



The Daily Dish

Reciprocal Tariffs and the VAT

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Among President Trump's list of tariffs - which includes those on China, Mexico, Canada, steel, aluminum, pharmaceuticals, chips, autos - is his [proposal](#) for "reciprocal tariffs." The basic notion is to equalize the burden of tariffs on U.S. and foreign producers by pegging the level of U.S. tariffs to the tariffs and other trade barriers of other countries. This is utterly unworkable, if only because our number of trade partners and traded goods would produce a list of tariffs running into the millions - and would need to be constantly adjusted.

Put that aside. It is also unworkable because the president proposes to offset tariffs, taxes, non-tariff barriers, exchange-rate manipulation, and any other unfair practice. There is simply no reasonable way to quantify this objective, with the result that the tariffs will be fundamentally arbitrary. The president may like this because it allows him to cut preferential deals with favored parties, but the economics of this approach are dreadful.

European countries' value-added taxes (VATs) are a particular source of the president's ire. The AP [noted](#): "Trump's proclamation identifies value-added taxes — which are similar to sales taxes and common in the European Union — as a trade barrier to be included in any reciprocal tariff calculations."

This is flatly wrong. European VATs are border-adjusted. That is, the VAT is the same on domestic goods and imported goods. There is no tax-based disadvantage to U.S. producers selling to Europe. It is also true that the VAT is not imposed on European exports, and is therefore not putting their firms at a tax-based disadvantage - at least not one emanating from the VAT. Europe has enough other taxes and regulations to disadvantage Superman.

An irony in all of this is that in 2017, the first proposal for tax reform was not what became the Tax Cuts and Jobs Act (TCJA). It was to move away from income taxation and instead use what is known as a destination-based cash flow tax (DBCFT). Businesses would be taxed on their cash flow - allowing for full deductibility of all investments in equipment, research and

development, software, and workers' skills - and the tax would be [border-adjusted](#). That is, like a VAT, it would be levied on imports but not on exports. This levels the playing field as the same tax is paid regardless of whether the good is domestic or foreign. It does not burden U.S. exporters. Moreover, it removes any incentive to locate overseas and sell back to the United States. The DBCFT should be in America's future.

In 2017, however, the DBCFT was rejected by President Trump and the TCJA became an exercise in income taxation, which does not include border adjustment. It also opened the door to the reciprocal tariff proposal. Alas.