

TABLE 1.—*Balance of trade effects of general taxes assuming fixed exchange rates and unchanged real demand for domestic output*¹

	Balance of trade effect		
	With border adjustment	Without border adjustment	
I. Raise indirect taxes: a. Product prices rise	NEUTRAL-----	Unfavorable.	
b. Factor prices fall	Favorable-----	Neutral.	
II. Raise social welfare charges: a. Product prices rise	Neutral-----	Unfavorable.	
b. Factor prices fall	Favorable-----	NEUTRAL.	
III. Raise corporate profits taxes: a. Product prices rise	Neutral-----	Unfavorable.	
b. Profits fall-----	Favorable-----	NEUTRAL.	
Balance of trade effect			
	Indirect tax with border adjustment, others without	All taxes with border adjustment	No border adjustment
IV. Substitute indirect tax for social welfare charges: a. Under Ia and IIa...	Favorable-----	Neutral-----	Neutral.
b. Under Ia and IIb...	NEUTRAL-----	Unfavorable--	Unfavorable.
c. Under Ib and IIb...	Favorable-----	Neutral-----	Neutral.
V. Substitute indirect tax for corporate profit tax: a. Under Ia and IIIa...	Favorable-----	Neutral-----	Neutral.
b. Under Ia and IIIb...	NEUTRAL-----	Unfavorable--	Unfavorable.
c. Under Ib and IIIb...	Favorable-----	Neutral-----	Neutral.

¹ This table is adapted from an unpublished submission by Richard N. Cooper and Richard A. Musgrave to the Symposium of Experts on Border Tax Adjustments held by the OECD in Paris, September 1964. Effects in capital letters reflect GATT reasoning.

Insofar as the actual extent of forward, or backward, shifting of relevant taxes cannot be determined clearly, the extent of tax neutrality brought about in international trade by the current border tax adjustment system is also unclear. Table 1 sets out a number of examples of possible effects on trade balances of various tax changes under different shifting assumptions. Thus an increase in indirect taxes, with full border adjustments, would not affect the balance of trade only if product prices rose to the full extent of the tax (case Ia), which is the case assumed by the GATT convention; if, on the other hand, factor prices were to fall, the trade effect would be clearly favorable. Thus substitution of, for example, an indirect tax, which is not fully reflected in product prices, but which is rebated in full, for a corporate profits tax, which was not reflected in prices and which was not rebateable, would have a favorable trade effect (case Va); the trade effect would be doubly favorable if the corporate profits tax was partially reflected in prices (case Vb).

Since there is a substantial body of theoretical and empirical evidence which tends to contradict the view that certain taxes are always fully shifted into price, while others are always fully absorbed by the factors of production, it is most likely that the true state of affairs