THE BORDER TAX ISSUE DEFINED

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With the disappearance in the postwar period of a large number of quantitative restrictions on international trade and the progressive dismantling of tariff barriers, nonquantitative and nontariff barriers to international trade have become relatively more important. Major among these barriers are differences in the relative ease and cost with which imported goods enter countries and a main element in these differences is the tax treatment accorded to goods crossing international borders.

Under present international rules, countries are permitted to levy charges on imports and allow rebates on exports up to the amount of indirect taxes levied on like products consumed or produced domestically.[1] The question at issue is whether or not this system of so-called border tax adjustments for differences in national systems of indirect taxation has a trade-diverting effect. This paper attempts to set out the rationale behind the current practice of border tax adjustments and to assess it against the body of discussion that has arisen since its inception. The conclusion is that the current system of border tax adjustments, under less-than-perfect market conditions, which is characteristic of the world we live in, tends to give a competitive advantage to countries which employ them vis-a-vis those that do not.

THE BORDER TAX SYSTEM

Under the rules laid down in the original GATT and in the 1955 revision, border tax adjustments may be made only for indirect taxes, such as excise, turnover, and value-added taxes. Thus, countries having such taxes normally will levy an import charge—or import equalization tax—designed to impose the same amount of indirect tax on the imported product as is embodied in the price of the like home-produced product. Conversely, exporters receive a rebate—or tax exemption—equal to the amount of indirect tax embodied in the price of an exported good. The intent of the adjustment system is to free world market prices completely from indirect taxation so that prices of imported goods reflect only indirect taxes levied in the country of consumption.

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[1] See appendix I (this paper) for the relevant provisions as laid down in the General Agreement on Tariffs and Trade (GATT) and the treaty establishing the European Economic Community.