

and retail sales taxes, which are classified as "indirect" taxes; beyond this the classification becomes a morass.³

Thus, it could be argued that the distinction made in international practice between direct and indirect taxes may essentially be arbitrary and seems to be based more on prevailing practice than on theoretical reasoning. For example, it is not at all clear whether employer contributions to social security fall into the indirect or the direct tax category, although GATT practice specifically places them with direct taxes. Conversely, value added taxes, according to GATT classification, are considered to be indirect taxes. However, value added taxes fall on both costs and profits of the producer (value added being defined as the difference between the value of a firm's purchases and sales) and to the extent that they fall on profits are not always clearly distinguishable from a profits tax in their effect. Nevertheless, corporate profits taxes are classified as "direct" and value added taxes as "indirect" taxes.

THE QUESTION OF TAX SHIFTING

Given the murkiness of the borderline between "direct" and "indirect" taxes, it is not surprising that the premise of full forward shifting into price of direct and full backward shifting to the factors of production of indirect taxes has given rise to even greater uncertainties. The shifting argument is based upon Marshallian price theory which holds that, under pure competition, profits taxes will not affect prices because prices are determined by marginal producers and marginal producers have no net profits. Modern theory of shifting and incidence of taxation has moved a long way from so clear cut a statement. For example, statistical studies can be found which support either the full backward shifting or the full forward shifting theory for some direct taxes.⁴ Basically most experts today would argue that shifting of either type of tax can and does occur in both directions and that the degree of shifting will vary with different circumstances, such as variations in demand and supply elasticities, in degree of market control and in government policies. The current border tax adjustment system, however, is solely predicated upon a general full shifting assumption and, therefore, cannot be conditional upon the structure of market forces or upon certain government actions, such as a permissive monetary or fiscal policy.

³ Richard A. Musgrave and P. B. Richman, "The Allocation Aspects of Direct vs. Indirect Taxation," Brookings conference on the role of direct and indirect taxes in the Federal revenue system.

⁴ Full forward shifting into price of corporate profit taxes is suggested by Marian Krzyzaniak and R. A. Musgrave, "The Incidence of the Corporation Income Tax," Johns Hopkins Press, 1963; full backward shifting by Challis Hall, "The Incidence of the Corporation Income Tax," American Economic Review, May 1963.