

To the extent that an upward change in an indirect tax rate (either by initial imposition or by a rate rise), is not passed along in full to the purchaser, the residual amount must be absorbed by the manufacturer, becoming, in effect, a direct tax on corporate earnings.

If, following such an increase in tax, a country raises its import equalization charges (border taxes) and export remissions by the full upward change in indirect taxes, to the extent that the increase in the domestic tax is not fully shifted to purchasers, imports are penalized by paying a higher burden than the equivalent product sold domestically, and exports are favored by a remission rate higher than the indirect tax being charged within the border.

C. The need for analysis of the theory of tax shifting

If the situation outlined in Section B, above, does or can occur, then underlying tax theory regarding the shifting of direct and indirect taxes needs new analysis and empirical testing. The GATT provisions governing tax impositions and remissions seem to have assumed that indirect taxes are always shifted 100% forward, while direct taxes are not shifted at all. From that assumption trade advantages and disadvantages are derived, in that U.S. products going into Europe face added costs of entry in the form of border taxes which overcompensate for the internal indirect taxes, while the European products going into export receive substantial tax remissions that sometimes can make the difference between winning an order and losing it.

The practical trade consequences of the GATT-endorsed theory of tax shifting are evident to General Electric as it competes in world markets: added costs of entry on its exports and import competition sharpened by tax remissions whose rates run as high as 20%. When these tax remissions are added to dual pricing disparities, they become a particularly significant and adverse factor in international competition. It is important, then, that the theoretical rationale on which the GATT provisions rest be re-examined and realistically tested for its soundness. Competitive equity demands no less.

D. Additional inequities

Two other aspects of the European administration of high rate sales taxes should be noted.

The first of these arises from the fact that European countries compute import equalization taxes on a base that includes transportation, insurance and duties, in addition to the factory price of the goods. The U.S., in applying its few import equalization levies, does not include transportation. Two arguments can, therefore, be advanced: (a) since inclusion of transportation, insurance and duties unfairly raises the import equalization charge above the internal sales tax, the equalization charge should be based on the price f.o.b. country of origin, and (b) in any event, transportation charges should not be included in the base.

Exhibit VI shows General Electric's experience with European border taxes that are levied on landed cost instead of on the price f.o.b. factory. The rates shown are those in effect during 1967. It will be noted that in the case of the Netherlands and France, the domestic sales tax rate and the rate of the import tax were the same. Yet, because these countries include transportation, insurance and duty in the tax base, the border tax was much higher than the tax paid by the European manufacturer.

Exhibit VI also shows the effect of a second administrative practice on imports and exports where the turnover tax is of the "cascade" variety. Because of the total tax borne by an article is a function of the number of turnovers that brought it to market, the amount of import tax necessary to equalize sales tax burdens is imposed at a rate higher than that applicable to a single turnover. For example, 11.5% as opposed to 7% in the case of tungsten carbide to Belgium. There is little evidence available about the degree of vertical integration among European industries. However, it is fairly clear that where the border tax is equivalent to the *average* integration of a European industry, the leaders of that industry who are more integrated than the smaller firms, bear a tax burden well below that of the American exporter.

As the Kennedy round of tariff reductions takes effect, and the European Economic Community adopts a uniform t.v.a. system of taxation, the barrier effect will actually worsen in some countries, as demonstrated in the specific example of Exhibit VII.

Assume that a U.S. manufacturer is exporting electric knives to West Germany, and the value of his product at the port of New York is 100—an index