0%
	FDIUS	5.3%	6.3%	8.7%	11.3%	7.9%
Information	USDIA	-6.5%	3.1%	13.7%	17.2%	6.9%
	FDIUS	-9.1%	-2.7%	2.1%	4.9%	-1.2%
Depository institutions	USDIA	4.9%	2.4%	4.3%	5.0%	4.2%
	FDIUS	3.0%	2.8%	2.6%	4.4%	3.2%
Finance (excluding depository institutions)	USDIA	4.0%	5.6%	7.0%	7.8%	4.7%
and insurance	FDIUS	-0.8%	-2.0%	4.3%	4.4%	1.5%
Professional, technical services	USDIA	5.2%	6.8%	11.3%	14.9%	9.6%
	FDIUS	-0.8%	-0.7%	-0.1%	7.1%	1.4%
Other industries	USDIA	9.6%	9.2%	10.2%	9.4%	9.6%
	FDIUS	1.6%	2.2%	2.2%	3.2%	2.3%
of which Management companies	USDIA	10.3%	9.8%	10.7%	9.4%	10.1%
including holding companies	FDIUS	-3.6%	-1.5%	0.0%	-0.2%	-1.3%

(Compiled from the Department of Commerce data)

- Profitability of USDIA and FDIUS in depository institutions segment has been consistently low compared with other industry sectors. Banking business is not profitable for both USDIA and FDIUS.
- The net profit in absolute terms is not large. USDIA (depository institutions) net profit of US$3,247 million is only 1.6% of total USDIA while FDIUS (depository institutions) net profit of US$4,619 million is 5.0% of total FDIUS.
- The rate of return gap between USDIA and FDIUS in depository institutions sector is relatively small compared with other industry sectors. USDIA and FDIUS are nearly equal in terms of profitability.

5. Holding Companies Abroad

This section examines USDIA's holding companies whose presence has been increasing in recent years.

(1) Proliferation of Holding Companies in USDIA

Holding companies that have been classified under "other industries" since 1999 had been classified under "finance (except depository institutions) and insurance and real estate" up until 1998. The latter sector includes as its core part such highly growing investment areas as securities and insurance. This implies a sharp increase of investment position in "finance (except depository institutions) and insurance and real estate" does not necessarily mean a sharp increase of holding companies. As the data on investment position by industry are not available for the years up to 1998, we will use other parameters, i.e., total assets, owners' equity and net profit. Table 2-21 presents those data together with holding companies' share in majority-owned non-bank foreign affiliates of US companies for the period from 1983 to 2003.

Table 2-21 Total Assets, Owners' Equity and Net Profit of USDIA Holding Companies (1983-2003)

(US$ billion)

	majority-owned non-bank foreign affiliates			of which Holding companies			Share of Holding companies		
	Total assets	Owner's equity	Net profit	Total assets	Owner's equity	Net profit	Total assets	Owner's equity	Net profit
1983	585.2	233.1	30.6	29.8	23.6	(D)	5.1%	10.1%	(D)
1984	597.4	244.0	36.7	32.2	26.2	3.0	5.4%	10.7%	8.2%
1985	655.6	264.3	36.6	38.8	30.8	3.5	5.9%	11.7%	9.6%
1986	728.1	296.9	40.8	46.5	36.0	4.5	6.4%	13.6%	11.0%
1987	860.8	353.4	54.2	51.3	41.1	6.3	6.0%	11.6%	11.6%
1988	950.6	368.4	66.4	59.6	48.6	10.3	6.3%	13.2%	15.5%
1989	1,080.2	407.1	72.1	81.9	64.1	10.6	7.6%	15.7%	14.7%
1990	1,275.0	465.2	73.3	103.0	76.4	11.3	8.1%	16.4%	15.4%
1991	1,375.8	507.0	66.0	110.8	83.9	10.3	8.1%	16.5%	15.6%
1992	1,474.1	539.9	62.9	123.7	94.9	12.0	8.4%	17.6%	19.1%
1993	1,738.0	589.5	66.6	143.8	111.5	11.0	8.3%	18.9%	16.5%
1994	2,022.7	682.7	81.1	164.8	128.1	15.3	8.1%	18.8%	18.9%
1995	2,420.1	795.8	108.7	186.9	143.4	19.0	7.7%	18.0%	17.5%
1996	2,657.8	920.1	118.9	232.2	176.4	21.9	8.7%	19.2%	18.4%
1997	2,952.0	1,025.4	140.5	270.2	205.7	28.2	9.2%	20.1%	20.1%
1998	3,389.8	1,192.6	134.5	363.2	260.5	37.0	10.7%	21.8%	27.5%
1999	4,056.4	1,447.5	162.8	564.9	382.1	45.4	13.9%	26.4%	27.9%
2000	4,745.3	1,813.3	199.9	815.4	587.0	51.5	17.2%	32.4%	25.8%
2001	5,254.5	2,065.9	177.3	1,026.8	762.4	79.0	19.5%	36.9%	44.6%
2002	6,126.2	2,491.9	212.6	1,396.9	1,044.4	103.9	22.8%	41.9%	48.9%
2003	7,468.7	3,113.9	336.2	1,837.1	1,364.0	151.3	24.6%	43.8%	45.0%

(Compiled from the Department of Commerce data)

- Holding companies' presence in total USDIA started increasing gradually in the late 1980s and has been accelerating its rising trend since 1998-1999.
- Holding companies' share of owners' equity in total USDIA as of 2003 reached 43.8%. USDIA owners' equity excluding that of holding companies increased from US$209.5 billion in 1983 to US$1,749.9 billion in 2003, with annual growth rate of 10.6%, while owners' equity of holding companies increased from US$23.6 billion in 1983 to US$1,364.0 billion in 2003, with annual growth rate of as high as 21.3%.
- Holding companies' share of net profit in total USDIA is also high at 45.0% in 2003. It was as high as 48.9% in 2002.
- Reflecting the business character of holding companies, their share of total assets in USDIA has not been as high as that of net profit or owners' equity. However, it increased from 7-8% level in early 1990s to nearly 25% in recent years.

Unlike ordinary operating company that owns assets and sells goods or services, majority of holding company's balance sheet is consist of owners' equity and corresponding investment to other group affiliates.

(2) Major Ratios of Holding Companies

This section examines key ratios of USDIA (holding companies) and USDIA (other industry sectors). Table 2-22 presents comparison of ROA between the two.

Table 2-22 ROA of Holding Companies (1999-2003)

(US$ billion)

		1999	2000	2001	2002	2003
USDIA Holding companies	Total assets	567.9	835.2	1051.3	1444.4	1859.6
	Net profit	48.1	53.4	80.6	107.4	154.0
	ROA	8.5%	6.4%	7.7%	7.4%	8.3%
USDIA, excluding Holding	Total assets	4,063.9	4,514.9	4,833.1	5,358.0	6,334.6
	Net profit	133.8	168.7	112.0	121.3	278.4
	ROA	3.3%	3.7%	2.3%	2.3%	4.4%

(Compiled from the Department of Commerce data)

Average ROA of holding companies for the period is 7.7%, which is extremely high. This is due to the fact that the majority of assets held by holding companies are investment in other group affiliates, and that, unlike ordinary operating companies, they do not own tangible assets such as factories, equipment, inventories. ROA, therefore, should be at a level equal to ROE.

Table 2-23 presents comparison of equity to total assets ratio between USDIA (holding companies) and USDIA (other industries).

Table 2-23 Equity to Total Assets Ratio of Holding Companies (1999-2003)

(US$ billion)

		1999	2000	2001	2002	2003
USDIA Holding companies	Total assets	564.9	815.4	1,026.8	1,396.9	1,837.1
	Net profit	382.1	587.0	762.4	1044.4	1364.0
	ROA	67.6%	72.0%	74.3%	74.8%	74.3%
USDIA, excluding Holding	Total assets	3,491.5	3,929.9	4,227.7	4,729.3	5,631.6
	Net profit	1,065.3	1,226.3	1,303.4	1,447.4	1,749.9
	ROA	30.5%	31.2%	30.8%	30.6%	31.1%

(Compiled from the Department of Commerce data)

Holding company's equity to total assets is high because of its business nature. The table above indicates that holding companies re-invest equity contribution from parent companies to other group affiliates and that the reinvestment balance constitutes their major assets. Average growth rate of owners' equity for the period at 37.5% exceeds total assets growth for the period at 34.3%.

Table 2-24 presents USDIA net profit (net of withholding tax) by industry for the period from 2001 to 2004.

Table 2-24 Net Profit by Industry (2001-2004)

(US$ million)

	2001	2002	2003	2004
All Industries	110,029	124,940	171,229	209,338
Mining	9,262	8,915	11,274	16,905
Utilities	2,068	2,095	2,054	2,086
Manufacturing	27,603	26,411	35,981	48,328
of which Food	2,597	2,604	3,137	3,227
Chemicals	7,161	8,632	10,857	13,792
Metals	1,422	1,158	1,718	2,578
Machinery	1,313	1,926	2,221	2,873
Computers, etc.	4,335	1,519	4,623	5,985
Electric products	669	509	591	1,348
Transportation equipment	2,148	1,190	2,335	4,523
of which Motor vehicles and parts	531	-588	-240	1,419
Wholesale trade	13,706	13,382	18,759	24,145
Information	-3,084	1,320	6,224	9,078
Depository institutions	2,343	1,347	2,528	3,247
Finance (excluding depository institutions) and insurance	9,224	14,585	21,356	27,329
Professional, technical services	1,741	2,219	3,730	5,775
Other industries	47,166	54,666	69,322	72,447
Holding companies	41,483	48,277	60,795	61,473

(Compiled from the Department of Commerce data)

Holding companies' share of net profit in total USDIA net profit averages 34% during the period, which far exceeds all manufacturing's 22%.

(3) Major Locations of Holding Companies

Holding company acts as a strategic buffer between parent company and its group's subsidiaries to minimize effective tax rates for the group as a whole as well as to maximize efficiency of intra-group financial operations, etc. Holding companies have significantly increased their presence since in the late 1990s. One major background to the proliferation of holding companies is increasing use of such organizational structure in mega M&A deals in recent years.

Table 2-25 presents investment position by host country of USDIA (holding countries) as of 2004-end (on a historical-cost basis).

Table 2-25 Investment Positions by Host Country of USDIA Holding Companies (2004)

(US$ billion)

	All industries		of which Holding companies		
	Investment position	Share in all areas	Investment position	Share in all areas	Share in each area
All	2,064.0	100.0%	711.8	100.0%	100.0%
Canada	216.6	10.5%	29.6	4.2%	13.7%
Europe	1,089.9	52.8%	429.5	60.3%	39.4%
Luxembourg	74.9	3.6%	63.9	9.0%	85.3%
Netherlands	201.9	9.8%	127.9	18.0%	63.3%
Spain	45.2	2.2%	21.9	3.1%	48.5%
Sweden	36.4	1.8%	27.2	3.8%	74.7%
Switzerland	100.7	4.9%	67.9	9.5%	22.4%
United Kingdom	302.5	14.7%	68.7	9.7%	22.7%
Latin America	325.9	15.8%	113.0	15.9%	34.7%
Bermuda	91.3	4.4%	34.1	4.8%	37.3%
U.K. Caribbean	63.1	3.1%	45.4	6.4%	71.9%
Africa	22.2	1.1%	2.5	0.4%	11.3%
Middle East	19.2	0.9%	3.6	0.5%	19.0%
Asia and Pacific	390.1	18.9%	133.6	18.8%	34.3%
Hong Kong	43.7	2.1%	12.6	1.8%	28.8%
Singapore	56.9	2.8%	(D)	(D)	(D)

(D):denotes data not-disclosed (Compiled from the Department of Commerce data)

- Holding companies are mainly located in European countries such as the Netherlands, Luxembourg, Switzerland, the U.K., representing 60% of total USDIA (holding companies).
- USDIA (holding companies) investment position as percentage of total USDIA in each host country is as follows: Luxembourg (85%); the Netherlands (63%); Sweden (75%); United Kingdom Islands; and Caribbean (72%).
- The presence of Asia and Pacific as host countries of USDIA (holding companies) has increased recently and surpassed the share of Latin America, the traditional location of holding companies. One major factor behind this is recent mega M&A deals in Australia using holding company structure, though the relevant numbers are not disclosed in the Department of Commerce data.

(4) USDIA Position and Income by Industry of Affiliate and by Industry of U.S. Parent

The data on USDIA by the Department of Commerce are traditionally compiled on the basis of industry by affiliate. As an example, an acquisition of a consumer loan firm by an U.S. electronics manufacturing company itself is classified as USDIA in “finance (except depository institutions) and insurance.” Should the consumer loan firm be acquired through a holding company of the U.S. electronic manufacturing company, the investment is classified as USDIA in “other industries.” With the proliferation of using holding company structure by USDIA in diversifying U.S. companies’ international operations, the data on a traditional basis do not provide sufficient information as to which U.S. industry segment are ultimate investor into which USDIA industry sector.

In order to supplement data on a traditional basis, the Department of Commerce added data series based on industry by parent. Table 2-26 compares USDIA position as of 2004 end on a historical basis by industry of affiliate to that by industry of parent. In Table 2-26, holding company is classified in the left side of the table as “other industries” while it is classified in accordance with industry classification of parent company in the right side.

Table 2-26 USDIA Position by Industry of Parent Company (2004)

(US$ billion)

		Industry by affiliate		Industry by parent	
		Position	Share	Position	Share
All industries		2,064.0	100.0%	2,064.0	100.0%
Mining		101.5	4.9%	52.9	2.6%
Utilities		19.0	0.9%	42.0	2.0%
Manufacturing		428.2	20.7%	1,228.8	59.5%
of which	Food	26.0	1.3%	59.5	2.9%
	Chemicals	107.9	5.2%	307.0	14.9%
	Metals	26.3	1.3%	43.5	2.1%
	Machinery	24.5	1.2%	143.2	6.9%
	Computer, etc.	58.6	2.8%	154.8	7.5%
	Electric products	12.4	0.6%	16.2	0.8%
	Transportation equipment	48.4	2.3%	155.5	7.5%
Wholesale trade		136.9	6.6%	62.9	3.0%
Information		56.4	2.7%	82.4	4.0%
Depository institutions		68.1	3.3%	73.5	3.6%
Finance (except depository institutions) and insurance		371.0	18.0%	287.1	13.9%
Professional, technical services		42.1	2.0%	76.1	3.7%
Other industries		840.8	40.7%	158.3	7.7%

(Compiled from the Department of Commerce data)

- While investment position of other industries is US$840.8 billion (40.7% of total USDIA) by industry of affiliate (in which holding companies are classified as other industries), it is only US$158.3 billion (7.7% of total USDIA) by industry of parent.
- While investment position of wholesale trade is US$136.9 billion (6.6% of total USDIA) by industry of affiliate, it is only US$62.9 billion (3.0% of total USDIA) by industry of parent.
- While investment position of “finance (except depository institutions) and insurance” is US$371.0 billion (18.0% of total USDIA) by industry of affiliate, it is only US$287.1 billion (13.9% of total USDIA) by industry of parent.

- While investment position of manufacturing sector is US$428.2 billion (20.7% of total USDIA) by industry of affiliate, it is as large as US$1,228.8 billion (59.5% of total USDIA) by industry of parent. This indicates as follows:
  - Manufacturing sector actively use holding company structure in its international operations.
  - Investment in sales/distribution affiliate abroad by U.S. manufacturing company is classified as “wholesale trade” by industry of affiliate. It is classified as “manufacturing” by industry of parent. The most conspicuous sector is transportation equipment. Its investment position increases from US$48.4 billion (2.3% of total USDIA) by industry of affiliate to US$155.5 billion (7.5% of total USDIA) by industry of parent.
  - Manufacturing sector’s investment in other industry sector (e.g. investment in financial sector by industry of affiliate) is also conspicuous.
  - Investment position of depository institution on the basis of industry of affiliate is US$68.1 billion while that on the basis of industry of parent is US$73.5 billion. The difference reflects investment by depository institutions in “finance (except depository institutions) and insurance” sector exceeds investment by other industry sectors in depository institutions sector.

Likewise, Table 2-27 compares income and rate of return of USDIA by industry of affiliate and by industry of parent.

Table 2-27 USDIA Income by Industry of Parent (2004)

(US$ million)

		Industry by affiliate			Industry by parent		
		Income	Share	Investment Return ratio	Income	Share	Investment Return ratio
All industries		209,338	100.0%	10.9%	209,338	100.0%	10.9%
Mining		16,905	8.1%	17.9%	7,471	3.6%	15.2%
Utilities		2,086	1.0%	10.2%	3,903	1.9%	9.0%
Manufacturing		48,328	23.1%	12.0%	129,059	61.7%	11.2%
of which	Food	3,227	1.5%	12.9%	5,858	2.8%	10.4%
	Chemicals	13,792	6.6%	13.5%	32,961	15.8%	11.5%
	Metals	2,578	1.2%	10.6%	3,873	1.9%	10.0%
	Machinery	2,873	1.4%	12.6%	10,921	5.2%	8.5%
	Computer, etc.	5,985	2.9%	10.9%	15,324	7.3%	10.5%
	Electric products	1,348	0.6%	11.5%	1,383	0.7%	8.9%
	Transportation equipment	4,523	2.2%	9.4%	11,655	5.6%	7.8%
Wholesale trade		24,145	11.5%	18.7%	8,056	3.9%	13.9%
Information		9,078	4.3%	17.2%	11,856	5.7%	15.1%
Depository institutions		3,247	1.6%	5.0%	5,880	2.8%	8.7%
Finance (except depository institutions) and insurance		27,329	13.1%	7.8%	19,081	9.1%	7.2%
Professional, technical services		5,775	2.8%	14.9%	9,614	4.6%	13.9%
Other industries		72,447	34.6%	9.4%	14,419	6.9%	9.8%
Holding company		60,665	29.0%	9.4%	n.a.	n.a.	n.a.

(Compiled from the Department of Commerce data)

- As holding companies by industry of affiliate are classified in the right side of the table in accordance with industry by parent, the share of other industries sector decreases from 34.6% by industry of affiliate to 6.9% by industry of parent. The levels of rate of return are almost equal.
- The share of total manufacturing increases from 23.1% by industry of affiliate to 61.7% by industry of parent. All manufacturing segments increase their shares. Most remarkable segments are: Chemicals (from 6.6% to 15.8%); machinery (from 1.4% to 5.2%); computers and electric products (from 2.9% to 7.3%); and transportation equipment (from 2.2% to 5.6%).
- Income share of “finance (except depository institutions) and insurance” sector in which other industry sectors invest actively decreases from 13.1% by industry of affiliate to 9.1% by industry of parent.
- A remarkable change in rate of return is seen in machinery segment in which the rate decreases

from 12.6% by industry of affiliate to 8.5% by industry of parent. The reason appears to be that investment by machinery sector in low profitability areas (e.g. finance sector) that is classified as other industries sector in the left side of the table is re-classified as machinery sector in the right side of the table.

- While rate of return of depository institutions sector is 5.0% , the lowest in all industries, in the left side of the table, it is 8.7% in the right side of the table, exceeding the level of "finance (except depository institutions) and insurance" sector at 7.2%. This indicates that the investment by former sector in the latter sector is performing relatively well. This is consistent with the fact that the latter sector's rate of return decreases from 7.8% in the left side of the table to 7.2% in the right side of the table.

(5) Net Profit to Corporate Tax Ratio of Holding Companies

As we discussed earlier in section 3.(3) "Comparison of Corporate Tax for USDIA and FDIUS by Host Country", net profit to corporate tax ratio of USDIA exceeded 5 in 2003. We examine this aspect further in this section in connection with holding companies. Table 2-24 presents the corporate tax amount paid by USDIA to major USDIA host countries and net profit amount in each of the major host countries together with the ratio between the two amounts for the period from 1999 to 2003. The data are not prorated in accordance with equity holding share, but on the basis of entire affiliate. The data do not include depository institutions.

Table 2-28 Net Profit to Corporate Tax Ratio of USDIA Holding Companies (1990-2003)

(US$ million, %)

	1990		1995		2000		2002		2003	
	Corporate tax	Net profit	Corporate tax	Net profit	Corporate tax	Net profit	Corporate tax	Net profit	Corporate tax	Net profit
All	31,693	73,254	38,801	108,662	59,801	199,864	50,916	215,564	60,708	336,153
	2.31		2.80		3.34		4.23		5.53	
Canada	2,811	5,350	4,123	7,743	8,081	17,727	5,128	14,040	6,726	21,669
	1.90		1.88		2.19		2.73		3.22	
Europe	14,578	43,714	18,062	60,019	27,946	108,136	22,867	123,126	25,691	200,396
	3.00		3.32		3.87		5.38		7.80	
Ireland	167	3,778	620	6,545	1,347	13,339	2,075	27,125	2,012	31,766
	22.60		10.56		9.90		13.07		15.79	
Luxembourg	57	209	80	1,907	103	3,444	258	17,879	-400	22,603
	3.67		23.84		33.43		69.30		-56.50	
Netherlands	1,224	7,082	1,721	10,207	1,935	17,251	2,012	19,568	2,463	46,402
	5.79		5.93		8.91		9.73		18.84	
Spain	827	1,975	684	1,460	679	2,583	562	3,865	620	5,323
	2.39		2.13		3.80		6.88		8.59	
Switzerland	595	5,186	623	7,238	799	12,142	709	15,294	904	19,330
	8.72		11.62		15.20		21.57		21.4	
United Kingdom	3,027	9,781	4,336	15,424	9,199	27,278	6,028	13,203	6,782	25,400
	3.23		3.56		3.00		2.19		3.75	
Latin America	878	9,593	3,938	17,469	5,831	32,851	5,946	36,338	7,640	62,434
	10.93		4.43		5.63		6.11		8.17	
Bermuda	59	2,524	117	4,030	428	11,127	458	26,068	524	34,782
	42.78		34.44		26.00		56.91		66.38	
U.K. Caribbian	8	651	34	1,298	279	5,204	142	3,727	143	10,481
	81.38		38.18		18.65		26.24		73.29	
Africa	2,787	990	1,616	1,683	3,750	3,981	3,410	2,821	4,608	4,812
	0.36		1.04		1.06		0.83		1.04	
Middle East	1,000	926	989	1,250	1,776	2,529	1,743	2,070	1,811	2,674
	0.93		1.26		1.42		1.19		1.48	
Asia and Pacific	6,388	11,533	10,049	19,809	12,418	34,641	11,822	34,168	14,231	44,167
	0.82		1.97		2.79		2.89		2.89	
Hong Kong	182	1,519	430	2,539	562	4,871	472	4,638	590	6,009
	8.35		5.90		8.67		9.83		10.18	
Japan	2,324	2,088	4,258	4,286	4,977	6,404	4,552	7,095	5,653	9,524
	0.9		1.01		1.29		1.56		1.68	
Singapore	183	1,982	450	4,022	564	8,228	859	6,370	668	8,957
	10.83		8.94		14.59		7.42		13.4	

(Compiled from the Department of Commerce data)

The ultimate reason why net profit to corporate tax ratio of all areas in Table 2-28 has been rising since 1990 through 2003 is rapidly increasing share of net profit of USDIA in such areas as Ireland, Luxembourg, the Netherlands, Spain, Switzerland, Bermuda, the United Kingdom Islands, Hong Kong, Singapore in which USDIA holding companies are located. Assuming for the sake of simplicity that USDIA before-tax profit is aggregate amount of net profit and corporate tax, before-tax profit rose 6.9-fold from US$28.2 billion in 1990 to US$193.2 billion in 2003. In contrast to such nine areas, before-tax profit in other areas rose only 3.8-fold from US$104.7 billion to US$394.9 billion for the same period. The weighted net profit to corporate tax ratio in the nine areas in 2003 was as high as 24.67 while the comparable ratio of other areas was only 2.83.

Table 2-29 presents net profit to corporate tax ratio by industry since 1999 through 2003 for which period data on holding companies are available. The data do not include depository institutions.

Table 2-29 Net Profit to Corporate Tax Ratio by Industry 2003

(US$ million except (2)/(1))

		1999			2003		
		(1) Corporate tax	(2) Net profit	(2) / (1)	(1) Corporate tax	(2) Net profit	(2) / (1)
All industries		45,068	162,759	3.61	60,708	336,153	5.54
Mining		6,983	10,646	1.52	18,317	23,073	1.26
Utilities		849	3,201	3.77	1,353	2,290	1.69
Manufacturing		20,372	54,246	2.66	18,203	69,213	3.80
of which	Food	1,575	3,378	2.14	2,321	5,441	2.34
	Chemicals	6,020	18,957	3.15	6,016	28,011	4.66
	Metals	774	1,815	2.34	765	2,595	3.39
	Machinery	1,142	2,656	2.33	1,152	3,305	2.87
	Computers, etc.	2,833	8,788	3.10	1,489	7,888	5.30
	Electric products	439	1,099	2.50	326	871	2.67
	Transportation equipment	2,593	6,233	2.40	42	3,303	78.64
Wholesale trade		5,711	19,045	3.33	6,995	33,706	4.82
Information		1,002	1,420	1.42	1,815	1,575	0.87
Finance (except depository institutions) and insurance		5,102	19,245	3.77	7,920	40,141	5.07
Professional, technical services		2,084	3,812	1.83	1,668	6,613	3.96
Other industries		2,966	51,145	17.24	4,437	159,543	35.96
of which	Holding companies	543	45,425	83.66	1,032	151,275	146.58

(Compiled from the Department of Commerce data)

Net profit to corporate tax ratio in 1999 and 2003 was as high as 83.66 and 146.58 respectively. If holding companies are excluded, the ratio drops as low as to 2.64 and 3.10 respectively. The ratio in year 2003 indicates that USDIA recorded net profit exceeding 100 after paying 1 for corporate tax. The data also indicate that holding companies, while recording net profit of US$151.3 billion (45% of total USDIA profit), paid only US$1.0 billion (1.7% of total USDIA) of corporate tax in 2003. The above illustrates how effectively USDIA uses holding company structure in optimizing tax strategy, minimizing cash-out from the group, and strengthening its financial position.

It should be noted that difference of corporate tax imposed on USDIA and FDISU by respective tax authorities not only affect financial position of USDIA and FDIUS, thus indirectly impacting rate of return of USDIA and FDIUS as discussed above, but also directly impact rate of return of USDIA and FDIUS. As shown in Table 2-28, USDIA paid corporate tax of US$60.7 billion in 2003 while recording net profit of US$336.2 billion. Accordingly, effective corporate tax rate for USDIA is calculated at 15.3% thanks to low level of corporate tax of the countries where holding companies are located. Applicable corporate tax to FDIUS is 35%, the U.S. statutory corporate tax. The profit that was used in calculating rate of return of USDIA and FDIUS in Table 1-8 is after-tax profit. Therefore, the USDIA’s rate of return of 9.9% in 2003 and the FDIUS’s 4.6% should be calculated at 11.7% and 7.1% on a before-corporate tax basis respectively. The rate gap between USDIA and

FDIUS, therefore, drops from 5.2% to 4.6%. If the same levels of corporate taxes are applied to 2004 data, the comparable rates are as follows: the USDIA's rate of return of 10.5% (net profit basis) and 12.4% (before-corporate tax basis); and FDIUS's 6.4% (net profit basis) and 9.8% (before-corporate tax basis). Rate gap between the two should, therefore, narrow from 4.1% to 2.6%. In other words, rate of return of USDIA is not only shored up by strong cash flow of foreign affiliates thanks to smallness of corporate tax amount paid by foreign affiliates, but also is calculated higher, as USDIA before-tax profit is less negatively affected than FDIUS thank to low level of applicable corporate tax rate.

(6) Possible Tax Evasion by FDIUS

This section examines whether or not tax evasion by U.S. affiliates of foreign companies through manipulations such as transfer price could be a factor of low profitability of FDIUS

A group company could shift its profit to other group companies by transfer price. An affiliate located in a country of higher corporate tax could sell its products at a low price (even at a price below cost) to another group company in a country of lower tax rate, or the former could purchase products from the latter at a high price. Likewise, a group company located in a country of higher corporate tax could grant a license in respect of certain technology it had researched and developed at a level below a fair price to another group company located in a country of lower corporate tax. Through these measure, taxable income of a group company located in a country of higher corporate tax could be effectively reduced while that of another group company located in a country of lower corporate tax could be boosted.

Tax evasion issue has been a matter of keen interest for tax authorities of each country, and has been studied extensively by them. One of such research paper[10] by the U.S. Treasury Department examines whether FDIUS is shifting profit or not, using two hypotheses. The first hypothesis is that the larger profit a foreign company earns in the U.S. the stronger becomes its incentive and ability to minimize their profit. Conversely, should an U.S. affiliate of foreign company record loss in the U.S., other affiliates in foreign tax jurisdictions should have an incentive to shift profit to the U.S. affiliate to minimize the group's overall taxes. The second hypothesis is that foreign affiliates in the U.S. with higher percentage of U.S. shareholders should have less opportunities to shift profit to foreign countries than otherwise would be, as income shifting would be more difficult when other shareholders are involved..

Should the first hypothesis hold good, income shifting would work in both ways, thus causing the ratio of taxable income to assets distribution of foreign controlled companies to concentrate near zero zone with U.S. companies. According to the research paper, the ratio distribution of foreign controlled companies displayed a very clear concentration near zero (Table 2-30), supporting the first hypothesis. As to the second hypothesis, the paper examined whether or not companies with foreign ownership between 25 and 50 percent have lower profit shifting than 100% foreign-owned companies. The examination found that the former has low profitability similar to the latter, implying that the second hypothesis does not hold good.

It should be noted, however, that some observe[11] (i) the study above used data from a time before 1999 when U.S. statutory corporate tax rate was lower than OECD member countries weighted corporate tax rate, (ii) that foreign controlled companies in the U.S. had relatively little incentives to shift income to foreign countries, and (iii) that any incentives they had would be stronger after 1999. As the rate of return of FDIUS has been in an improving trend since 2000 (Table 1-8), we have yet to see FDIUS's active profit shifting. However, this needs to be closely followed up.

[10] Grubert (1997).
[11] Congressional Budget Office paper dated December 2004 referred to in section 2

Table 2-30 Distribution of Taxable Income

Taxable income to total assets ratio	All firms		Manufacturing		Wholesale trade	
Category	Foreign	Domestic	Foreign	Domestic	Foreign	Domestic
Less than -0.15	0.0282	0.0247	0.0279	0.0252	0.0274	0.0180
-0.15 to 0.10	0.0336	0.0227	0.0418	0.0203	0.0219	0.0080
-0.10 to -0.075	0.0302	0.0207	0.0265	0.0211	0.0192	0.0180
-0.075 to -0.05	0.0625	0.0369	0.0516	0.0349	0.0604	0.0220
-0.05 to -0.025	0.0998	0.0538	0.0907	0.0544	0.0631	0.0261
-0.025 to 0	0.1687	0.1059	0.1466	0.0878	0.1648	0.1024
0 to 0.025	0.2104	0.1541	0.2108	0.1224	0.2500	0.2208
0.025 to 0.05	0.1284	0.1514	0.1187	0.1272	0.1538	0.1706
0.05 to 0.075	0.0880	0.1283	0.0977	0.1228	0.1126	0.1566
0.075 to 0.1	0.0457	0.0857	0.0530	0.0947	0.0412	0.0722
0.1 to 0.15	0.0544	0.1126	0.0642	0.1447	0.0521	0.1004
0.15 to 0.2	0.0269	0.0547	0.0418	0.0736	0.0082	0.0401
0.2 to 0.25	0.0121	0.0231	0.0139	0.0321	0.0109	0.0281
Greater than 0.25	0.0114	0.0247	0.0139	0.0382	0.0137	0.0160

(Source: Research paper by the U.S. Treasury Department)

(7) Summary of Chapter 2

Factors affecting rate of return of USDIA and FDIUS are summarized as follows:

i. USDIA rate of return should include additional risk premium (e.g. country risk of host country) on top of FDIUS rate of return. It should be noted, however, that theoretically calculated risk premium should not necessarily be detected ex post facto.

ii. The U.S. market is considered to be the most severe business environment with most demanding shareholders, strict legal system, highest transparency requirement, and fierce competition. Generating higher rate of return in less severe environment abroad would not be very difficult for U.S. corporations. Conversely, it would not be easy for FDIUS to generate the same level of rate of return as U.S. companies in the tough U.S. market, let alone the level of USDIA.

iii. Net profit to corporate tax ratio of USDIA has been far exceeding that of FDIUS. USDIA has been aggressive in tax minimization strategy by using holding companies.

iv. USDIA has strategically retained most of its huge after-tax profit within affiliate by reinvesting and limiting cash-out while FDIUS has allocated most of its after-tax profit to dividend distribution and interest payments to parent company. Cumulative effect of USDIA's strategy on reinvested earnings has substantially strengthened financial position of USDIA while FDIUS has far lagged behind USDIA in this regard, resulting in financial cost gap between the two.

v. Rate of return of USDIA (net profit base) is calculated higher than that of FDIUS as USDIA before-tax profit is less negatively affected than FDIS due to substantially low corporate tax rate applicable to USDIA (approximately 15%) compared with the rate applicable to FDIUS (35%).

vi. There is no evidence that tax evasion by foreign-owned companies in the U.S has caused low level of rate of return of FDIUS.