



### HIGHLIGHTS from Box 3.2

#### NO TARIFFS, NO PROBLEM: MANAGING THE REVENUE IMPACT OF TARIFF CUTS

##### Key Points

- *Most South Asian countries derive 4–19 percent of their government revenues, or 0.7–3.7 percent of GDP, from trade.*
- *Past episodes of major tariff cuts were, on average, accompanied by a small decline in trade revenue of less than 0.1 percentage point of GDP, while total tax revenue-to-GDP ratios stayed broadly flat as gains in other tax revenues more than offset losses in trade tax revenue.*
- *Non-trade tax revenue increase of at least 0.1 percentage point of GDP has been common and rarely required tax rate increases.*

**Heavy reliance on trade revenue.** All South Asian countries generate lower tax revenues than the average EMDE. Trade-related tax revenues account for a higher share of total tax revenue in all South Asian countries except for Bhutan (figure 1). Any trade revenue losses from tariff cuts to open the region's economies to international trade would therefore have to be offset by revenue gains elsewhere.

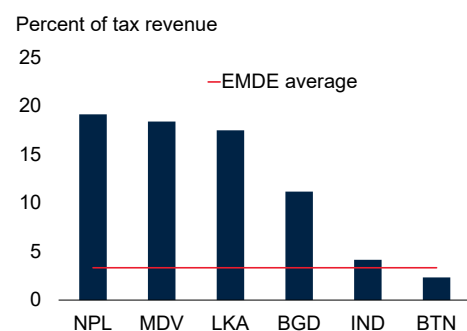
**Revenue impact of tariff cuts.** Episodes of major tariff cuts during 1980–2024 were associated with statistically significant—but small—declines in trade revenue, by less than 0.1 percentage point of GDP on average. Despite declines in trade tax revenue, total tax revenue during these episodes remained broadly flat, as increases in non-trade tax revenue (averaging 0.2 percentage point of GDP) offset declines in trade revenue.

**Non-trade revenue increases.** Increases in non-trade tax revenue of 0.1 percentage point of GDP or more have been common since the 1980s, taking place in more than half of country-year pairs. The average increase was 0.9 percentage point of GDP, substantially larger than the gain needed to offset the average loss in trade revenue from major tariff cuts. Consumption tax revenue accounted for two-fifths of the average increase in non-trade tax revenue.

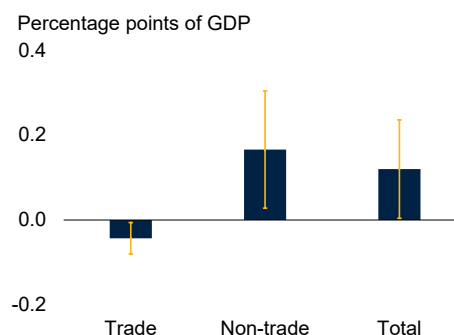
**Options for raising non-trade revenue.** Raising non-trade tax revenue typically did not require tax *rate* hikes. Only one-fifth of the country-year pairs with increases of non-trade tax revenue were accompanied by increases in non-trade tax rates. Even among episodes with sustained increases of non-trade tax revenue for five or more years, one-half were achieved without raising non-trade tax rates. Governments can instead raise non-trade tax revenues by broadening tax bases and making tax administration more efficient (World Bank 2025).

**FIGURE 1: Managing the revenue impact of tariff cuts**

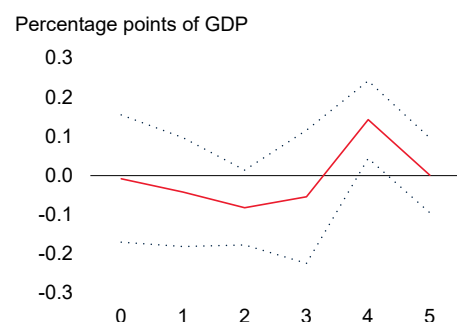
**A. Trade tax revenue, 2019–23**



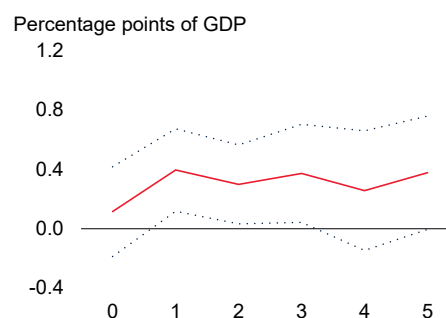
**B. Differentials in annual revenue changes between episodes and non-episodes: Total, trade, and non-trade tax revenue**



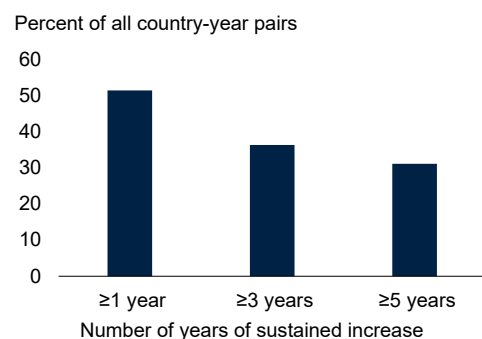
**C. Cumulative change after start of tariff reduction episode: Trade tax revenues**



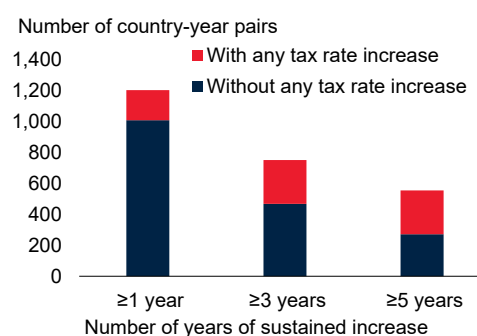
**D. Cumulative change after start of tariff reduction episode: Non-trade tax revenues**



**E. Frequency of sustained non-trade tax revenue increase of 0.1 percentage point of GDP**



**F. Composition of sustained non-trade tax revenue increases, with and without non-trade tax rate hikes**



*Sources:* Haver Analytics; IMF Government Finance Statistics (database); UNU-WIDER; U.S. Agency for International Development Collecting Taxes (database); Vegh and Vuletin (2015); World Bank Fiscal Survey; World Development Indicators (database); World Bank.

*Note:* BGD = Bangladesh; BTN = Bhutan; EMDE = emerging market and developing economy; IND = India; LKA = Sri Lanka; MDV = Maldives; NPL = Nepal. South Asia comprises Bangladesh, Bhutan, India, Maldives, Nepal, and Sri Lanka.



A. EMDE average is the nominal GDP-weighted average of 111 EMDEs. Tax revenue includes social security contributions and excludes grants.

B–D. Episodes and methodology are detailed in annex 3.1. Episodes are defined as the largest decile of tariff reductions in both the first year and over a five-year period among up to 122 countries, of which 31 countries (25 EMDEs) experienced 33 tariff reduction episodes. Tax revenue excludes social security contributions and grants.

B. Bars show the difference in the annual average revenue-to-GDP ratio between the first 5 years of an episode and all years outside of episodes, derived from a country fixed effects regression. Whiskers indicate 90-percent confidence intervals.

C.D. Impulse response functions from a local projection estimation of cumulative changes in trade revenue-to-GDP ratio (C) and non-trade revenue-to-GDP ratio (D) on a dummy variable marking the start of the tariff reduction episode. Dotted lines indicate 90-percent confidence intervals.

E.F. The methodology identifies whether a country-year pair recorded an annual increase in non-trade tax revenue of 0.1 percentage point of GDP or more from the previous year. Tax revenue excludes social security contributions and grants. A revenue increase is sustained for at least 3 years if non-trade tax revenue increased by 0.1 percentage point of GDP or more between years  $t-3$  and  $t-2$ , and remained at the higher level for each year until year  $t$ . A revenue increase that is sustained for at least 5 years is defined analogously.

E. Bars show the frequency with which a country-year pair recorded a sustained increase in non-trade tax revenue, as a percent of all country-year pairs.

F. Bars show the breakdown of sustained increases in non-trade tax revenue, according to whether the episode was accompanied by increases in any non-trade tax rate, including personal income tax, corporate income tax, and consumption tax rates. Sample includes only those with data on change in each tax rate during the sustained window.