Compliance
Study Says U.S.Lost Nearly $45 Billion In 2000 from Abnormal Pricing of Goods

The United States lost an estimated $44.55 billion in imports and exports to abnormal pricing of goods by corporations engaged in cross-border trading, according to a study by two professors with the Center for Banking and Financial Institutions at Florida International University.

The estimate is an increase from the $42.7 billion the professors calculated the United States lost in 1999. For the study, the researchers—John Zdanowicz and Simon Pak—used U.S. import and export data from the U.S. Department of Commerce, contained in the U.S. Merchandise trade database.

According to Zdanowicz, he and Pak looked at data from 1,060 countries, examining more than 13,000 import commodity codes and more than 6,000 export commodity codes. This yielded a matrix of more than 6 million cells, each containing an import or export of an item from a particular country, he said.

Using the interquartile range, the professors evaluated every import transaction and compared it to the country-specific import upper quartile price to determine whether it was overvalued, Zdanowicz said. They then determined the dollar value of overvaluation for each import transaction. For exports, they compared harm to the country-specific export lower quartile price to determine whether it was undervalued, and determined the dollar value of undervaluation for each export transaction, he said.

The executive summary of Pak and Zdanowicz's study lists several U.S. importers the researchers determined were abnormally high, including:

- Sunflower seeds from France at $5.519 per kilogram;
- Toothbrushes from the United Kingdom at $5.655 per unit;
- Hack saw blades from Germany at $5.485 per unit; and
- Vinegar from Canada at $5.430 per liter.

The summary also lists exports the professors determined were abnormally low, including:

- Truck caps to Mexico at $4.68 per unit;
- New military aircraft to Australia at $19.445 per unit;
- Single lens reflex cameras to Mexico at $3.30 per unit; and
- Soybeans to the Netherlands at $1.58 per ton.

The executive summary appears in the Text section.

Interquartile Range. Zdanowicz said that the first year he and Pak conducted the study, using data from 1992 and 1993, they calculated the average price in each cell and used a 50 percent filter to flag suspicious transactions. The professors began using the interquartile range after the 1994 Section 482 regulations, which introduced the concept, were issued, he explained. Using the interquartile range "added massive calculations" to the study, Zdanowicz said. The new approach required "ranking" the data for each cell and determining a mid-point and an upper and lower quartile. "It took a year of programming to figure out how to do it," he said.

The interquartile range also helps to account for the "heterogeneity" of products in the same category, according to Zdanowicz. Some molasses or chlorine is of higher quality than other brands, and allowing a range of acceptable results takes that fact into account, he said.

But Zdanowicz said he would like to see the classification codes become more specific. "We believe the harmonized codes are too aggregated," he said, noting that eight millimeter video cassette recorders have the same code as VHS VCRs. Differences exist in categories or in sophomore, he also noted, Rubies, sapphires, and emeralds have separate codes when li-

Shift in Income. Critics of Zdanowicz and Pak's study have pointed out that, according to the analysis, most of the income allegedly shifted out of the United States went to Canada, Japan, Mexico, and the United Kingdom—all of which have tax rates comparable to or higher than the United States's. In response, Zdanowicz said the purpose of the study is to point out anomalies rather than to determine the reason behind them. However, he said, one hypothesis that would explain a complete shift to high-tax countries is that its Canadian affiliate is incurring losses. Further, he said, income shifted to a high-tax country might not remain in that country. "Who knows where these transactions stop?" he asked.

When the study points out a suspicious price, Zdanowicz said, three possibilities exist:

- the price is right;
- the price is wrong due to a clerical error; or
- the price is abnormal and taxable income is moving.

Critics also pointed out that Zdanowicz and Pak's study does not flag under-invoiced products. Thus, it does not account for income that could be moving into the United States from other countries, which would reduce the tax gap. Zdanowicz said that argument "is like saying, 'I just won the lottery, but I got mugged, so it even out.'" He also said that another study he had conducted showed that after a Swiss bill on money laundering became effective in January 1998, the amount of money that moved from Switzerland to the United States doubled.

In response to a question about whether the study calculated increased customs duty from imports that were found to be overvalued, Zdanowicz said it did not. However, he said, it is possible that companies that artificially inflated prices were willing to pay added customs duty for decreased taxes. "It's like stepping over a dime to pick up a dollar," he said.

Court Cases. Asked why the IRS does not win more large tax cases in court, Zdanowicz said that he and Pak were expert witnesses for the United States in a criminal case against health and beauty product importers Tet-Fu and Ol-Lin Chen, in which he said the IRS recouped $93 million. "We view what we do as the new DNA of trade price research," he said. "Nobody has used our methodology except in [the Chen cases]."

"If this data can be used to prosecute, it can also be used to defend," Zdanowicz added. "We know the IRS has not done it our way."

Asked about funding for the study, Zdanowicz said he and Pak had funded it themselves, and that their company, Trade Research Inc., had received some consulting income. "We have had government agencies contract with us," he said.