

On My Mind

A tax by any other name



CIO VIEWS

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We have reached an important juncture in the trade wars, as the United States struck preliminary agreements with Japan and the European Union (EU). In both cases, the United States will be imposing a 15% baseline tariff—though there will be exemptions and possibly different rates on specific products.

The EU is America's top trading partner, accounting for close to one-fifth of US imports; Japan is the fifth largest, at 5% of imports. These agreements follow those reached with the United Kingdom (2%), Vietnam (4%), Indonesia (1%) and the Philippines (0.4%). The big ones missing are China, Canada and Mexico, which together account for 42% of US imports. However, whereas two weeks ago progress might have looked negligible, now the US administration's goal to renegotiate trade relations with its partners seems much more advanced.

It's a good time therefore to assess what is shaping up

The most under-appreciated point, in my view, is that the additional revenue from tariffs might be substantial. As I noted three months ago ([On My Mind: T-Day](#)) tariffs are a tax, and at this stage we are in a better position to estimate the likely impact on public finances and economic activity. So far this year, tariffs have yielded about US\$130 billion in revenue, compared to just over US\$50 billion in the same period last year.¹

What could a new steady state look like? Negotiations are ongoing, but to fix ideas, assume that we end up with the equivalent of a 15% tariff across the board, along the lines of the recent EU and Japan deals. In 2024, imports amounted to US\$3.3 trillion; let's suppose they remain unchanged at this level. Let's further assume that US\$1 trillion in imports will not be subject

to tariffs, either because they fall under the United States-Mexico-Canada Agreement or thanks to ad hoc exemptions. A 15% tariff rate on the remaining US\$2.3 trillion in imports would yield about US\$340 billion in revenue, broadly in line with the latest collection numbers.

That's US\$260 billion in additional revenue over and above the average of the past three years—a tax hike of close to one percent of gross domestic product (GDP). This would help narrow the budget deficits in the coming years to somewhere in the range of 5%–6% of GDP, compared to current projections of 6%–7% of GDP.²

Over 10 years, the additional revenue would amount to about US\$2.6 trillion, broadly equal to the US\$2.4 trillion cumulated increase in the primary deficit caused by the Big Beautiful Bill (BBB), according to Congressional Budget Office (CBO) estimates.³

Now this begins to look interesting: By extending the 2017 Tax Cuts and Jobs Act tax cuts, the BBB “gave up” US\$3.7 trillion in potential revenue, according to the CBO. This was partly compensated by US\$1.3 trillion in expenditure cuts. It looks like the remainder might be made up through a hike in indirect taxes—because import tariffs are in effect a sales tax. Fiscal policy remains loose, but a bit less so. Compared to existing policies, there is a tax hike, but it is from indirect taxes (on sales of imported goods) rather than direct taxes (on household and corporate income).

How big of a tax hike? Total tariff revenue would be the equivalent of a 5% sales tax on all goods (consumption of goods in 2024 was about US\$6.2 trillion out of close to US\$20 trillion of goods and services). Meaningful, but not dramatic: Most EU countries impose a value added tax (VAT) of about 20%–22% on most goods and services.

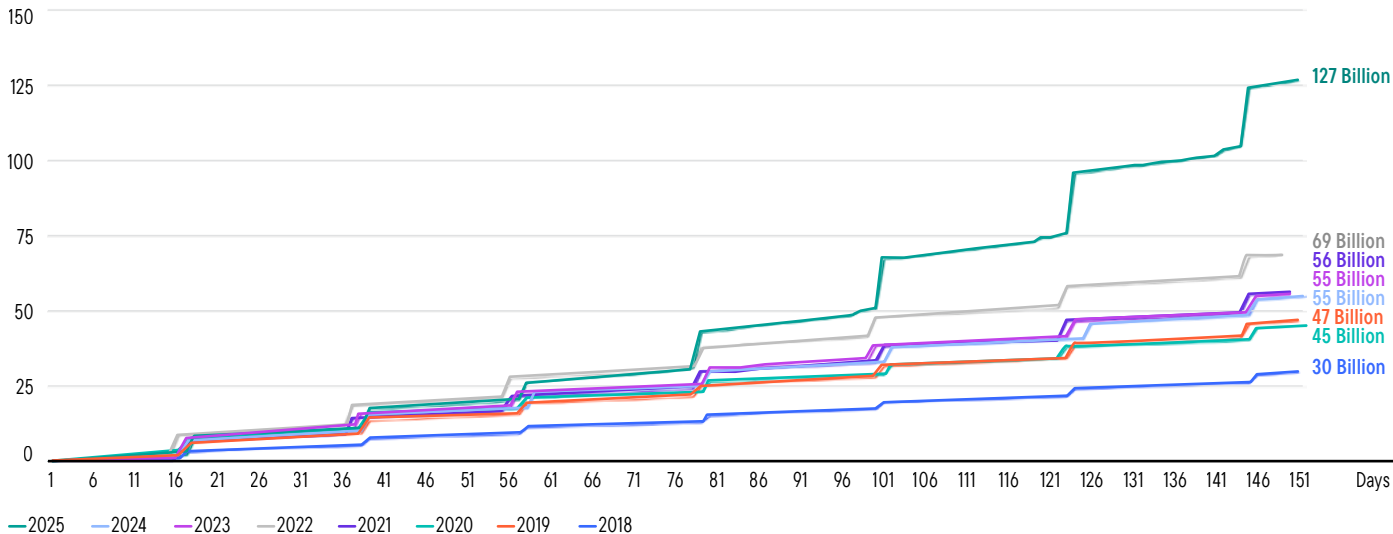
Economists agree that indirect taxes are generally better than direct taxes: They cover a broader base, are easier to administer and collect, and do not distort work incentives. (They are, however, regressive. Since lower-paid households spend a greater share of their income, they are hit relatively harder.)

1. Source: How much are US tariffs raising in revenue? Bipartisan Policy. April 23, 2025.
2. There is no assurance that any estimate, forecast or projection will be realized.
3. Source: H.R. 1, One Big Beautiful Bill Act. Congressional Budget Office. June 17, 2025.

Gross Tariff Revenues ~US\$130Bn in the First Seven Months of 2025

2018–2025

USD, Billion



Sources: US Treasury, Macrobond. Analysis by Franklin Templeton Fixed Income Research. As of August 4, 2025.

Tariffs are a sales tax that discriminates in favor of domestically produced goods. But within every European country, the VAT also discriminates, in favor of selected goods and services (for example food, medicine, books), which are subject to lower or zero rates.

We're seeing a stealth shift toward indirect taxation, which is flying under the radar for two reasons: One is that since the CBO ignored the impact of tariff hikes, they did not enter the budget debate. The second is the administration's obfuscating argument that tariffs will be paid by foreign producers.

In all likelihood, at least three-quarters of the tariff burden will fall on US corporates and households. In some cases, foreign producers will likely cut prices to maintain market share, as Japanese automakers have been doing in the past few months, but such instances of 'taxation without representation' will most likely be rare, and possibly temporary. So far US corporates have absorbed the bulk of the tax hike through a squeeze in profit margins. As trade deals are finalized, I expect a greater portion will feed into higher consumer prices. This would give a moderate, temporary bump to inflation, and should slow GDP growth somewhat—we're already seeing some evidence in activity and jobs creation data. But if you wanted to minimize the hit to growth from an indirect tax, a tariff on imports is exactly what you would choose: the reduction in demand will fall disproportionately on imports, which do not contribute directly to GDP growth.

What are the key implications for the outlook?

1. We anticipate some modest downside risk to growth, though the impact should be moderate—and with 5%–6% of GDP budget deficits, fiscal policy remains expansionary. Additional headwinds might come from trade disruptions as supply chains adapt.
2. The Federal Reserve's (Fed's) job gets complicated. The sizable downward revisions to recent jobs data confirm some weakening in the labor market, but the unemployment rate is still at the exact same low level as a year ago. With tariffs likely to feed more into prices in the coming months, the Fed will have to carefully gauge the balance of risks in determining if and when to cut rates. I remain of the view that scope for rate cuts is extremely limited, barring a sharp slowdown, because we're very close to my estimate of the natural policy rate.
3. The long-term fiscal challenge remains. Barring a productivity miracle, it will have to be addressed through some combination of expenditure cuts and tax hikes. It will be interesting to see if these significant tariff increases prove to be a first step toward more significant reliance on indirect taxes—the route taken by many other advanced economies.

Donald Asai

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