STATEMENT BY REPRESENTATIVE OF UNITED STATES ON 30 APRIL 1968

The United States welcomes the convening of this Working Party. We realize that the examination we are about to embark upon will be complex, and that fundamental policy issues regarding governmental intervention in trade will be raised. Nonetheless, we believe that it is essential at this time that the entire question of border tax adjustments be re-examined, and we hope that the appearance of such strong delegations is an indication of the desire of all of us to deal with this problem constructively and expeditiously.

When the present GATT language was drawn up more than two decades ago, the question of border taxes did not appear to be a major one. Levels of indirect taxes were much lower. Under these circumstances, overly simple and sweeping assumptions about tax shifting seemed acceptable, and already existing practices were incorporated without searching examination. The rules were drafted in very general terms. The United States at that time had no pressing reasons for seeking more elaborate provisions which provided more equitable safeguards for its trading position. On the contrary, at that time the United States was conscious of the need to assist other countries in relieving the pressures of the so-called dollar gap and the requirements for post-war reconstruction. Little detailed attention was paid to a problem which might hypothetically arise which would be harmful to our then strong payments position.

Times have changed, and the United States must now pay very careful attention to rules and practices which are unfairly prejudicial to our trading interests. As President Johnson stated in his 1 January statement on this issue, "We must now look beyond the great success of the Kennedy Round to the problem of non-tariff barriers that pose a continued threat to the growth of world trade and to our competitive position".

More generally, the effect on trade of border tax adjustments and other non-tariff barriers is relatively much more important multilaterally now than when the GATT was drawn up. Since that time, tariffs have become considerably less of a hindrance to trade, and quantitative restrictions have been substantially...
reduced in number and scope. Border tax adjustments have been placed in sharper focus by these developments particularly since there has been a steady increase in the rates and coverage of indirect taxes in many important trading countries. Most of this increase has been reflected in higher border tax adjustments. In some cases these rates are very high and cover almost all traded products. Consequently, in some countries the border tax adjustments on many items are well in excess of the tariff rate, and changes in border tax rates may often dwarf recently negotiated trade concessions.

When the current practices were in their early stages of development, principally after World War I, indirect taxation tended to be confined to sumptuary taxes on a limited number of goods or to low-rate general taxes. Border tax problems were then simpler and relatively little attention was paid to the border tax issue. Now, the general growth of indirect taxes has made prominent the issue of border tax adjustments, and a major re-examination is essential. But the problems have recently been further accentuated by the series of upward changes in border tax adjustments which have taken place in the past few months, and by the variety of new changes contemplated by various member countries of this Working Party. These changes, coming as they have at a time when the international balance-of-payments adjustment process is already under strain, have exacerbated a serious multilateral trade and payments adjustment problem.

For some time now, both in international organizations and in bilateral consultations, United States representatives have indicated a growing concern over the present arrangements on border tax adjustments and their effects on trade. As early as July 1963, the United States proposed in the Organisation for Economic Co-operation and Development a comprehensive study of the problems of border tax adjustments and their effect on trade. Our concerns are well-documented in the various discussions and consultations held in that Organisation. Also, in the GATT during the past several years, United States representatives have at various times suggested that this problem needed to be explored more fully. Since these adjustments are governed principally by the GATT, under Articles II, III and XVI in particular, we believe that a GATT review of its own rules is now in order. We believe that the Working Party should review the relevant rules in these articles with a view toward amending them or reaching new agreement on their interpretation and application in light of the current world trade and payments situation and of the need to improve the GATT in our continuous search for fairer trading rules and practices.
We have not come to this Working Party with fixed and inflexible views as to the results it must achieve. We wish the discussion to be a wide-ranging one. There will undoubtedly be other members of the Working Party who will wish to raise aspects of the problem which have not yet occupied us, or to present substantive argumentation to develop points that we have made. We shall welcome such contributions.

There are several general problem areas with which we should like to deal in this Working Party.

First, we should like to have a serious comprehensive discussion of whether there should in fact be border adjustments to compensate for national differences in taxation. There are no adjustments for a wide range of government measures which directly affect prices, nor for many forms of taxation which affect prices. Why then should governments make specific border adjustments for certain types of taxes? When governments adopt new domestic economic policies which have side effects on trade or payments, domestic action is not necessarily accompanied by offsetting action to neutralize the balance-of-payments effect. Many government actions, for example, affect general price levels. But only in the case of indirect tax measures is there an institutionalized provision for such offsets. What is the characteristic of indirect taxation that makes it uniquely qualified for automatic border adjustments?

If there are to be border adjustments, then they should be designed to allow no more adjustment at the border than is warranted by the impact on prices caused by taxes. From this point of view, we doubt that the current GATT rules and border tax practices are a good approximation of reality. The underlying assumption of the current rules is that certain kinds of indirect taxes are always fully passed forward in prices to the ultimate buyers of those goods, but that direct taxes and other indirect taxes are never passed forward to the buyers of those goods. Several issues arise out of this theoretical distinction.

Under present rules, it is unclear whether certain border tax adjustments are legal or not. In the first place, the definitions of direct and indirect taxes are by no means unanimously agreed. The GATT itself does not refer to the distinction, and the report of the Experts Group on this question is ambiguous in many respects. This is not surprising. Even today, economists have difficulty in defining direct and indirect taxes, depending upon the conceptual framework within which they are working and the purpose for which they wish to find definitions. The distinction between taxes which are shifted and those which are not is generally considered insufficient for analytical purposes; and distinctions are often made between taxes which are meant to be shifted...
(whether they are or not) and those not so meant; between taxes on expenditures and taxes on receipts, and taxes on business enterprise as opposed to taxes on individuals. There are many examples: some authorities consider property taxes as direct, and others consider them indirect; some authorities consider employer contributions to social security as direct and some as indirect. In the second place there is wide diversity of opinion of just which taxes are "levied on" or "borne by" goods. The practice of certain countries varies significantly from the practice of other countries on this point. In the third place, under current rules, countries have had difficulty in assigning precise border adjustments to products in relation to taxes on those products. Averaging has often been used to determine the precise amount of adjustment at the border for some taxes removed from the last stages of production. The averages, because of the nature of the problem, have sometimes been based on sweeping and dubious calculations. The current system allows, and perhaps even encourages, imprecise arithmetic to determine the amount of adjustments. In these cases, imprecision often can mean continuous pressure for upward adjustments as a result of protectionist desires.

Putting aside these problems of classification and imprecision, there is a fundamental issue. Even when one is talking about relatively easily classifiable taxes, such as income and sales taxes, the economic validity of the distinction implied by the GATT between direct and certain indirect taxes is open to serious question. We think it is a fair statement to say that economists generally believe that indirect taxes are neither always nor fully shifted forward, and that direct taxes are seldom borne fully by the producer. There are differences of view on the extent of forward shifting of direct and indirect taxes but the extreme assumptions underlying the present GATT provisions are patently wrong. Therefore, a border adjustment equivalent to the full internal indirect tax has the same effect on international trade as an export subsidy or an additional customs duty on imports. Similarly the failure to make border adjustments for that portion of direct taxes shifted forward into prices penalizes the domestic producer vis-à-vis his foreign competition, both at home and in export markets. This handicaps countries relying primarily on direct taxation.

Well-known economists and fiscal experts brought together in a symposium organized by the Secretary-General of the Organisation for Economic Co-operation and Development in September 1964 reached conclusions along these lines. In brief, the conclusions of the experts were: 1. "In practice, indirect taxes are not fully shifted into product prices..." and 2. "Certain direct taxes, and particularly the corporation profits tax, may be partially shifted into product prices, although the degree of shifting may vary from country to country."
Similarly, the Business and Industry Advisory Committee to the OECD (BIAC) in a report on the problem of tax shifting stated: "In a strongly competitive situation the prices obtainable - and hence the degree of tax shifting - are substantially determined by the market itself." The BIAC study on tax shifting found that while producers normally try to shift all taxes, their ability to do so is determined by a range of factors, including the state of the business cycle, the producer's control over his market, and institutional factors which vary from country to country.

Thus, it appears to my delegation that the GATT rules create the inequitable situation where indirect taxes which are not fully shifted forward to the consumer can be rebated on export but corporate income taxes which are shifted forward to the consumer cannot be rebated on export. The inequity also exists with respect to the use of compensatory import charges.

In summary, the present GATT provisions on border tax adjustments do not neutralize the effects of taxes on trade. Instead, they are export promoting and import restricting for the indirect tax countries. The basic assumptions underlying the GATT provisions are not realistic. The full border tax adjustment provided for with respect to indirect taxes constitutes both an export subsidy and an import surcharge. Adjustments for indirect taxes should be eliminated, or they should be reduced under carefully circumscribed conditions, or some comparable advantage should be granted to countries who do not have heavy indirect taxes to balance the advantages now granted to the indirect tax countries.

This brings me to the second basic, general problem area which we wish to have examined. That is the question of changes - that is to say, increases - in rates of border tax adjustments. Many countries have made or are making increases in their border tax adjustment rates. Some of the same countries, as well as a number of other countries, are planning to increase their border tax rates in the near future. These changes will raise obstacles to exports into their markets and give price advantages to their products in export markets. We are particularly concerned in cases where tariff concessions which we had obtained by reciprocal bargaining have been offset, or are currently threatened by new or increased compensatory import charges and by export rebates affecting other markets where we have received concessions.
These changes take two different forms, although they are sometimes mixed together: sometimes, changes are made on the argument that an adjustment from undercompensation to full compensation at the border is allowed. Sometimes changes are made in relation to a changeover from one system of indirect taxation to another system of indirect taxation.

Quite apart from the question of price shifting, changes raise fundamental problems. Once a country has established its rate of domestic taxation, its rates of border tax adjustment, its tariff rates, and its exchange rates, then any increase in the rates of border tax adjustment will create new advantages for the country's trade. Clearly, a change from so-called undercompensation to some higher, so-called full compensation level has markedly favourable effects on the trade of the country making such a change.

The changes which have recently taken place and which are soon to take place have intensified the balance-of-payments problem of my country. We believe that these changes have a fundamental adverse effect on the balance-of-payments adjustment process. The changes have been made even by countries which are in substantial payments surplus, and who ought to be seeking ways to avoid exacerbating balance-of-payments difficulties of other countries. The United States Government, in the framework of international co-operation, is presently seeking to achieve equilibrium in its balance of payments in a manner conducive, in the long term, to an increased flow of world trade. Increases in the level of border tax adjustment operate directly against these efforts. There is understandable interest in harmonization of their tax systems by the members of the European Communities. The shift from a turnover to a value-added system may be applauded as a tax simplification measure, but the increases in border tax adjustments which accompany such action can be harmful to the process of achieving a better pattern of multilateral payments balances.

In saying this we recognize the right of each country or group of countries to adopt any tax system it chooses. But, I repeat: the concurrent increases in border tax adjustments by surplus countries can be disequilibrating and contrary to the balance-of-payments adjustments which are needed internationally. Taking into account the basic problems which require new examination, and mindful of the urgencies brought about by the present and planned changes in the border tax adjustments of some countries, the United States Government respectfully requests that all countries contemplating changes in border tax adjustments refrain from increasing the level of their adjustments pending completion of the work of this Working Party. This is a difficult request to meet. We recognize the awkwardness it may create for certain countries. But we believe that these planned changes will very seriously exacerbate an already very difficult international trade and balance-of-payments situation, and that a standstill for the time being is a modest step compared with the general difficulties further rate changes may create for the United States, and for all countries.
A third general problem area which we believe requires careful and detailed examination is the ambiguity in present rules and the need for a more precise code of practices relating to present rules and any changes which might eventually be contemplated by this Working Party. We are concerned with the ambiguities already referred to regarding distinctions between direct and indirect taxes. An attempt must be made to clear up what is legitimate and what is not. The question of what is meant by the terms "levied on" must be re-examined. Averaging and allocating practices should be examined. The valuation bases for assessment of border adjustments should be examined. Where a product is not produced in the home market, serious doubt exists that border adjustments should be made. Cases where production at home may be provided with special exemptions or escapes from taxes while at the same time requiring border tax adjustments on similar foreign goods should be examined. The broad scope for abuse of turnover tax systems, because of the ambiguity in them, should be examined. Ultimately, the question of what is "levied on" a product must be re-examined. New tax systems which might be adopted should be caught up in this basic review.

In order to assist other delegations in assessing the significance of present practices and the scope and dimension past, present, and projected developments in border tax practices in a number of countries, we shall make available to other delegations some descriptive information we have collected on border tax practices in a number of countries. We would welcome comments upon and additions to this compilation. Its purpose is to provide background as to why we believe the problems are growing in number, and why the work of this Working Party is a matter of urgency.

We would hope that in due course certain OECD documents can be released generally to members of this Working Party. Eventually, the documentation of this Working Party itself may grow large. The subject, as I said at the outset, is extremely complex. We believe, however, that it is extremely important, and that new approaches must be found, in spite of the great burden of work which it will place upon us.

The Working Party will in due course reach conclusions. We hope these conclusions will take the form of recommendations to change certain aspects of the GATT rules, and new interpretations of existing rules which might, perhaps, take the form of a Code, or a multilateral agreement of some kind. As I stated earlier, our ideas are not fixed. We would welcome suggested approaches by other countries. We are guided by certain broad considerations. We question whether there is a sound conceptual basis for any general border tax adjustments. If, however, it is a widely held view that some forms of border tax adjustments should continue, we believe that these border adjustments should not act in such a way as to give an unfair advantage to countries with one type of tax system and to penalize countries with other types of tax systems. If border tax adjustments are to serve the purpose of neutralizing the effect on trade of price and resource distortions caused by taxation systems, the rules should not have the effect of encouraging countries to adopt one sort of tax system over another sort of tax system, merely because the GATT rules on border taxes give trade
advantages to one system over the other. We believe that a country generally should be able to choose its tax system primarily because of domestic considerations without regard to trade advantages conferred by GATT rules on certain tax systems. Finally, we believe that the border tax adjustments, and changes in them, should not be set or operated in such a way that they exacerbate the international balance-of-payments adjustment process.