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A new world trade order? How the EU should respond to US tariff policy

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The so-called "Liberation Day" proclaimed by the Trump administration marks a pivotal shift in the global economic order. On April 2, President Trump announced a sweeping set of unilateral trade measures, including a 10-percentage-point increase in import tariffs on all foreign goods. These were accompanied by sector-specific actions and country-specific "reciprocal" tariffs targeting nations with trade surpluses in goods vis-à-vis the United States. Together, these measures represent a historic step backward for the multilateral trade system.

Faced with adverse market reactions, President Trump announced on April 9 a 90-day pause on the new tariffs. However, the across-the-board 10-point tariff increase remained in place, and the administration signalled its intent to pursue bilateral negotiations.

This paper explores possible scenarios for the evolution of the US-EU trade relationship in light of these developments. We argue that the appropriate response by the European Union to the US's unilateral tariff escalation should be guided by three key considerations:

i) the economic costs imposed by the tariffs on both the US and EU economies;

ii) the costs associated with potential retaliation; and

iii) the anticipated impact of retaliation on future US trade policy.

We provide quantitative estimates of the economic effects based on independent simulations conducted by the French CEPII and the German Kiel Institute for the World Economy. In addition, we discuss potential strategic interpretations of the US tariff policy and the broader objectives the Trump administration may be pursuing.

Preserving the openness of global trade must remain a core EU objective. This requires:

i) articulating a credible and proportionate retaliation strategy against discriminatory US tariffs;

ii) supporting European firms facing disrupted access to the US market; and

iii) coordinating closely with other major trade partners and accelerating efforts to conclude additional Free Trade Agreements.

In this context, the European Union must assume a leadership role in defending the rules-based global trading system and upholding international trade norms.

The so-called Liberation Day tariffs imposed by the Trump administration mark a pivotal shift in the global economic order, reflecting a broader trend toward fragmentation in trade and finance along geopolitical lines visible in recent years. Globalization, once seen as an irreversible force, now faces an uncertain future – arguably more so than at any point in the past half-century. After imposing additional tariffs of unprecedented size on almost all countries on April 2, the US President soon thereafter announced a 90-day moratorium for all countries, except China. A number of smaller states have started to engage in tariff negotiations with the US administration. The EU has expressed its willingness to negotiate, starting with the offer of a reciprocal tariff reduction on all industrial goods to zero.

In this policy paper, we provide potential interpretations of the US tariff policy and estimations of the economic effects of the different tariff scenarios that may evolve over the coming months. Furthermore, we discuss strategies the EU may choose in the course of these negotiations and how they may affect their outcome. As we will argue, the European Union's appropriate response to the tariffs introduced by the US administration depends on the goals the US administration intends to achieve. While the medium to long-term objectives the US government pursues are not entirely clear yet, it seems likely that they might go beyond purely economic interests. This should be taken into account when considering appropriate responses.

There are at least two potential interpretations of the US tariff policy and the announcements made by the US president so far. One interpretation is that the Trump administration intends to impose substantial tariffs on a permanent basis to generate revenues and move jobs back to the US. A second possible interpretation is that the Trump administration uses the threat of high tariffs to obtain concessions from trade partners. These two interpretations are of course not mutually exclusive. An indication which of the interpretations is more likely may be the size of the tariffs and the goods on which they are imposed. We will discuss the different scenarios in turn.

Case #1: An import tariff increase of 10 percentage points on all imports and higher taxes on selected goods

In the scenario, which currently prevails, the US administration imposes an additional 10 percentage points (pp) tariff on essentially all countries (a higher one on China) and on all imports (with some exemptions). In addition to the general 10 pp import tariff increase, the US government has also raised duties on imports of steel and aluminum to 25 pp[1] and imposed a 25 pp tariff increase on cars and car parts.

How to interpret the 10 percentage points tariff increase on all imports

The 10 pp tariff increase does not seem up for negotiation, in contrast to the much higher so-called "reciprocal" tariffs for which there is currently a 90-day moratorium. The most likely interpretation is therefore that this 10 pp import tariff increase is going to stay.

The US government gave two justifications for increasing tariffs.

First, that foreign countries must pay for the international public goods that US offers, most importantly military protection. While this reasoning may have some prima facie appeal to outside onlookers, it is fundamentally flawed. Recent evidence from the 2018 US-China trade war has shown that a substantial share of tariffs is fully passed on to import prices (Amiti et al., 2019; Fajgelbaum et al., 2020; Flaaen et al., 2020), i.e. foreign producers do not reduce their prices when tariffs are imposed. Thus, import tariffs will be paid by US households, not by foreign countries.

The Trump administration claims that these tariffs can serve as a federal income source, which will make the US government less dependent on income tax revenues and hence allows tax reductions. Given that the import tariffs will be paid by US households, replacing revenues from income taxes with revenues from tariffs will have a regressive effect, that is, it will increase inequality among households. Whether this is an intended or unintended consequence of the tariff policy remains unclear.

A second justification given for the tariffs on foreign goods is that this will bring back manufacturing jobs by forcing firms to shift production to the US. This is unlikely to work as intended for several reasons: shifting production takes time; there is a likely shortage of workforce; US manufacturing firms will become less competitive due to tariffs on imported intermediate inputs; and because potential tariff retaliations from foreign countries will reduce export opportunities for firms producing in the US. Most importantly, it is unlikely that foreign firms will commit to the huge investments involved in shifting production to the US in a situation where the economic conditions are highly uncertain, and where the US economy is likely to go into recession or stagflation.

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[1] The official statements of the US administration are contradictory, in some places stating that duties on steel and aluminum are raised to 25 pp, in other places stating that they are raised by 25 pp.

How to interpret the tariffs on selected goods like cars and steel and aluminum

Like the 10 pp tariff increase on all imported goods, these tariffs are not part of the 90-day-moratorium. The US president may want to keep these tariffs permanently in place to induce manufacturers to move production to the US with the idea of bringing jobs back to the US. He may also count on using these tariffs to obtain trade concessions.

What does the US stand to gain from a permanent 10 percentage point tariff increase on imported goods and permanent tariffs on selected products like cars and steel and aluminum?

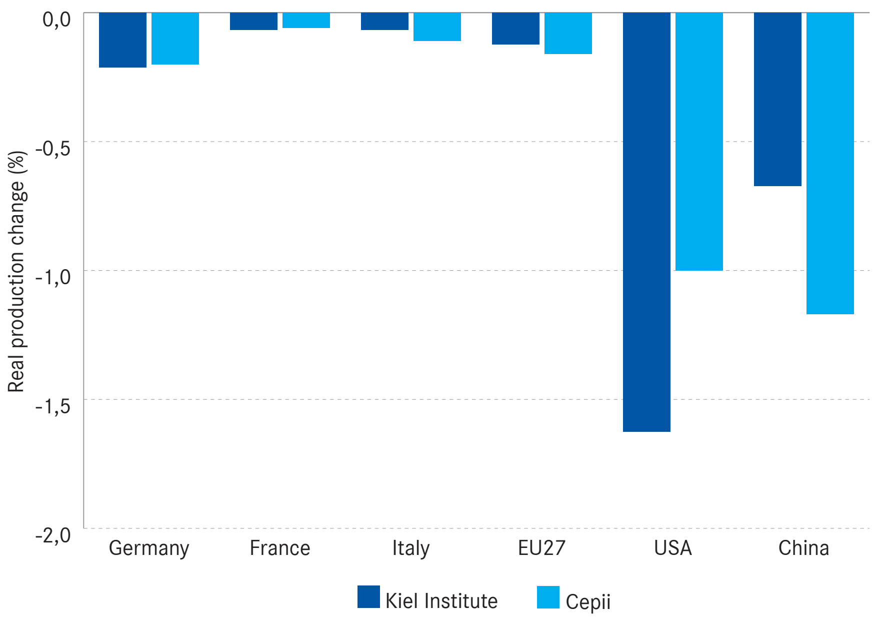
As outlined above, the economic benefits for the US of a permanent tariff are dubious at best. As this is a tariff imposed on countries all over the world, it does not change the competitive situation of exporters from one country vis-à-vis that of exporters from other countries. Therefore, the cost is mostly borne by the US, as well as China, as long as the near prohibitive tariffs between the US and China remain. Instead, the impact on European countries is relatively limited.

This is confirmed by the simulations independently run by the German Kiel Institute and the French CEPII. Both institutes have used their internal models to simulate the potential impact of the current set of tariffs. The KITE model of the Kiel Institute is a multi-country, multi-sector quantitative trade model calibrated with elasticities that are meant to capture short-run consequences (Hinz et al., 2025). The Mirage model of CEPII is a computable general equilibrium model calibrated to longer-run adjustments (Bouët et al., 2025b). The tariffs included in the simulations are the following:

i. a 10 pp increase in tariffs on all US imports from all countries, with exemptions on pharmaceutical products, semiconductors, wood products, gold, energy, and mineral ores,
ii. an increase of tariffs for automobiles by 25 pp and for steel and aluminum to 25 percent,[2]
iii. a 25 pp increase on imports from Canada and Mexico for products that do not comply with the rules of origin imposed under USMCA,
iv. a 145% tariff on Chinese imports, matched with a 125% tariff of China on US imports.[3]

Despite the differences of the models, both institutes reach very similar conclusions as to the order of magnitude of the economic consequences one should expect for the different regions (see ▶**Figure 1**).

Figure 1: Estimated economic consequences of the current US tariffs



Notes: The figure compares the real output consequences of the current set of tariffs estimated by the Kiel Institute using their KITE model (dark blue bars) and CEPII using the Mirage model (light blue bars). The KITE model is a multi-country, multi-sector quantitative trade model calibrated with elasticities that are meant to capture short-run consequences. The Mirage model is a computable general equilibrium model calibrated to longer-run adjustments. **Source**: Hinz et al. (2025) and Bouët et al. (2025b)

[2] The CEPII model includes an increase of tariffs for automobiles and steel and aluminum by 25 pp.

[3] These scenarios do not include exemptions on US-China trade that have been decided after the tariff escalation.

Given the aggregate increase in US import costs, the simulated real output loss for the US economy is substantial, between 1 and 1.63% of real output, depending on the model. The cost is mostly borne by US consumers, whereas some US firms benefit from decreased competitive pressures from foreign suppliers. Instead, the impact of the 10 pp tariff increase on EU countries is relatively mild, around 0.15% of GDP.

There is important heterogeneity across EU industries. According to the CEPII's Mirage model, the 25 pp tariff increase on cars, for example, imposes significant value-added losses in the German car industry (up to -7% of real value added) or the French transportation equipment sector (up to -3.1%).[4] Beyond these sectors, the impact of the universal 10% pp tariff increase on all imports is rather mild. There are also a few sectors that actually benefit from China's losing competitiveness in the US. Examples include electrical equipment (+1% in Germany and +0.4% in France according to the Mirage model) or textile products (+0.8% in Germany and +0.5% in France). The corresponding results from the KITE model broadly align with those from the Mirage model. For Germany, the estimated effects tend to be somewhat more moderate—for instance, a -3.14% decline in the automotive sector. In contrast, the impacts for China and the United States are similar in magnitude to those in Mirage model, though generally slightly more negative. Examples include a -6.9% drop in value added in the U.S. pharmaceutical sector and a -7% loss in the U.S. automotive sector.

How to respond to these tariffs

If the 10 pp tariff increase imposed by the US is meant to be permanent, despite the severe economic costs on the US consumers, this would suggest that the US government is determined to go this route for political reasons, sticking to its dubious narratives that the US people will benefit from this policy. For the EU, this means that the pros and cons of a potential retaliation must be weighed carefully. Responding with a similar tax on all US goods will impose direct costs on EU customers (if tariffs are imposed on final goods), as well as on businesses exposed to increased input costs (if tariffs target intermediate goods), hurting their export competitiveness. The benefits of such a retaliation, however, are uncertain, as the US government may not be open to economic rationales that call for no tariffs at all. One could instead consider negotiating with the US about committing to increasing imports of certain American products in exchange for tariff reductions. Increasing imports of fossil fuels could actually help diversify European supply sources. Of course, such a concession must not lead to the EU becoming dependent on US imports of fossil fuels in the way it was dependent on Russian gas supplies before the Ukrainian war.

The situation is somewhat different for the higher tariffs on selected goods like cars. It seems less likely that these tariffs are meant to be permanent, and more likely that they are intended to strike a deal with the affected countries. In this bargaining situation, the EU should consider retaliatory measures, like selected tariffs on targeted goods, similar to the approach taken in Trump's first presidency. Then, the EU selected products such as Bourbon Whiskey or Harley Davidson, with limited impact on the EU customers but potentially substantial impact on strategic constituencies in the US. Other products could be considered as well. As an example, Bouët, Fontagné, Guimbard, Wibaux, and Zheng (2025a) identify a "blacklist" of 412 products, along with 1,064 product categories for which the EU accounts for over 20% of US exports. These segments are particularly vulnerable to retaliation since the EU represents a high share of demand for US goods.

The aim of such a response would be to create burdens for US firms and financial markets to achieve a partial withdrawal of US tariffs. While such a relatively cautious and targeted stance could help to stabilize economic conditions in the short term and is likely in the best interest of European customers (who would otherwise pay higher tariffs on a large set of goods), it also carries the risk of being interpreted by some observers as political weakness. This might increase the likelihood that the United States will continue to take unilateral measures in the future.

Case #2: High "reciprocal" tariffs

A plausible and likely interpretation of the so-called "Liberation Day reciprocal tariffs" is that the Trump administration uses the threat of high tariffs to obtain concessions from trade partners.[5] If this is the right interpretation, then it seems likely that US tariffs are meant to be temporary and will be reduced once a deal is struck. The Trump administration seems to have been successful with Vietnam, Cambodia, as both countries have offered to negotiate trade deals with the US in the week following April 2. The US is likely to obtain concessions from other countries as well.

[4] Bouët A.et al.(2025b). Detailed estimates are available in Table A1 in the appendix. The analogous effects computed with the KITE model are similar in magnitude but somewhat smaller (-5.1% and -2.6%).

[5] The April 2 Liberation Day reciprocal tariffs are higher than the tariffs described under "Case #1" above for all countries except for China: the tariff on imports from China was set to 54% on April 2 while it is set to 145% in the scenario described above.

How to respond to these tariffs

Compared to smaller countries who have little bargaining power with the US, the EU is able to hold out and negotiate in a way that is not simply giving in to the demands of the Trump administration. To make this clear from the very beginning, the EU should not offer concessions unless they are met by equivalent concessions by the US. The EU's offer of zero tariffs on all industrial goods was going this route of offering a tariff deal to the US government. This offer should stay on the table.

Most importantly, the EU should announce potential retaliation if more comprehensive "reciprocal" tariffs on all goods were again to come into force, like the ones announced on April 2 and currently suspended for a ninety-day period. In this case, the focus would no longer be on the economic expediency of possible reactions, but on the question of the European Union's political capacity to act.

First, the economic cost for Europe of such high and discriminatory tariffs would be substantially higher, as illustrated in ►**Figure 2**. For the EU as a whole, the real output loss is estimated to be twice as big, between -0.22 and -0.33% of real GDP. Instead, the increase in the real output loss for the US is not huge, whereas the situation of China is improved. The reason is that tariffs on Chinese products are comparable to the taxation of EU products under the "Liberation Day" scenario when the current situation involves prohibitive tariffs between the US and China, which is extremely costly for these countries while benefiting to some EU producers.

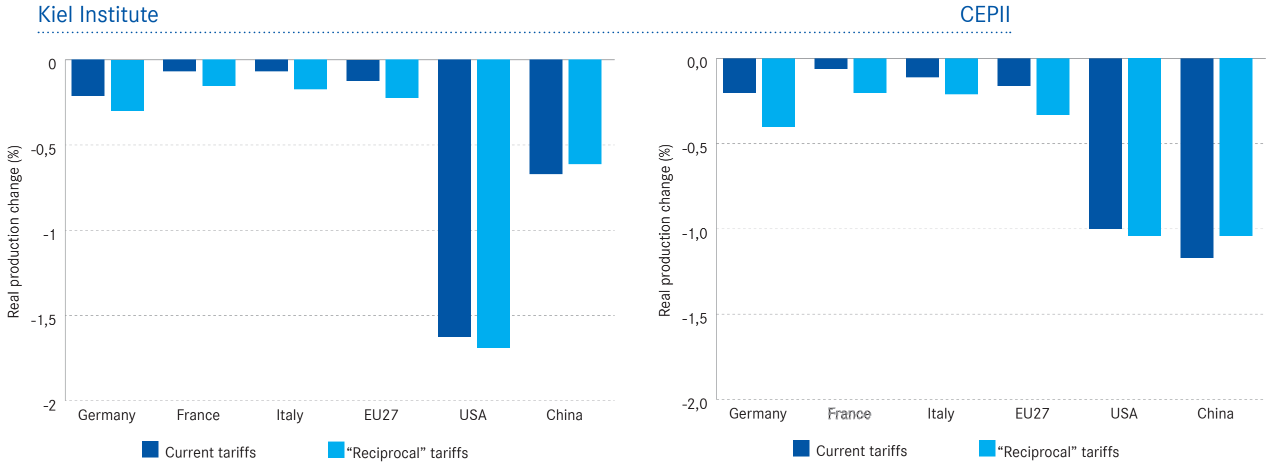
Second, a significant expansion of the conflict by the United States would have to be interpreted as a strategically motivated decision that would require not only an economic but also a political response. Responding to an aggressive unilateral trade policy that goes against multilateral principles may thus be necessary for reputational reasons. A lack of response could encourage the US to pursue further tariff escalation. Beyond trade policy, the Trump administration could also target other key aspects of the Union's functioning.

In such a situation, similarly drastic measures could be considered in areas in which the European Union has market and negotiating power. These include access to the European market, regulatory intervention in digital services and tax policy measures vis-à-vis US multinationals. Such measures would not primarily be aimed at economic compensation, but at demonstrating the European Union's ability to assert itself.

Preparing for a response

To prepare such an escalation – with the aim of preventing it – it seems appropriate to announce now the possibility of retaliation within six months, while the moratorium on "reciprocal tariffs" still lasts. This window of opportunity should be used for the negotiation of tariff de-escalation against the backdrop of the announced retaliation. During this time, the US may decide to withdraw the tariffs themselves if they experience negative macroeconomic effects (rising prices, recession…).

Figure 2: Estimated economic consequences of the current US tariffs versus the "reciprocal" tariffs announced on "Liberation Day"



Notes: The figure compares the real output consequences of two tariffs scenarios, the current set of tariffs including a 10% tariff on all imports and the prohibitive US-China tariffs (dark blue bars), and the "reciprocal" tariff scenario in which each country running a trade surplus on the US is imposed a reciprocal tariff in proportion to its net exports (light blue bars). Estimates are recovered from the Kiel-KITE model (left panel) and the CEPII-Mirage model (right panel). The Mirage model is a computable general equilibrium calibrated to long-run adjustments. The Kite model is a quantitative trade model calibrated with elasticities meant to capture short-run adjustments. **Source**: Hinz et al. (2025) and Bouët et al. (2025b)

Several principles can guide the targeting of retaliatory measures:

i. Favor tariffs on final goods (which affect European consumers), rather than intermediate goods (to preserve the competitiveness of European firms);

ii. Target products for which substitution alternatives exist (e.g., agricultural products), or for which the US has asymmetric vulnerability (products where the EU is a major customer, but US imports represent only a small share of EU imports);[6]

iii. Coordinate measures with other strategic partners (United Kingdom, Canada, Japan, South Korea…) to increase their impact and credibility.

Other tools beyond tariffs are available to the EU:

Export taxation

An export tax on certain strategic goods that are difficult for the US to substitute (e.g. chemical intrants to the agricultural sector, or lithography technologies for semiconductors) could generate revenues for the EU and cause a significant price shock in the US. Implementation should be at the EU level, with targeted compensation for the affected companies.

Anti-coercion regulation

The new European anti-coercion regulation applies when a third country takes or threatens to take a measure affecting trade or investment in order to force the EU or individual member states to take certain political decisions. If joint consultations cannot resolve the matter, the Union can take unilateral countermeasures, ranging from tariff increases and exclusion from public procurement to restrictions on intellectual property rights protection. This instrument could be considered for example for services, a sector where the US runs a surplus with the EU.

Conclusion

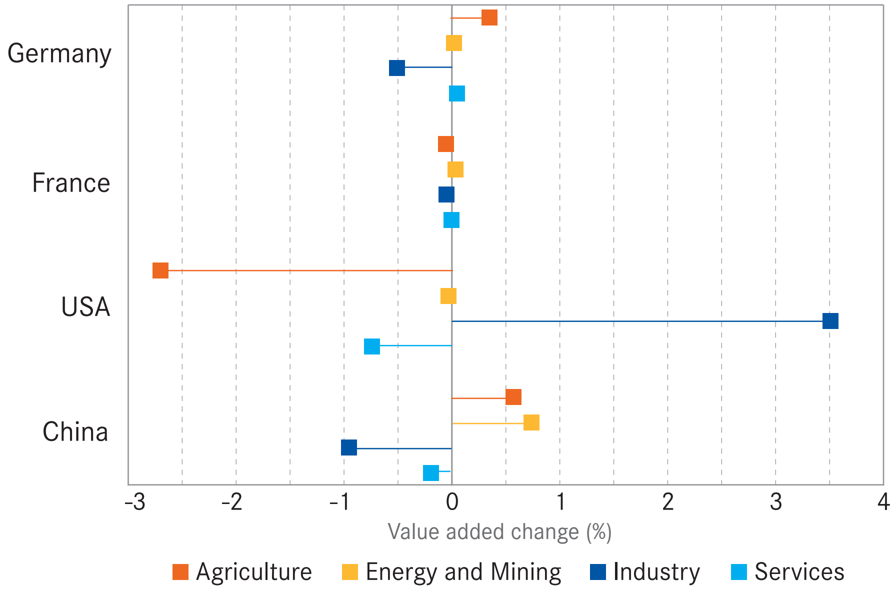
Preserving the openness of global trade is an important goal that the EU must strive to sustain in times when it is more under pressure than ever. For this, it is essential for the EU to support European companies whose access to the US market might be at risk by helping them to find new export markets with other trading partners. Moreover and most importantly, the EU should use the moratorium to prepare new trade agreements with other countries, for instance Australia. Free Trade Agreements are currently under negotiation with India and Indonesia and should be pursued further. And, of course, it would be wise to sign the EU-Mercosur agreement. The more the global economy (outside the US) remains open, the lower the economic costs will be for the EU and for the rest of the world. The European Union must adopt a leadership role in defending the global trade order and its international trade rules. This requires taking a strong position and being ready to fight – when needed – against tariffs that put global trade and the world economy at risk.

[6] The list of 1064 products in Bouët et al. (2025a) could serve as a starting point.

Appendix. Detailed Estimated Economic Effects of the Current US Tariffs

This appendix presents estimates of the economic impact of current US tariffs based on simulations from the CEPII-Mirage model. The first figure and table report changes in sectoral value-added across selected countries, at both an aggregated (agriculture, energy and mining, industry and services) and a more detailed (12 sub-sectors) level. The last table shows the estimated changes in bilateral goods trade between selected countries.

Figure A.1: Estimated sectoral effects of the current US tariffs on value-added by 2030



Notes: The figure compares the change in sectoral value-added by 2030 under the current set of tariffs. Estimates are recovered from the CEPII-Mirage model. The Mirage model is a computable general equilibrium calibrated to long-run adjustments. **Source**: CEPII (2025)

Table A.1: Estimated sectoral effects of the current US tariffs on value-added by 2030

Sub-sector	Germany	France	China	USA
Beverages and tobacco	0,2	-0,8	-0,5	-0,2
Chemistry	1,2	-0,2	3,5	-3,0
Dairy products	0,4	-0,2	0,2	-0,6
Electrical equipment	1,0	0,4	-4,4	8,4
Other manufactures	0,6	0,5	-5,9	7,2
Other processed food	0,3	0,0	-0,9	0,2
Pharmacy	2,3	0,7	1,6	-6,7
Rubber and plastic	-0,5	-0,6	0,4	1,1
Textile	0,8	0,5	-4,2	22,6
Transportation equipment	-0,2	-3,1	2,2	2,2
Vehicles and parts	-7,0	-0,4	2,9	-4,2
Wood and paper	1,0	0,0	0,7	0,1

Notes: The table shows the change in sectoral value-added (%) by 2030 under the current set of tariffs. Estimates are recovered from the CEPII-Mirage model. The Mirage model is a computable general equilibrium calibrated to long-run adjustments. The color gradient reflects all values across the entire table. **Source**: Bouët et al. (2025b).

Table A.2: Estimated consequences of the current US tariffs on bilateral trade flows by 2040

Exporter \ Importer	Canada	China	France	Germany	Italy	Mexico	Rest of EU27	Spain	UK	USA
Canada	0,0	0,8	-8,1	-2,5	6,4	14,0	-3,1	4,8	-20,0	16,3
China	18,8	0,0	1,0	-1,2	1,2	-7,6	-0,2	1,5	0,3	-92,6
France	17,5	-3,0	0,0	-0,4	0,5	1,4	0,9	0,5	0,5	-3,4
Germany	27,3	-2,8	0,8	0,0	0,2	2,6	0,9	0,2	-0,1	-21,6
Italy	16,7	-1,2	0,8	-0,2	0,0	2,2	0,7	0,5	0,5	-13,1
Mexico	22,7	-26,5	-32,5	2,6	-7,0	0,0	-8,8	10,1	-15,8	-8,5
Rest of EU27	16,8	-1,6	-0,1	-1,5	-0,2	1,2	-0,1	-0,3	-0,3	-10,4
Spain	20,3	-1,7	0,5	-0,7	0,1	2,3	0,5	0,0	0,4	-17,8
UK	17,5	-4,8	-0,3	-1,4	-1,4	1,2	-0,3	-1,8	0,0	-12,2
USA	-9,8	-89,9	-22,8	-25,6	-21,9	-12,1	-23,8	-22,4	-13,2	0,0

Notes: The table shows the projected change in bilateral goods trade (%) by 2040 under the current set of US tariffs. Estimates are recovered from the CEPII-Mirage model. The Mirage model is a computable general equilibrium calibrated to long-run adjustments. The color gradient is applied separately for each importer. **Source**: Bouët et al. (2025b).

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