

APPENDIX A

Stanley S. Surrey, Assistant Secretary of the Treasury, summed up the impact of the switch to value-added taxes as follows:¹

"In the German situation, the rebates for taxes paid on goods purchased by the exporter and import charges under the value-added tax are turning out to be higher than the averages used under the previous turnover taxes. * * * In effect, it would appear that some German exporters presumably have not been receiving rebates at the level that their tax costs under the turnover taxes appeared to call for. Of course, German exporters presumably had adjusted to that situation * * *. Hence viewed as of today as the starting point in time—which is the proper way to consider the effects of the change—this sudden increase in export rebates under the value-added tax while the internal overall burden of the tax remains unchanged, becomes an advantage to German exporters. And equally, the rise in import charges can be added competitive burden to imports.²

"What is happening in Germany is, and will be, reflected elsewhere in Europe as the countries shift to value-added taxes. * * * As a consequence, European exporters in general will get an added lift in most countries."

Mr. Surrey analyzes the indirect tax aspect of the problem in this fashion:

"The European practice of rebates and import charges for turnover and value-added taxes reflects the basic assumption that such taxes are passed along through channels of trade so that their burden is borne by households buying goods for personal consumption. * * * As a working assumption for domestic legislation and for general judgments on the distribution of the burden of a tax system or of a new excise or sales tax, it is a useful operational device. But the balance-of-payments world of today, with its fixed exchange rates and the attention that must be focused on both the overall balance and its component parts, including the trade portion, requires much more attention to specific than ever before. * * *

"If sales taxes or other indirect taxes—whether they be value-added, however, retail or other tax forms—cannot be fully passed on in price, *then a manufacturer selling in his domestic market must lower his prices and reduce his profits. But if the full rebate of the tax cost and the exemption of exports from the tax make it unnecessary to change his export prices*, then he is not concerned about passing anything along on an export sale, he need not lower his export price, and his export profits would not suffer as would his domestic profits. The business of exporting becomes that much more attractive, and the sales tax system has become an incentive to export activity. *Similarly, on the import side*, the importer to meet the competition of lowered domestic prices must reduce his price, his profits decline and he is less interested in pushing those imports. In essence, one gets to the question of tax incidence and whether these sales taxes are fully shifted forward in price or only partly shifted.

"Put another way, a value-added tax is carefully structured to pass the tax along in an *accounting sense*. Its effect on international trade, however, depends on whether the *economic effects follow* the accounting structure. If the tax is *not fully shifted forward in an economic sense*, then the international trade of the country using the tax will be favored regardless of the accounting structure." (Emphasis ours.)

In Surrey's opinion, it is not the levels of rebates per se and the differentials between them that measure the competitive effects of border tax adjustments.

Surrey concludes his discussion with the following comment:

"The problem will become more acute if the Europeans take the next step of harmonizing their indirect tax rates * * *.

"Certainly, to the extent that the generalities are not fully valid, the disparity in indirect tax levels can only be working to the disadvantage of the United States in world trade." (Emphasis ours.)

"The premises and rules of GATT with respect to export subsidies and border tax adjustments rest on the generalities of incidence and shifting that I have described. Under those premises and rules the European countries have almost

¹ Remarks by Surrey before the National Industrial Conference Board on February 15, 1968, "Implications of Tax Harmonization in the European Common Market," pages 28 through 29.

² Surrey points out, parenthetically: "The Germans assert that these trade advantages are offset by transitory tax arrangements outside the value-added tax affecting investments in plant and equipment, and state that in any event any calculations are to a large extent hypothetical."