

# GENERAL AGREEMENT ON TARIFFS AND TRADE

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## WORKING PARTY ON BORDER TAX ADJUSTMENTS

### Secretariat Note on Meeting of 30 April to 2 May 1968

1. The Working Party held its first meeting from 30 April to 2 May 1968. This note, which has been prepared by the secretariat, summarizes the main points raised at the meeting for the convenience of delegations.
2. The Chairman, Mr. H.E. Thrane (Denmark), recalled that the terms of reference and composition of the Working Party were set out in L/3002 and that the discussion in the Council, which the Working Party was specifically instructed to take into account, was summarized in C/M/46.
3. The Working Party heard general statements and agreed to certain procedures concerning the organization of its work.
4. The text of the statement of the representative of the United States is reproduced in full in the annex to this note.
5. The representative of Canada recalled that his delegation had supported the establishment of the Working Party, believing that the great progress made in trade liberalization in the past years should not be nullified or impaired by measures such as border taxes. The representative of the United States had raised some difficult concepts which would require consideration and study. His delegation would be anxious to ensure that the concept developed should not detract in any way from attention being given to the more immediate aspects about what taxes might reasonably be adjusted at the border, precisely the tax definition itself and the administration of tax measures. The representative of the United States had referred to the question whether an f.o.b. or a c.i.f. base should be used for the purpose of making adjustments at the border and to the question of special tax exemptions for domestic producers. He wished to add the question of taxes collected both at the border and domestically which were linked to the subsidization of domestic production in the country levying the tax; the question of taxes of a very complex nature which, in his view, had the intent and effect of being protective; and questions relating to the level at which the tax is applied, e.g. the manufacturers' level or the wholesalers' level. He concluded by stressing the importance which his delegation attached to ensuring that tax adjustments made at the border related to precisely measureable taxes.

6. The representative of Japan said that his delegation shared the concern of the delegation of the United States regarding the problem of border taxes. They recognized the need for international co-operation in the reduction of non-tariff barriers. The matter for discussion in the Working Party was not, however, to determine whether or not the border tax adjustments made by each country were justified, but to examine the essential character of such taxes in the context of the GATT rules. The discussion should be oriented towards finding a rational solution, rather than towards a confrontation of national interests.

7. The Japanese Government attached special interest to the strict distinction which was made in the application of the GATT rules between direct and indirect taxes. The assumption that all indirect taxes were fully passed forward and that all direct taxes were fully passed back seemed to them unrealistic and resulted in some disequilibrium in the trade effects on individual countries, depending on whether their systems were based on direct or indirect taxes. Furthermore, even if the rule in question were not without justification, his Government doubted whether member countries made tax adjustments at the border on the same conceptual basis. The Working Party must therefore endeavour to find a procedure for the imposition of border tax adjustments which was acceptable to all contracting parties, taking into account the results of the discussion in the Organisation for Economic Co-operation and Development and the procedures followed by each country in this respect. The work should be done on a long-term basis and hasty conclusions avoided. A detailed and comprehensive examination should be made of the possible effects that the various changes in border taxes could have on trade as the OECD discussion clearly showed. From this point of view, the United States representative's request for a standstill for the time being therefore deserved special attention by all concerned.

8. The representative of Sweden said that the implementation of the Kennedy Round results would lead to a considerable measure of liberalization in the tariff field. It was, therefore, natural that the CONTRACTING PARTIES turn their attention to other trade problems in their continued efforts to promote the development of world trade, and obvious that taxation had an important bearing on these issues. His delegation thus believed that GATT was appropriate as a forum for a discussion of these matters. The problem of border tax adjustments had been discussed for a long time in international bodies and in bilateral consultations. The countries taking part in these deliberations had gained considerable experience and assembled useful documentation. However, in the view of his delegation, they had not so far been able to reach a sufficient degree of unanimity regarding the evaluation of the issues. One of the first tasks of the Working Party should be to establish a better common ground. One of the problems in this context was to get a clearer interpretation of border tax adjustments as a barrier to trade. A starting point for the work of the Working Party should be the collection of relevant background material. It would be useful if the secretariat could prepare documentation on the GATT rules relating to border tax adjustments and their interpretation. The secretariat might also analyze experience already gained in other bodies and propose such additional information as would be required by the Working Party.

9. The representative of the European Communities recalled that the Working Party had been established to examine a question raised by the United States. They were prepared to participate in the work of the Working Party which, like all GATT work, aimed at facilitating the application of the Agreement and at promoting the achievement of its objectives. They would participate in this spirit. He emphasized the complexity of tax matters and their effects, which touched on all aspects of the economy and influenced countless factors involved in economic activity and price formation both internally and in international trade. If the work of the group were to be meaningful, as they intended, the different tax practices and structures should be examined, as provided for in the terms of reference. The complexity of the matters within the mandate of the Working Party was confirmed by the studies referred to by the United States, studies which yielded no precise and unanimous results from which conclusions could be drawn.

10. The subject to be dealt with was traditionally the responsibility of parliaments which jealously guarded their prerogative and which could refuse to enter into negotiations. Every day they found that governments encountered difficulties vis-à-vis their parliaments over tax matters.

11. He agreed with the representative of the United States that the questions before the Working Party involved the fundamental rules and practices of GATT. They also involved an examination of universally accepted rules dating back to the inception of indirect taxes. From the outset the contracting parties have considered that these taxes should be principle affect only national consumption. In general, his delegation considered that, in this world where perfection was not the rule, the rules adopted in GATT, OECD and numerous integration treaties had operated in a relatively satisfactory way.

12. Among the particular points which had been raised, two deserved an immediate reply. First, his delegation wished to state that they were far from sharing the view that countries relying predominantly on direct taxes were at a disadvantage compared with those for which these taxes are less important. For example, firms in these countries, whatever the structure of their budgetary revenue, bore substantially the same burden of direct taxation on their profits. Leaving aside this form of direct taxation, certain States placed more emphasis on indirect taxes and others more emphasis on direct taxes on personal income. In the view of his delegation these were merely two different tax techniques which yielded virtually the same economic result, without having any advantage or disadvantage for the international trade of the country concerned, thanks to the mechanism of border tax adjustment for indirect taxes. Changes in this mechanism might disturb trade and even createdistortions. Second, some speakers had maintained that border tax adjustments could nullify or impair negotiated tariff concessions and had perhaps wished in this way to equate such adjustments made in conformity with GATT rules with customs duties. On this point, which had already been discussed and examined the year before, they would refer these delegations to the statement that the Community had made at the last meeting of the Trade Negotiations Committee during the Kennedy Round (TN.64/SR.16, paragraph 5). He also noted that among the difficulties cited was the use of fixed averages in making border tax adjustments. This had been one of the reasons which had led the Community to introduce the added-value tax which ensured competitive neutrality.

13. He concluded by saying that he reserved the right to reply if need be to other points raised and to expound the views of his delegation in detail. He warned against hasty or superficial conclusions based on specious analysis, and reiterated the readiness of his delegation to co-operate in a positive spirit in all efforts to clarify the various questions put to them and to enable the Working Party to carry out its terms of reference.

14. The representative of Australia said that his delegation would examine the points which had been raised. His delegation was not as directly involved as were some others, because of the composition of its exports. Its main concern was non-tariff barriers to the export of agricultural products. He recognized the importance of border tax adjustments for industrialized countries since these could affect their competitive position. He concluded by agreeing with the delegation of Japan that a co-operative approach was preferable to an approach based on confrontation.

15. The representative of the United Kingdom said that his delegation welcomed the initiative the United States had taken in raising this question as a general question; i.e. in the longer-term context rather than in a short-term context. His delegation recognized that a review was needed of this aspect of the General Agreement, since it was necessary both to see how the Agreement had been applied and how circumstances had changed to affect the conditions of its application. It was thirteen years since the General Agreement had been reviewed; and it was certainly time to look at it again. He did not personally rule out the possibility that they would want to go on eventually to look again at other parts of the Agreement too; but that was outside the scope of the Working Party and he did not want to raise that here then.

16. His delegation also took note of the concern which the United States had expressed, although their own view of the situation might not be the same at all points. Their views on some points were familiar at least to some members of the group both from what he had said in the Council and as a result of the discussions in OECD. He agreed with the view expressed by the representative of the Community that this was a highly complex matter and they did not want likely to rush in and upset a system whose operation was based reasonably satisfactorily on the accumulated wisdom of twenty years. However, they remained ready to look further into the question of border tax adjustments in the context of the GATT. What was in question was the validity of GATT rules and the way in which they were applied. For this reason they were particularly interested to note the formulation of the problem contained in the statement of the United States. This seemed to them to present it in an appropriate general context. It would, he said, be fair to say that the main questions posed in that statement were these:

- (i) Should there be any border tax adjustments at all and was the existing distinction between indirect and direct taxes justified?

- (ii) If there were to be border tax adjustments should the timing of changes have regard to such factors as the conjuncture of the international payments situation?
- (iii) The need for making more precise the application of the rules for border tax adjustments.

17. As regards the first, if the Working Party was to have a fundamental examination, this question must be asked. It would, he suggested, be an aid to the consideration of this question if the secretariat were to set out the history of the present rules including not only the rules themselves and their interpretation but also their legislative history, by which he meant the summary of the discussions which underlay their formulation. In this way they would be reminded of the considerations and intentions of the founding fathers of the GATT. One thought he would voice was that most indirect taxes were taxes on the consumption of goods in each country. It was understandable that consumers and producers expected the same tax to be levied on goods in their country regardless as to whether they were produced domestically or abroad; and by the same token they refrained from taxing goods which were to be consumed in another country.

18. Changes in border tax adjustments presented a different issue. On the previous point some might argue that differences in pre-existing structures of taxation would have been allowed for any levels of exchange rates but that could not apply to changes which affected the circumstances of a particular time. In this connexion they appreciated the anxiety of the United States that changes in border tax adjustments, for whatever reason, which might be within the GATT rules, might be awkwardly timed, for example in disturbing agreements laboriously reached, like the Kennedy Round, or relations between countries in different balance-of-payments situations. Although he had reservations about whether it would be possible to find acceptable criteria to govern the timing of such changes, he agreed that they should look at this aspect of the matter.

19. The third point was what one might call the wording of the GATT rules. Examination of this wording and of its application was clearly essential to the purpose of seeing how the formulations agreed twenty years ago were being applied. Moreover, it was central to the terms of reference.

20. With regard to the procedural question of how the Working Party might undertake the tasks set out in those terms of reference he said that this should be conducted in the context of broad trade policies although some inevitably technical questions might be dealt with in smaller groups. The Working Party should find ways of avoiding being unduly delayed by a prolonged fact-finding exercise but some documentation would be required in the way of background

material for the various points in the terms of reference. He concluded by making specific suggestions in this regard.

21. The representative of Chile said that the statement made by the representative of the United States illustrated the great complexity of the problems before the Working Party. Attention would have to be given to the best way of organizing the work and emphasis should be placed on the practices of contracting parties rather than on an examination of the existing GATT rules.

22. The representative of Spain referred to the argument that the GATT rules relating to border taxes lacked precision and said that the rules on other subjects often went into no more detail. His Government had felt when it joined the GATT that it was equitable that products should be subject to the same internal taxes whatever their origin and continued to feel that the fundamental principles of the GATT on this subject must be maintained. These principles had been taken into account when the Spanish tariff, which entered into force in 1960, had been drawn up. The adjustments which Spain made at the frontier had not proved to be a barrier to the exports of other contracting parties. This was demonstrated by the fact that Spanish imports had increased very considerably and at a rate greater than national income. Imports had also increased more rapidly than exports. It would be difficult to persuade his Government that, after following a policy of trade liberalization leading to a deficit on trade account, it would have to do away with a set of rules which, in their opinion, ensured equitable fiscal treatment for national and foreign products and to adopt a system which would favour the latter. Referring to point 1(b) in the terms of reference, he suggested that the Working Party should concentrate on finding common rules to prevent unfair competition based on the incorrect application of the general principles of neutrality in the field of border tax adjustments.

23. The representative of Denmark welcomed the statement by the United States that the problems before the Working Party to be connected with immediate balance-of-payments difficulties but to be more fundamental in character. His delegation also felt that the task before the group was a long-term one, and came to the Working Party prepared to take part in the work of examining those problems with a relatively open mind but with some doubts as to the need for a change in the GATT rules.

24. The Chairman said that several suggestions had been made in the Working Party with regard to the documentation which would be required in its work and the organization of that work. After having informal contacts with delegations he had some proposals to make in this regard.

25. He suggested that at its next meeting the Working Party should take up substantive discussion of point 1(a) relating to the provisions of the General Agreement relevant to border tax adjustments and that before this members of the

Working Party should have had an opportunity to look at an analytical paper drawn up by the secretariat giving the relevant GATT rules, examining the legislative history of these rules and the way in which they have been interpreted during the past twenty years. It was his understanding that it would be possible to have such a paper in two to three weeks time; he therefore suggested that the next meeting of the Working Party should take place in about six weeks time. The exact date to be set by the Chairman in consultation with delegations.

26. Turning to the question of documentation required for discussion of point 1(b), the practices of contracting parties in relation to border tax adjustments, the Chairman said that the OECD fact-finding report dealing with the practices of OECD member countries would be of great importance and would be available, it was hoped, in the relatively near future to the members of the Working Party. He suggested that the Working Party should attempt to obtain information similar to that contained in the fact-finding report from other contracting parties and that the best way to do this would be to ask the secretariat to prepare a questionnaire to be sent to these contracting parties which were not members of the OECD. The questionnaire would be a simplified version of that used by the OECD. He noted that the information contained in the OECD fact-finding report was not entirely up to date. He therefore suggested that contracting parties members of the OECD be requested to supply the Working Party with short papers setting out any new developments since the time covered by the fact-finding report and any plans which they might have for change in border tax adjustments.

27. With regard to point 1(c) of the terms of reference, the possible effects of border tax adjustments on international trade, the Chairman said that it was perhaps unnecessary to go into detail at the present stage but suggested that delegates which had points to raise under this heading might introduce papers setting these out in writing at an appropriate later stage in the work.

28. Finally, he referred to the suggestion that had been made that the Working Party consider the establishment of smaller groups to deal with certain questions. This was an extremely useful suggestion to which the Working Party would no doubt show revert when specific questions arose. There would no doubt be technical questions which they might wish to remit to a group of technical experts.

29. The representative of the European Communities asked that, when contacting delegations, the secretariat request the rate or rates of tax on profits of industrial and commercial firms and a brief description of the elements used in the determination of the tax base, indicating in particular the elements which could be deducted from the gross profit.

30. The representative of the United States said that the OECD Fact-Finding Report showed tax revenues by type of tax and related each class of tax revenues to total taxes and to gross national product. These figures were, however, aggregated for all levels of government and it would be useful, in addition, to have a more detailed breakdown, following the same form but showing revenues of the national government separate from those of lower governmental levels such as State and local governments. He requested the secretariat to enquire whether the OECD could make such information available to the Working Party. If not, contracting parties should be asked to submit such information to the secretariat. He emphasized that this request should in no way interfere with, or delay, the collection of the other documentation to which the Chairman had referred.

31. The Working Party approved the procedural suggestions made by the Chairman in paragraphs 25 to 28 and the addition of the two specific points referred to in paragraphs 29 and 30. It agreed that its next meeting would be held in mid-June, the exact date to be fixed by the Chairman in consultation with delegations.

ANNEXStatement by Representative of United States

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 positions.

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 Organization. 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.