Draft Note by the Secretariat on the Meetings of 23 to 25 April and 30 June to 3 July 1969

Addendum

Attached is the draft note completing that reproduced in Spec(69)94 of 3 July 1969.

Members of the Working Party are invited to submit any comments they might have by 15 September 1969.
VI. Problems relating to developing countries

70. As had been agreed at the seventh session, the Working Party devoted part of its eighth session to the question of border tax adjustments as they related to the special interests of developing countries.

71. Part of the exercise took the form of a discussion on the information supplied by developed countries, members of the Working Party, on taxes levied on products of interest to developing countries and reproduced in documents Spec(68)134 and Addenda 1-12. This part of the discussion has been reproduced in document Spec(68)134/Add.13.

72. On the basis of an interpretation given to Articles II:2(a) and III:2 of the General Agreement, it was stated that inasmuch as an imported commodity was not the same as, or similar to, a domestically-produced commodity in the importing country, it should not be subject to a border tax adjustment. Border tax adjustments were only justified provided they were not in excess of the exact amount of tax borne by the same, or similar, domestically-produced commodity. Since domestic production was not put at a disadvantage by the importation of products not domestically produced, any border tax adjustments for such imports could not be considered trade neutral, because the question of tax shifting would not arise, and would therefore have adverse trade effects for exporters of those products. Recent fiscal measures that had been taken by a developed country to favour imports proved that it was administratively possible to exempt from internal levies imported goods which were not domestically produced. Any loss of budgetary revenue to the importing country due to such an exemption could be simply replaced by taxing another source. Furthermore, it was stated that some excise taxes could be found to discriminate against developing countries, especially in the tropical products area.

73. It was pointed out that some changes in indirect taxes in the past few years, particularly in those cases where a cumulative turnover tax system had been replaced by a tax on value added system, had led to increases in tax incidence on products from developing countries. These changes in indirect taxes were contrary in general to Part IV and in particular to Article XXXVII of the General Agreement which enjoined
developed contracting parties to refrain from imposing new fiscal measures on imports from developing countries. Moreover, the Ministerial Conclusions of 1963 stressed that industrialized contracting parties should suppress taxes on products imported essentially from developing countries. Where such taxes existed, developed countries should give prior consideration to their reduction and eventual elimination. In view of the complexity of the subject it was suggested that an expert analysis be undertaken on the incidence of changes in border tax adjustments on exports of developing countries so that the full implication of these measures be understood. Members interested would discuss an outline for the study with the secretariat.

74. It was remarked that border tax adjustments which fully compensated exporters in one developed country could also hurt the exports of developing countries to third countries. For example, if a country applying the tax on value added system imported silk from a developing country and made silk shirts from the raw material, it could export the shirts to a third country and fully compensate the exporter through a border tax adjustment. Such an adjustment would have the effect of an export subsidy and would adversely affect the exports of silk shirts by developing countries into the third country's market.

75. The view was also expressed that if Articles II:2(a) and III:2 were interpreted as meaning that there should be no internal taxes levied on all imported or similar products not produced domestically, such a principle would deprive developing countries of a large part of their budgetary revenue while hardly affecting developed countries which produced practically all the products figuring in the Brussels Tariff Nomenclature. Even if primary and semi-processed imports from developing countries were exempted from the tax on value added this would be of no consequence since the tax would eventually be collected at a successive stage of value added on the imports. The only logical procedure would therefore be to exempt the final product from the tax on value added, but since developing countries exported only small amounts of finished products any measures taken at the fiscal level for these products would be of limited significance.
76. General indirect taxes were levied, in most developed countries where they were applied, on the basis of budgetary rather than commercial policy considerations. To exempt products interesting developing countries from internal taxes would be equivalent to introducing preferential treatment into the fiscal domain, and could establish a dangerous precedent.

77. The main purpose of Article III of the GATT was to prevent internal taxes affording protection to domestic production. It was remarked that Part IV of the General Agreement referred to excise or selective taxes and not to indirect taxes of general application. Article XXXVII referred to taxes applied specifically to products wholly or specifically produced in developing countries.

78. On the question of selective and excise taxes on tropical products, it was stated that during the past ten years a certain number of them had been eliminated in the markets of some developed countries. Since the attention of developed contracting parties had been drawn to this issue no new cases of selective taxes had been reported. Moreover, since most of these taxes were specific, their incidence had been considerably reduced by the general rise in prices over the past ten years.

79. Regarding the changeover from a cumulative turnover tax system to a tax on value added system, the changes in tax rates corresponded to changes in the method of collection and not to the amount of tax collected. Consequently, it was difficult to generalize on whether taxation had increased as a result of the changeover. Regarding recent fiscal measures taken by a developed country to favour imports, it was stated that such measures should be examined in the context of commercial policy since they could not be regarded as fiscal measures.

VII. General

80. Several members of the Working Party seemed to consider that border tax adjustments were normally not being applied with a view to solving international balance-of-payments problems, and that likewise they had no significant impact on the balance-of-payments position. Such effects could make themselves felt, but neither the maintenance of existing systems nor the change-over to new
systems involved such a degree of advantage to domestic production that they could have significant adverse trade effects. They felt that the question of stability in any shifting models seemed to indicate that it would be extremely difficult, if not impossible, to translate such varying shifting into practical GATT terms. In this context, it was mentioned that the extent of shifting varied as between products, markets and periods, and from one type to another. No conclusions could be arrived at from the concept of tax structures as to the effect of existing rules and practices on border adjustments on international trade. It was not likely that full fiscal neutrality in international trade could be achieved and the present GATT rules could be regarded as generally well suited and easy to administer. They maintained that under the present circumstances a change in the rules of the General Agreement was not warranted. On the other hand, GATT could provide a useful forum for study, discussion and possibly consultations with regard to the practical implementation of border tax adjustments.

81. Others felt that the impact of border tax adjustments on the balance-of-payments position as well as on the competitive position of domestic industry was obvious and that GATT should study the monetary implication of all taxes levied at the border. They claimed that recent changes in the taxation system as well as in the level of border taxes continued to create an imbalance. The present GATT rules gave a competitive advantage to countries relying more heavily on indirect taxes. Full forward-shifting into the prices did not always take place. The situation had been aggravated by countries making up for under-compensation. Furthermore, the varying border adjustments made for taxe occulte gave rise to trade effects; acceptable definition was therefore needed. The present GATT rules did not reflect a satisfactory approximation of reality.

82. It was pointed out that further study was still needed before the Working Party could reach any consensus on the points that had been examined. To this end various delegations submitted papers to the Working Party stating in summary form their views on border tax adjustments and the points that had been discussed.
The EEC submitted their statement in document Spec(69)89, Switzerland in Spec(69)100 and the United States in Spec(69)98. The Nordic countries referred to their statement made at the seventh meeting and reproduced in Spec(69)55.

It was agreed that these statements, along with others that members might wish to submit, should be carefully studied in the different capitals of members of the Working Party before the next meeting. These statements would prove useful when the Working Party would report its findings and conclusions to the Council or to the CONTRACTING PARTIES.

Members whose governments had adopted the tax on value added system, or intended to do so, were requested to submit short papers on the trade effects of the new tax before the next meeting.

Other

The Working Party came back to point 1(a) of the terms of reference to examine the provisions of the General Agreement relevant to border tax adjustments, taking document L/3039 as a basis for further discussions. It was felt that discussion on this point should be taken up after proposals and suggestions were considered under point 2 of the terms of reference and before reporting to the Council.

The Chairman informed the Working Party that the Industrial Committee considered that the notifications listed in document Spec(69)79, which had been extracted from section F of document Spec(69)71/Add.1, fell within the competence of the Working Party. It was agreed that the Working Party would discuss this point at the next meeting after members had the time to study the relevant documents.

Reference was made to the study being prepared in the OECD on the use made of instruments acting on international trade flows for balance-of-payments adjustment purposes. The study was expected to be completed in September. The secretariat was asked to request the OECD Council to make the study available for the internal use of the Working Party.
Date and agenda for next meeting

88. The Working Party agreed to hold its next meeting from 30 October to 4 November.

89. The Working Party should then:

- consider any comments on the proposals made and any new proposals put forward, as called for under point 2 of the terms of reference;

- continue the discussion on: (a) the effects of the change-over to the tax on value added system in certain countries since this system would have been in force for a period of time long enough to enable assessment of these effects; (b) the problems facing the less-developed countries; (c) the interpretation of GATT rules relevant to border tax adjustments; (d) and any remaining points;

- consider, in the light of its examination, how to deal with the presentation of its report to the Council or the CONTRACTING PARTIES.
ANNEX

Bibliography of Recent Books and Articles on Border Tax Adjustments in Addition to Those That Appear in Annex I of the OECD Publication "Border Tax Adjustments and Tax Structures in OECD Member Countries" 1968

BOOKS


ARTICLES


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"Taxation, Substitution, and Industrial Location". (Journal of Political Economy, forthcoming)


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Strumpel, Burkhard "The Disguised Tax Burden Compliance Costs of German Businessmen and Professionals". (National Tax Journal, March 1966)