

levies on imports to compensate domestic producers for indirect but not direct taxes. This rule is based upon the theory that indirect taxes are always fully shifted into the final price of the goods and that direct taxes are absorbed by the factors of production. As businessmen have long realized and economists have more recently accepted, this theory is not valid under existing competitive conditions. There are many indications that at least part of the corporation tax and social security taxes are shifted into the final prices of goods and some of the indirect taxes may be absorbed by business companies. Since the United States relies heavily on direct taxes and Western European countries rely substantially more on indirect taxes, the GATT rule tends to discriminate against U.S. products and to place them at a competitive disadvantage with those of Western Europe.

The question of border taxes is a highly complex and controversial issue. Since the GATT rule has been in effect for many years, many argue that the trade distorting effects of border taxes have been largely adjusted by changes in relative exchange rates, tariffs, and prices and by shifts in factors of production. On the other hand, there are many doubts of this with respect to many industries in which the United States and Western European countries compete from share of market studies and from the trends in this country's balance of payments. With the huge investments made to modernize industries, the expansion of markets, the establishment of larger size firms through merger, the achievement of internal and external economies of scale, and rationalization of industries, Western European industries have been giving American ones more severe price and non-price competition. Furthermore, exchange rate adjustments have been difficult to make under the present international currency system and the dollar as a key reserve currency has been fixed in terms of gold. Tariff rate changes in the past have in no way considered border tax adjustments. Shifts in factors is a slow process. In view of more severe price competition faced by U.S. manufacturers, the border tax adjustments probably take on more significance at present than in the past in placing this country's exports at a disadvantage. I recognize that there is disagreement about this issue, but this is the point of view of a number of knowledgeable international executives with whom I have had discussions.

What can be done about the inequity of border tax adjustments to the U.S. foreign trade position? Unfortunately, no ideal or easy solution is possible. The alternatives would be as follows:

1. The United States could change its tax system and impose a value added tax to at least in part replace the corporation tax as recommended by the CED;
2. The GATT rule could be changed to allow countries to compensate in full or more realistically in part for corporation taxes;
3. This country could negotiate with other countries to reduce border tax adjustments as part of a total approach to reduction of all types of barriers to international trade;
4. The United States could try to obtain a GATT waiver to permit some subsidies on its exports to industrial nations to compensate for the disadvantage it suffers from border tax adjustments.

All of these approaches present serious difficulties and would be difficult to implement. It would be unrealistic to expect a major change in this country's tax structure under which the value added tax would partly replace the corporation tax. Major tax changes in this country are not enacted for foreign trade reasons. Strong opposition could be expected to a value added tax on the grounds that it is more regressive than the corporation tax.

Changing the GATT rule on border tax adjustments would also be difficult to accomplish, as the countries which benefit from the present rule would not readily agree. However, difficult as it may be since the GATT rule is based upon incorrect theory, we should make a determined effort to achieve a border tax adjustment on a part of the corporation tax. Further study would be helpful to determine the percent of corporation taxes to be compensated, but even with comprehensive studies no ideal answers would probably be obtained. At any rate, some workable average percentage could be developed for negotiating purposes. Even though it may be difficult to achieve, I believe that the United States should press for this change in the GATT rule.

If the GATT rule cannot be changed, I believe that the United States should ask for a waiver to permit subsidies to compensate for the average disadvantage experienced by its exports as a result of border tax adjustments. Such a request might facilitate bargaining on a change in the GATT rule. Probably of greater sig-