In the past year, the Working Party on Border Tax Adjustments has met frequently, and given intense study to the questions raised in the first part of its terms of reference. We have examined the legal background, the practices of a large number of countries, and the trade effects which flow from the divergence in tax systems.

Whilst the work regarding the first part of our terms of reference is not quite finished, the United States believes that it would be both possible and fruitful to begin now the exploration of means by which inequities in the present rules of the GATT and in the present practices of countries, might be remedied. In discussion of remedies, we will no doubt be led back from time to time to further elaboration of the fact-finding and legal interpretation issues we have until now been discussing. Thus, in our view, we need not fear that movement into the second major phase of our terms of reference would prejudice the development of a more definitive expression of our views regarding the first phase. At the same time, we believe it is necessary to press ahead in our work, because of the great importance of this issue in terms of the effects on trade, and in terms of the concern expressed by business circles. The United States continues to attach high priority to the resolution of the border tax issue.

It will be recalled that our initial statement of 30 April 1968 set out three broad problem areas upon which the United States believed the Working Party should concentrate its energies. At this juncture, taking into account the discussions of the past year, our thinking has further evolved, and we now believe that there are four general and related issues which must be dealt with:

**First**, interpretation of the rules and practices implementing the rules. **Second**, the effects of changes in border taxes on international trade and adjustment. **Third**, the inequitable trade effects resulting from the GATT rules concerning the amount of adjustment for indirect and direct taxes. **Fourth**, the use of border taxes as a balance-of-payments adjustment mechanism.
It will be noted that this conceptual framework, as compared with our earlier statement, places greater stress on the relationship of the issues before us to the international adjustment process. A very broad view of the international adjustment process is the context for this. There is a close interrelationship between the basic structural problems of border tax adjustments, changes in border tax adjustments, trade measures for international adjustment purposes, and various other issues relevant to international economic and financial concerns. The United States believes it is necessary to take account of discussions elsewhere in the international monetary system and its adjustment process. It is necessary to have a clearer understanding of the direction of the evolution of the international monetary system, before taking up specific proposals for reform of the GATT rules as they relate to the structural problems of border tax adjustments, and to the adjustment process. Consequently, while developments in the international monetary system unfold somewhat further, we have not deemed it wise to put forward proposals on these broad, and basic, matters during this session of the Working Party.

Nonetheless, we do believe it possible now to begin consideration of solutions to one group of problems we have posed, that is, the broad question of the interpretation of the present GATT rules and practices that relate to those rules. The United States believes that the language of present GATT provisions is extremely vague and has led to practices which stretch the intent of the rules, and which are trade diversionary. In our view, there is a basic need to clarify definitions and practices with regard to such questions as:

- what are "taxes occultes";
- what is meant by a "like domestic product";
- what is "borne by the product" or "levied on the product";
- what is a charge equivalent to an internal tax;
- are the practices with respect to averaging uniform and fair;
- should a country move from less than full to full compensation irrespective of its balance-of-payments position;
- should countries which increase border tax adjustments without accompanying comparable increases in the fiscal burden on domestic industry or commerce make compensation for their trade effects;
- is there a need for surveillance of changes in border tax adjustments as well as some overall limitation on their level?
Consideration of these questions would be a first step in improving upon the present rules and interpretation of them.

The difference in interpretation of the GATT provisions by different countries has permitted countries to make adjustments for taxes occultes. The United States has asserted that such adjustments are inconsistent with the GATT, as are any adjustments for charges not incorporated into products themselves when such products move in international trade. The United States believes that precise definitions and uniform interpretations must now be established. In this connexion, we also wish to express the doubt whether the adoption of a value-added tax system does really eliminate adjustment for taxes occultes.

A further problem with the present system is that it fails to take into account the uses to which tax revenues are put. Many government expenditures directly reduce firms' costs, including subsidies to transportation systems, and extensive medical and other social benefits that substitute for a part of wages paid directly to workers. We question whether taxes financing this type of expenditure should be adjusted for.

Another problem involves border adjustments on imports when the same or a similar product is not produced domestically. A variation of this problem involves many different rates or valuation bases for imported products than are applied to like or similar domestic products. Most often such practices are protective in nature.

The use of averaging techniques is inevitable in cascade tax systems and can lead to border tax adjustments which are in excess of the domestic tax burden. Even when under-compensation may exist, the fact that no outside authority has any control over averaging procedures enables the country to increase border tax adjustments by any amount and then claim that the increase merely reflects some portions of the under-compensation. This argument has frequently been used in the past year to "explain" the adjustments made by Belgium, the Netherlands, and others. The United States believes that there should be supervision of averaging practices.

Changes in border adjustments clearly have trade effects which have been recognized by our trading partners. Due to the balance-of-payments implications of such changes, it is important that there be appropriate international surveillance in order to insure that changes are not disequilibrating. Increases in border adjustments, and restructuring tax systems to take advantage of the present rules, improve a country's trading position. As there is a danger of proliferation in border tax adjustments, an overall limit may be needed to keep the problem manageable.
While the United States is not fixed on any single approach to these issues, we wish to suggest, for discussion purposes, some illustrative examples of possible approaches:

I. Changes in border tax adjustments

Members of the Working Party have recognized that changes in border tax adjustments without accompanying comparable increases in domestic fiscal burden can adversely affect the trade of other countries. It is also widely recognized that changes in the trade account have balance-of-payments effects. In view of this, overall limits could be set on adjustments and changes in adjustments could be placed under surveillance, consistent with the following principles:

(1) a country should not change its border tax adjustments without regard to the consequences for its and other countries' trade;

(2) if changes in adjustments have inappropriate effects on international trade the changes should not be made or the trade effects should be offset.

Changes in border tax adjustments might be placed under surveillance in several ways. For example, an appropriate forum could (under existing or new procedures) examine the reasons for the change and its likely trade impact. (In this connexion, a method should be devised for establishing the probable magnitude and incidence of the trade effects resulting from the changes.) Among other things, it could be determined whether the change appears appropriate, whether it should be phased over a period of time in coverage or extent and whether it should be permanent. A country insisting upon making a change despite inappropriate consequences on one or more other countries' trade would agree to offsetting action determined by multilateral consultation. Should appropriate offsetting action not be taken by the country making the changes, those countries affected could do so by means of appropriate unilateral or multilateral action.

In order to avoid proliferation, overall limits on the amount of change and on the size of border tax adjustments could be established.

II. Rebate of taxe occulte

A note to the present GATT articles could be drafted which provides for a better definition of the terms "borne by" and "levied on" and could indicate that adjustment for taxe occulte is not permitted. This is particularly important where varying practices have sprung up under the existing rules, which are often clearly inconsistent with the spirit and intent of the GATT.
III. Averaging

The use of averaging techniques is inevitable in cascade tax systems and can lead to border tax adjustments in excess of the domestic tax burden. Even when under-compensation may exist, the fact that no outside authority has any control over averaging procedures enables the country to increase border tax adjustments by any amount and then claim that the increase merely reflects some portion of the under-compensation. For example, a uniform set of averaging procedures might be established and a special GATT group be established to oversee averaging calculations. As the European Communities have had a great deal of experience with averaging under the cascade system and in the development of uniform practices, they might be able to formulate a proposal.

IV. Like and similar products

In some instances, imports are taxed at rates different than that applicable to "like or similar" domestic products and may be taxed even though no domestic production exists. An experts group could be convened to provide a clearer interpretation of these terms. Such an interpretation should focus on the substitutability between products. Other members of the Working Party could be asked to explain how their countries apply these GATT terms. A possible approach to this problem could involve a consultation procedure in which the country imposing the border adjustment would have to justify its claim that imports are "like or similar" to a domestic product.