Policy Brief
Issue n˚33/24 | December 2024

How the European Union should respond to Trump's tariffs

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Executive summary

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PRESIDENT-ELECT TRUMP has threatened to increase United States tariffs to 60 percent on imports from China and 10 percent to 20 percent on imports from other trading partners, including the European Union. In doing so the US would be ignoring its World Trade Organisation commitments and would also rollback the substantial liberalisation that has taken place during the past 80 years, with a potentially major negative impact on the world economy.

IN RESPONSE TO THIS THREAT, the EU should pursue a three-pronged strategy.

FIRST, THE EU SHOULD ENGAGE bilaterally with the US to seek to avoid the imposition of tariffs. This could include an offer to consider measures on facilitation of bilateral trade and on economic security cooperation, while making clear that any trade measures adopted by the EU will be consistent with WTO rules. This offer should be backed up with a credible threat of retaliation that could be implemented if the US decides to impose tariffs on EU exports. Retaliation could take the form of a negative list – the EU would increase its tariffs on all US exports to the same level as the US tariffs, except for products imported from the US identified as crucial for the EU.

SECOND, THE EU SHOULD ACT to preserve a functioning rules-based multilateral trading system, including on dispute settlement, and should continue to pursue WTO reform. To this end, the EU should build a coalition of countries including key players from the Global North and the Global South ready to lead in this endeavour.

THIRD, THE EU SHOULD EXPAND its network of bilateral and regional preferential trade agreements. The priority should be ratification of the agreement with Mercosur, but the EU should also aim to improve trade relations with the United Kingdom and Switzerland and to further strengthen partnerships in the Indo-Pacific region, and with Africa.

The authors thank Doug Irwin, Inu Manak, Alan Wolff and Bruegel colleagues for comments on earlier drafts.

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Recommended citation
García Bercero, I., P.C. Mavroidis and A. Sapir (2024) 'How the European Union should respond to Trump's tariffs', *Policy Brief* 33/2024, Bruegel

1 Introduction

The return of Donald Trump as United States President raises fundamental challenges for the European Union. On the international level, the main risk is that unilateral US action could fatally weaken three institutions that are critical for EU interests: NATO, the Paris Agreement forged in the United Nations Framework Convention on Climate Change, and the World Trade Organisation. Moreover, by threatening to raise tariffs against imports from the EU and many other economies, Trump's policies could have harmful effects on the EU economy both directly and by weakening US and global economic growth.

These challenges are interconnected and require a strategic response. The EU must act firmly to defend its interests in a coordinated and unified way, and to show a capacity for international leadership. It should not take any action that would contribute further to the erosion of multilateral institutions. It should strengthen its partnerships with likeminded countries and the Global South.

The EU and its members should be ready to increase defence expenditure in order to take on a greater commitment under NATO. The EU should also be ready to assume a leadership role both in the WTO and in the Paris Agreement. This implies staying the course on its net-zero commitment and promoting WTO reform.

This Policy Brief focuses on possible new Trump tariffs, based on statements made by the President-elect. We start by discussing the objectives the US might pursue through tariff policies, the legal instruments to implement those policies and their relationship with WTO rules. We then summarise the literature on the impact of the Trump tariffs, both those adopted during his first mandate and the potential tariffs of 60 percent on imports from China and 10 percent to 20 percent on imports from the rest of the world[1]. In the final section, we discuss what the EU policy reaction should be in terms of both engagement with the US and possible retaliatory action. We also discuss the broader implications for EU trade policy in the WTO, and through bilateral and plurilateral engagement with countries other than the US.

2 Potential US tariffs

2.1 Trump's domestic legal options

There is a risk that the new Trump administration will modify two sets of tariffs: a 10 percent to 20 percent 'most favoured nation' (MFN) tariff on goods imported by the US from all its trading partners, and a separate 60 percent tariff applied on goods originating in China. There is a risk that the Trump administration might want to finance at least part of the promised tax cuts for US citizens through the imposition of tariffs. If this is the case, the administration may link the level of tariffs to the extent of tax reductions. But the tariffs will have an impact on import volumes and revenues will therefore not go up in line with the level of the tariffs. Consequently, it is likely that a general tariff increase will be one of the elements discussed in Congressional tax and tariff legislation, although such a discussion may be preceded by executive action.

On China, rapid executive action is possible based on Section 301 of the US Trade Act. Alternatively, Congress could act. One bill that has been drafted would strip China of its

1 Paul Wiseman, 'Trump favors huge new tariffs. How do they work?' *PBS*, 27 September 2024, https://www.pbs.org/newshour/economy/trump-favors-huge-new-tariffs-how-do-they-work.

Permanent Normal Trade Relations (PNTR) status, which it has enjoyed since 2001[2]. The US refuses PNTR to Belarus, Cuba, North Korea and Russia. Whereas all PNTR countries export to the US at the WTO MFN bound rate, which is on average 3.4 percent (with an average of 2 percent for industrial tariffs), separate duties are fixed for those that do not enjoy that status. The consequence for China of withdrawal of its PNTR status is that the US could impose a 100 percent duty on a list of specific goods of Chinese origin and could increase all other duties to a (phased in) level of 35 percent[3]. The bill therefore is based on a strategy of almost full decoupling from China and, unlike executive action, would allow the administration little margin to use tariffs as leverage to negotiate market access commitments or structural reforms with China.

While there is a high likelihood that Trump will use executive orders to impose rapidly a 60 percent tariff on most Chinese imports, there is less clarity about whether the US will apply across-the-board or more product-specific tariffs on other countries. The high degree of unpredictability in tariff policy is illustrated by President-elect Trump's threat of 25 percent tariffs on imports from Canada and Mexico for reasons relating to immigration and drug trafficking[4]. And he has even threatened to impose a 100 percent tariff on imports from BRICS countries if they support a currency other than the US dollar in international trade transactions[5]. In any event increased tariffs are likely to be accompanied by a process of firm-specific exemptions, thereby increasing the costs of compliance and the opportunities for rent-seeking. The room for favouritism across countries, products and importers will likely be enlarged under the new Trump administration.

The lack of clarity on the rationale for imposing tariffs does not affect the near certainty that tariffs will be imposed

The lack of clarity on the rationale for imposing tariffs does not affect the near certainty that at least some tariffs will be imposed. Furthermore, from a pure legal perspective, the rationale for violating tariff commitments is immaterial, as we will show.

While there is little doubt that President Trump will have the legislative authority to impose the discriminatory tariff on Chinese imports (by virtue of Section 301), doubts have been raised about his authority to act alone when imposing the MFN tariff. The US Constitution assigns this competence to Congress. Trump might invoke the 1977 International Emergency Economic Powers Act (IEEPA) to justify the MFN tariff. When President Truman decided to seize the US steel industry during the Korean War, the US courts stopped him[6]. But President Nixon successfully invoked the Trade with the Enemy Act (the predecessor of IEEPA) when imposing a unilateral across the board tariff surcharge in 1971 (the 'Nixon shock'; Irwin, 2012). US courts are the ultimate arbiters and it is hard to see how the US Supreme Court as currently composed (with a conservative majority including three Trump appointees) would stand in the way of the new Trump administration.

To conclude, it is hard to see US law or US courts constraining the Trump administration in its use of tariffs. The main potential constraint to a broad exercise of tariff authority is the economic impact that such measures might have in terms of inflation and on financial markets. The risk of negative impacts might lead some in the Trump cabinet (Treasury) or in Congress to counsel caution and gradualism.

2 PNTR is the US Trade Law denomination for MFN trade. PNTR countries enjoy MFN trade with the US. On the proposed bill, see Select Committee on the CCP press release of 14 November 2024, 'Moolenaar Introduces Legislation to Revoke China's Permanent Normal Trade Relations', https://selectcommitteeontheccp.house.gov/media/press-releases/moolenaar-introduces-legislation-revoke-chinas-permanent-normal-trade.

3 At time of writing, it is unclear whether the US will impose a flat 60 percent tariff on all goods of Chinese origin, or whether the bifurcated approach embedded in the draft bill to remove China's PNTR status will prevail (see also footnote 2).

4 See, for instance, David Goldman (2024)., 'Trump ups the ante on tariffs, vowing massive taxes on goods from Mexico, Canada and China on Day 1', *CNN*, 26 November 2024, https://edition.cnn.com/2024/11/25/politics/trump-tariffs-mexico-canada-china/index.html.

5 Kaanita Iyer, 'Trump threatens 100% tariff on BRICS countries if they pursue creating new currency', *CNN*, 1 December 2024, https://www.cnn.com/2024/11/30/politics/trump-brics-currency-tariff/index.html.

6 See Youngstown Sheet & Tube Co. v. Sawyer, 343 U.S. 579 (1952), U.S. Supreme Court, https://supreme.justia.com/cases/federal/us/343/579/.

2.2 Assessing the international legality of tariffs

Articles I and II of the General Agreement on Tariffs and Trade (GATT), which regulates trade in goods among WTO members, provides the benchmark for assessment of the international legality of the new tariffs envisaged by Trump. The tariffs of 10 percent to 20 percent would breach Article II of GATT insofar as the US has 'bound' ('capped') tariffs, that is, to the extent that it has agreed not to increase tariffs above current levels. The US has in fact bound practically all its duties under various Harmonised System (HS)[7] tariff lines.

The proposed tariff on goods originating in China would violate the GATT because of its discriminatory nature

The proposed tariff on goods originating in China would violate both GATT Article II and Article I (MFN) because of its discriminatory nature.

The rationale for violating WTO tariff commitments – whether Trump wants to address a macro-economic disequilibrium, rebalance the US trade deficit or simply retaliate against China – is not germane to the finding of violation of Articles I or II of GATT. An increase in tariffs leads to a finding of violation of GATT Article II. If the increase is discriminatory, it also leads to a finding of violation of GATT Article I. However, the rationale for violating tariff commitments would become legally relevant (according to consistent WTO case law) when and if the Trump administration attempts to justify the violations.

To justify unilateral tariff increases while respecting WTO rules, the US could attempt to invoke one of the exceptions embedded in the GATT (Article XII: balance of payments; XX: various social preferences[8]; XXI: national security). The first is inapplicable in the present case (and anyway, in similar cases trading nations simply devalue their currencies). To successfully invoke Article XII, the US would have to show that an increase in tariffs is necessary to reverse a serious decline in its monetary reserves or to ensure a reasonable rate of increase in its monetary reserves if their current level is very low. This is not plausible for the US. The International Monetary Fund, from which the US would likely have to seek a favourable opinion[9], is very unlikely to support such an interpretation.

Trump has not mentioned any of the grounds included in Article XX either as potential justification for the contemplated action. Finally, invocation of Article XXI is unlikely to succeed, following the legal test established in DS512 Russia-Traffic in Transit. In that case, the panel report by the WTO Dispute Settlement Body stated that measures aiming to protect national security can be lawfully adopted only during times of war or in a war-like context[10]. This is hardly the case today. In any event, even a broader interpretation of Article XXI could never justify imposing tariffs on all US trading partners.

Consequently, it is hard to see the US imposing the tariffs announced by Trump without violating Articles I and II of GATT.

The US bill on China's PNTR status (section 2.1) suggested that Trump may seek to increase tariffs in a WTO-lawful way, using GATT Article XXVIII, which allows WTO members to renegotiate their MFN tariffs. However, this is not plausible, for three reasons.

First, Article XXVIII requires the US to maintain a reciprocal level of concessions that is not less favourable to multilateral trade than before the initiation of negotiations under this provision. This is inconsistent with the declared objective of the incoming US administration to raise protection across the board.

7 The system of classification of goods, which can be checked to see what tariffs apply; see https://trade.ec.europa.eu/access-to-markets/en/content/harmonised-system-0.

8 Article XX lists various economic and non-economic objectives, ranging from health and environmental protection to acquisition of products in short supply locally, that WTO members may invoke to justify violations of their WTO commitments.

9 Recent WTO panel practice shows deference towards the opinion expressed by IMF experts (DS302 Dominican Republic-Import and Sale of Cigarettes).

10 In this case, the Dispute Settlement Body held that for a measure to be justified under Article XXI, it must have been adopted during war or war-like circumstances. If is the case, the Dispute Settlement Body would defer to the exercise of discretion by the intervening state as long as it is minimally satisfactory. What matters therefore, is when a measure was adopted and less so what exactly was adopted. See https://www.wto.org/english/tratop_e/dispu_e/cases_e/ds512_e.htm.

Second, Trump's wish to increase tariffs quickly would be inconsistent with the WTO process required under Article XXVIII. The US would have to present to the WTO membership the list of tariffs it wants to renegotiate. WTO members with initial negotiating rights (INRs), ie those with which the US negotiated the MFN tariffs it wants to increase, would have a seat at the table, as would WTO members with a principal supplying interest (PSI), ie those that now occupy a larger market share than INRs in the US market for products for which the US wants to renegotiate MFN tariffs. Negotiations on multiple tariff lines with so many trading partners would need substantial time to complete. In the meantime, the US could not increase its tariffs unilaterally. It would have to wait for the end of negotiation, which will produce either agreement or disagreement among the parties on the new tariffs. In the former case, the US would be allowed to notify and apply its new MFN tariffs. In the latter case, the US would be allowed to increase its MFN tariffs as it wishes, while affected WTO members would be entitled to retaliate.

Finally, if the US were to decide to renegotiate its MFN tariffs using Article XXVIII, it would need to respect GATT Article I and treat all WTO members equally. None, including China, could face a higher tariff in the US than the MFN tariff. Hence, the Article XXVIII process could be initiated lawfully only with respect to the MFN 10 percent to 20 percent tariff that Trump wants to impose.

2.3 The wider picture

There is a strong possibility that the US will turn its back on the WTO

It remains to be seen whether the expected tariff hikes are a harbinger of things to come as far as wider US trade policy is concerned. There is a strong possibility that the US will *de facto* (if not *de jure*) turn its back on the WTO, in which case the discussion on the international legality of the new tariffs would become moot as far the new Trump administration is concerned. The US can also be expected to make more aggressive use of Section 301 in order to seek changes in third-party practices to which the US objects, and to threaten retaliation against such practices without following WTO procedures. Such use of Section 301 is likely to constitute coercion as defined in the EU Anti-Coercion Instrument (Regulation 2023/2675). Another risk for the EU is that the US might deploy secondary sanctions more aggressively on companies, in order to enforce toughened export controls on China.

The new administration will also prioritise the re-negotiation of the United States-Mexico-Canada Agreement (USMCA), already re-negotiated by the first Trump administration. The objective will likely be to prevent Chinese companies from circumventing US tariffs by investing and producing in Mexico. Meanwhile, it is unlikely that Trump will fully roll-back the Biden administration's various industrial policy initiatives (including the CHIPS and Science Act or parts of the Inflation Reduction Act, which directed public expenditure to Republican-voting US states). The Trump administration may, for instance, retain production tax credits that favour investment in Republican states, while cutting back or eliminating consumption subsidies. Tax benefits can of course be easily cut or eliminated, depending on the margin that Trump wants to maximise. It is likely that there will be a desire to reverse (roll back) some Biden policies, along with a desire to raise government revenues. Either or both of these parameters will influence the shaping of policies and the instruments used.

More generally, it is difficult at time of writing to assess the overall attitude of the Trump administration towards the WTO. During his first term, President Trump caused the WTO's Appellate Body – which takes decisions on appeals against WTO dispute rulings – to become inoperative (Poitiers, 2019)[11] and threatened to quit the WTO, although the threat was never implemented.

11 See also Bruegel, 'Appellate body politic,' *The Sound of Economics podcast*, 12 December 2019, https://www.bruegel.org/podcast/appellate-body-politic.

3 The economic impact of Trump's tariffs

3.1 The impacts of the tariffs introduced by the first Trump administration

Tariffs imposed on China by the first Trump administration reduced US-China trade and increased US and Chinese trade with other geographies

To start to grasp the potential economic effects of the new Trump tariffs, it is useful to analyse the consequences of the tariffs put in place during the first Trump administration (and retained by the Biden administration). The first Trump administration tariffs also involved two separate additional tariffs: 25 percent on goods from China, and 25 percent on steel and 10 percent on aluminium products from all trading partners, except Canada and Mexico.

When tariffs only cover some products and/or a limited number of trading partners, their economic consequences are mainly micro- rather than macro-economic. They affect the allocation of resources across geographies and/or sectors, but the impact on the overall economy may be quite limited.

The main impact of the tariffs imposed on China by the first Trump administration was to reduce bilateral US-China trade and to increase, respectively, US and Chinese trade with other geographies, including the EU. This reshuffling of trade was accompanied by little or no impact on US domestic production of the goods directly impacted by the US additional tariffs on China, as Alfaro and Chor (2023) and Freund *et al* (2024) have shown.

The situation with the tariffs on steel and aluminium was different. Although Canada and Mexico were exempted from the additional tariffs (though Canada and Mexico had to exercise restraint in their exports to the US), producers in these two countries were simply too small to be able to replace producers from all the other countries affected by tariffs, at least in the short to medium term, since the installation of additional production capacity for steel and aluminium takes time. The result was that US producers (who had been operating below capacity for a while) were able to raise production somewhat (+1.9 percent for steel and +3.6 percent for aluminium; USITC, 2023) at the expense of foreign producers. But this positive effect for the US steel and aluminium sectors was accompanied by a negative impact for US downstream producers of goods that use steel and aluminium as inputs, and ultimately for US consumers, because of higher prices for steel and aluminium products in the US market (Durante, 2024). Handley *et al* (2020) also found, unsurprisingly, that the steel and aluminium tariffs reduced US exports of downstream products.

Tariffs on a limited number of countries (the China tariffs) and/or sectors (the steel and aluminium tariffs) may therefore have had a limited impact on the overall economy of the country (the US) that imposed them. However, there are two caveats to this.

First, the additional tariffs were not the only measures adopted during the first Trump administration. There was also a substantial tax cut, which significantly increased the US budget deficit, resulting in a macro-economic stimulus through additional investment and reduced savings. The result was an increase in the US current account deficit. And since the bulk of the US current account is the balance of trade in goods, this meant that the trade deficit also increased. But it would be a mistake to conclude that the increase in the US trade deficit during the first Trump administration resulted from the imposition of tariffs, just as it is wrong to assert that the imposition of tariffs reduced the trade deficit. Instead, the US trade deficit increased because the US budget deficit increased as a result of the tax cut. Equally, therefore, it would be wrong to ascribe the boost to the US economy during the first Trump administration to the imposition of additional tariffs. Again, the macro-economic stimulus came from the tax cut and not from the tariff increase.

The second caveat relates to economic size. The US is a large economy, which means that by imposing import duties it can in principle force foreign suppliers to cut their prices. Given the size of the tariff and the fact that China was the main supplier of goods to the US market, such terms-of-trade gain for the US could have been economically significant. However, a detailed study by Amiti *et al* (2020) found that US tariffs did not result in a drop in prices charged by Chinese or other foreign suppliers, but in an increase in prices paid by US firms and consumers, although by less than the amount of the tariff. Thus, there was in fact a (small) terms-of-trade gain for the US from the tariff on foreign products. However, since China is also a large economy and it decided to retaliate one-for-one with tariffs against the US, it is likely that this nullified the terms-of-trade gains for the US from the Trump tariffs.

The lack of any positive economic effect from the Trump tariffs is confirmed by another detailed study by Autor *et al* (2024), which found that US import tariffs on foreign goods neither raised nor lowered US employment in newly protected sectors and that retaliatory tariffs (mainly by China) had a clear negative employment impact on the US economy, primarily in agriculture. However, the authors found that Trump's "*trade war appears to have been successful in strengthening support for the Republican party. Residents of tariff-protected locations became less likely to identify as Democrats and more likely to vote for President Trump*" in the 2020 presidential election.

3.2 How would the impact of new Trump tariffs differ?

An across-the-board tariff could raise inflation in the US and elsewhere, especially if it leads to a trade war

New Trump tariffs would differ from those of the first Trump administration in two important respects. First, the tariffs on products from China would increase by 60 percent instead of 25 percent. Second, all other countries (except probably Canada and Mexico) could face an additional tariff of 10 percent to 20 percent on their exports to the US, instead of simply a tariff of 25 percent on steel and 10 percent on aluminium products. While it is not clear whether an across-the-board tariff will be implemented, it is important to analyse the impact of a worst-case scenario.

An across-the-board tariff could raise inflation in the US and elsewhere, especially if it leads to a trade war and further trade fragmentation, but the extent of the effect depends on how the Federal Reserve and other central banks react.

Assuming that China retaliates against new Trump tariffs similarly to what it did with the first Trump administration tariffs, the two-way 60 percent tariff would almost completely shut off bilateral trade between the US and China. The central question then would be: what implication would a decoupling between the US and China have for the US, China and the rest of world (and in particular the EU), taking into account that exports from the rest of the world to the US could also be subject to a 10 percent to 20 percent additional tariff?

The economic impact of such a US-China decoupling would depend largely on the extent to which the US and China could redirect their bilateral trade to and from (a) other partners and (b) domestic producers and consumers. But even if the US and China succeed in redirecting their bilateral trade flows with relative ease – given that the process started already under the first Trump administration and continued under Biden – it is likely that the prices associated with these new sources of supply will be higher than before. Meanwhile, the prices of exports will decrease. Hence the terms of trade of both the US and China, and therefore the disposable income of both US and Chinese residents, will decrease.

The impact of this shock on output and inflation will depend on how fiscal and monetary policy responds (Blanchard, 2024). Fiscal stimulus – particularly in the form of a tax cut, which is likely in the US – could offset the effect of the depressed terms of trade on disposable income and output, but only at the price of higher inflation (beyond the impact effect of tariffs on the price level). If monetary policy seeks to lean against the stimulus by raising interest rates (as the Federal Reserve likely would), the impact on inflation would be contained, but at the price of a steeper output decline. In either case, the deficit would rise, adding to existing concerns about the sustainability of public finances. Higher interest rates, lower output and higher deficits (in some combination) would also create risks for the financial system.

The US current account and trade balance should not be affected much or at all by the new US tariffs, unless they trigger a sizeable decline in US disposable income, which would reduce US imports and therefore the trade deficit. But since the new Trump administration is likely to also engineer a tax cut, US disposable income may not decline at all and may even increase, which would result in no change or even an increase in the trade deficit. This is true even if the Federal Reserve leans against fiscal stimulus by raising interest rates, since this would trigger additional appreciation of the US dollar, making imported goods cheaper relative to domestic production, and partly (or even fully, depending on the size of fiscal stimulus) offsetting the impact of higher tariffs. An attempt by the US Treasury (which is in charge of currency intervention in the US) to prevent such appreciation would lead to more inflationary pressure and could lead to a currency war with trading partners, further increasing the risk of a collapse of the global trading system.

The consequence of an unchanged (or possibly even higher) US current account and trade deficit and the decoupling of the US from China would be to increase the US trade deficit with the rest of the world, including potentially the EU.

Europe could face several potential difficulties, depending on (1) how the US manages its tariff increase, (2) whether and to what extent the EU imposes retaliatory tariffs, and (3) whether the new Trump tariffs trigger a broader trade and currency war.

1. The additional tariffs of 10 percent to 20 percent that the US would be imposing on the EU and the rest of the world would hurt European export industries – including the automotive sector – which are already reeling from the impact of higher energy costs and competition from China. At the same time, US fiscal stimulus, higher inflation and a stronger dollar would make US exports more expensive and create an offsetting demand for EU exports. The net macroeconomic effect on the EU will depend largely on the reaction of the European Central Bank. If the ECB raises interest rates to resist 'imported' inflation – as it probably would – it is likely to be contractionary.
2. A trade war between the EU and the US, which could follow if US tariffs cannot be averted by negotiations, would add to this negative output effect by raising the price of EU imports. Pressures to raise tariffs against China (whether from the Trump administration, or from EU industries hurting from the redirection of Chinese exports to Europe) would have similar impacts. In effect, higher tariffs would act like a further negative supply shock to the EU economy. On the other hand, retaliation by the EU and others may partly nullify the terms-of-trade impact of the increased US tariffs. According to Bouët *et al* (2024), the EU will suffer less from the US tariffs in terms of GDP loss if it adopts mirror retaliation.
3. The consequences of a wider trade and currency war (with a general increase in the level of protection by most trading nations and a proliferation of discriminatory trade deals) would be much more negative for the global economy, with Europe being more affected than the US or China because of its greater trade dependency.

To summarise, the impact of Trump's new tariffs on the US, Europe and the world could be dire, although the extent of the damage is difficult to predict. The harm will depend on policy reactions in the US and the EU and the magnitude of the trade and potentially currency wars – both between the US and the EU and more globally – triggered by the tariffs.

4 The EU's policy response

The European Union response to the threat of US tariffs should be strategic and consistent with the urgent need to reinforce the EU single market, stay the course on the climate transition and increase European defence expenditure. The EU should also maintain its commitment to openness and continue to play an international leadership role.

Before considering trade policy responses, it would be beneficial for EU policymakers to contemplate the areas where EU interests are aligned to those of the US (for example, national security) and distinguish these from the areas for which this is not the case (the US is taking an isolationist turn that contradicts the EU commitment to openness and international law). Trade-offs will be unavoidable, but a clear mapping of the areas of convergence/divergence for the two transatlantic partners, once the new Trump administration's preferences have been adequately specified, would be a priority.

On trade policy, the EU response could have three elements: 1) bilateral engagement with the US to seek to avoid the imposition of tariffs; 2) action to maintain a functioning rules-based trading system while continuing to promote WTO reform; 3) reinforcing the EU network of trade agreements and partnerships, including with Global South countries.

4.1 Bilateral engagement with the US

During Trump's first administration, the EU had to respond to the threat and the imposition by the US of WTO-inconsistent tariffs (the 25 percent duties on imports on steel and 10 percent on imports of aluminium). In response, the EU increased tariffs on US imports (Harte, 2018). The US also threatened to apply a tariff on imports of EU passenger cars, but this measure was not implemented following a July 2018 agreement between President Trump and European Commission President Jean-Claude Juncker[12].

The agreement included an EU commitment to increase purchases of US liquified natural gas (LNG) and soybeans, and to start talks on further measures to facilitate bilateral trade. Subsequently, both sides reduced MFN tariffs on certain items, including EU imports of lobsters. Alongside bilateral engagement, a trilateral process was started with Japan to discuss improvements in WTO rules on non-market economy practices, and in particular subsidies and forced technology transfers.

The new threat of an across-the-board tariff is much more serious than trade policy measures during Trump's first term

The new threat from Trump of an across-the-board tariff is much more serious and systemic than trade policy measures during Trump's first term. The new measures that have been floated imply that the US would violate the most fundamental GATT/WTO commitment, rolling back progress on tariff liberalisation achieved since 1947. Moreover, there is the risk that the US will seek to extract from China or from other countries commitments to give preferential access to the US that would be inconsistent with the WTO MFN rule. The combination of all these elements could result in a collapse of the GATT/WTO system, which has been a bulwark for growth and development in Europe and the rest of the world. It is therefore essential that the EU calibrates its response carefully and acts consistently with its strategic interest in maintaining a rule-based trading system.

Engagement with the US could include three elements: 1) WTO-consistent measures to facilitate bilateral trade between the EU and the US (accommodating Trump's desire for increased US exports to the EU); 2) cooperation on economic security; 3) deterring US tariff increases through a credible and effective retaliation threat.

4.1.1 Bilateral trade facilitation

The EU should avoid discriminatory purchase commitments or preferential tariff concessions (since an EU-US FTA is not a realistic perspective). A number of steps could be taken however that would contribute to increased US exports to the EU and avoid disruption to transatlantic trade.

The EU has already substantially increased imports of US LNG but there is still room to further diversify away from imports of Russian LNG. More generally, there is considerable scope for enhancing trade with the US on energy, including in relation to small-scale nuclear reactors. In the context of enhanced burden sharing in NATO, commitments could be made to increase defence expenditure both at member state and EU level. This would open up new opportunities for increasing US military equipment sales to the EU. Diversifying away from Russian energy imports and increased defence expenditure is consistent with a common transatlantic strategy to maintain support for Ukraine and the US commitment to the defence of Europe, albeit with EU NATO members taking on more of the burden.

Both sides could also discuss ways of facilitating trade in some particularly important

12 See European Commission statement of 25 July 2018, 'Joint U.S.-EU Statement following President Juncker's visit to the White House', https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_18_4687.

sectors. To avoid any increase in tariffs on imports of EU cars into the US, the EU could offer to reduce its 10 percent MFN tariff on cars to the US MFN level (2.5 percent), since in any event most sources of imports are covered by FTAs and the EU is applying countervailing duties on imports of electric vehicles from China. The *quid pro quo* could be the US maintaining a balance of tariff commitments, implying MFN reductions on both sides, as was the case in the agreement reached during the first Trump administration. The EU could also discuss with the US and other countries a low-emission steel standard, which could be progressively increased until zero emissions is reached. This standard could be taken into account in the implementation of the EU carbon border adjustment mechanism (CBAM). It could be part of efforts to resolve finally the currently frozen steel and aluminium dispute.

Industries could also be asked to put forward joint proposals to further reduce regulatory obstacles to trade in areas such as conformity assessment or cooperation on standards. More generally the EU and the US could develop an effective 'early-warning' mechanism, including regulatory dialogues with a view to prevent unnecessary obstacles to trade, while fully maintaining the rights of each party to achieve its desired level of protection. There should also continue to be a dialogue on digital regulation and artificial intelligence, which are potential areas of trade friction. Such dialogues should not be linked to any trade negotiation, and should be held instead under the auspices of a streamlined EU-US Trade and Technology Council[13].

4.1.2 Economic security

The EU could offer the US reinforced cooperation on economic security, both bilaterally and within the G7 framework, which could be expanded to include other allies such as Australia and Korea. The EU shares US concerns about non-market economy practices that generate overcapacity and distort global markets. While the EU should not follow the US in increasing tariffs on China in a WTO-incompatible manner, it can continue to apply robust trade-defence instruments and other recently introduced legislation on subsidies.

In certain cases, the EU could also make use of the safeguard legislation (Regulation (EU) 2015/478), which allows for temporary protection in case imports cause or threaten serious harm to domestic producers. Even if safeguards apply to all imports, the remedies adopted can have a greater impact on suppliers responsible for an import surge (eg by applying a quota based on traditional trade). Moreover, short-term safeguards constitute a fully legitimate WTO instrument that does not give affected trading partners a right to take retaliatory action. The non-discriminatory nature of short-term safeguards may also make them more politically acceptable for China.

Beyond defensive action, the EU could explore the US interest in resuming trilateral discussions with Japan and expanding them to other like-minded economies. This could provide a common platform to develop ideas on how to reinforce WTO rules on non-market practices while in the meantime coordinating trade policy responses in relation to such practices. The Commission should also discuss with EU governments how to enhance cooperation on export controls, since this could potentially become an area of transatlantic tension. More broadly it is important to distinguish areas for which the objective is to seek transatlantic alignment (such as preventing technology leakage) from others on which both parties should cooperate in responding to common challenges (eg responding to overcapacity), while each side continues to take measures consistent with its legal and institutional setting.

The EU should ensure that any offer made to the US does not harm other countries or undermine support for the WTO

The EU should maintain close contact with allies, notably the United Kingdom and Japan, to ensure that any offer made to the US does not harm other countries or undermine support for the WTO system.

13 See https://ustr.gov/useuttc.

4.1.3 Potential retaliation

In view of Trump's threat to increase tariffs, the EU should act rapidly to establish an effective and credible retaliatory threat. The Commission has extensive experience in developing retaliation lists and, in all likelihood, has such a list ready. As in previous instances when the EU retaliated against unilateral foreign tariff hikes, such as the increase in US steel and aluminium tariffs, this is probably a positive list with a limited number of products targeted for retaliation.

The Commission should prepare a negative list, implying that all EU imports from the US should be subject to the same tariff imposed by the US on EU exports

We recommend, instead, that the Commission should prepare a negative list, implying that all EU imports from the US should be subject to the same 10 percent or 20 percent tariff imposed by the US on EU exports, except for those US imports on which the EU is highly dependent. This would ensure that the EU retaliatory threat is large enough to provide an effective deterrent. EU retaliation should be scalable upwards or downwards in light of US actions.

Before a negotiation starts with the US, the Commission should discuss with member states the overall strategy for negotiation and retaliation. The EU should not be trigger happy. By the end of March 2025, the suspended EU retaliation on steel and aluminium will, in principle, be introduced automatically. This is a consequence of the failure to agree with the Biden administration a steel and aluminium deal that would have eliminated the US Section 232 tariffs. In case there are no new US tariffs introduced by that time, the EU should postpone the steel and aluminium retaliation to give more time for negotiations.

The negative list of course would be a maximum retaliation option. If there is no US across-the-board tariff increase, more targeted options could be considered. The EU has different legal instruments that can be used to implement retaliatory measures. They include the Enforcement Regulation (Regulation (EU) 2021/167), which can be used following a dispute-settlement case, or in reaction to safeguard measures or Article XXVIII tariff increases. The Anti-Coercion Instrument (Regulation 2023/2675) could be used in response to a US Section 301 investigation that threatens unilateral retaliation unless the EU or its member states make policy changes. Finally, there is also the option of adopting a retaliation list through a legislative procedure involving the Council of the EU and the European Parliament.

If the US chooses to act outside the WTO framework, the argument could be made that retaliatory measures could be adopted without having recourse to WTO dispute settlement. In any event, in the case of Article XXVIII, a withdrawal of concessions can be implemented soon after the US increases tariffs without the agreement of its negotiating partners. Another feasible option would be to work with other negatively impacted countries to start a joint dispute-settlement case and retaliate in case the US decides to appeal against a condemnation of its measures.

4.2 Action at the WTO

At time of writing, there is considerable uncertainty about the new Trump administration's policy towards the WTO. It seems certain the US will not be ready to accept a binding dispute-settlement system. The US may however continue to engage in different WTO multilateral and plurilateral negotiations, or may wish to bring up new issues for discussion at the WTO, including those relating to non-market practices. It cannot be excluded however that the US decides to adopt a more disruptive position. The EU needs to be ready for all eventualities.

At a time of heightened tension in the global trading system, the EU has the responsibility to lead efforts to keep the WTO relevant. This should combine a defensive component – ensuring respect for the existing rules – and an offensive one: promoting modernisation of the rule book. The EU should invest in building a coalition to pursue these goals. This coalition should go well beyond the so-called like-minded and should include as many Global South countries as possible. South Africa will chair the G20 in 2025 and the next WTO Ministerial Conference, in 2026, will be held in Cameroon, creating opportunities for close cooperation on WTO reform. There is also the potential for close cooperation with Brazil in the context of the finalisation of negotiations with the Mercosur bloc[14], and with Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) members.

On dispute settlement, it is now clear that there is no prospect of reaching an agreement with the US, at least in the next four years. The EU should aim to maintain a functioning dispute-settlement system with as many WTO members as possible. This would also give the EU recourse to WTO dispute settlement on any measure that discriminates against its interests or otherwise breaches the WTO rules. An immediate step could be expansion of the membership of the Multi-Party Interim Arbitration Agreement (MPIAA), created as a partial solution to the US blockage of the WTO Appellate Body (see section 2.3)[15], but this should be combined with continued reflection on more structural approaches to dispute-settlement reform.

In terms of updating the WTO rulebook, the EU should support existing plurilateral initiatives (investment facilitation for development and e-commerce) and prepare new initiatives on trade and climate, and on reinforcing WTO disciplines on subsidies and other market-distortive practices. These new initiatives would show the relevance of the WTO to respond to current global trade challenges and could be combined with an initiative to support the better integration of developing countries in global value chains, with a particular focus on Africa.

All these initiatives should be open to US and Chinese participation, though launching an initiative should not depend on their readiness to join. The EU should seek as much participation as possible, not only by OECD countries but also countries in the Global South. The EU should further engage at political level with India and South Africa, which are currently objecting to the integration into the WTO institutional structure of open plurilateral agreements. If it is not possible to lift their objections, participants in these initiatives should be ready to implement them provisionally, pending integration of those agreements into the WTO. The EU should also support the reinforcement of the WTO as a forum for policy deliberation to ensure that the WTO provides a valuable service for all its members, including those that choose not to participate in plurilateral initiatives.

4.3 Trade agreements with other countries

A particular priority is ratification of the EU-Mercosur partnership agreement, because of Mercosur's economic and geopolitical significance

The new geopolitical context implies that the EU is unlikely to be able to improve its trade relations with either the US or China; at most, it can avoid a substantial deterioration. This further reinforces the need for the EU to seek to complete its network of trade agreements. A particular priority is ratification of the EU-Mercosur partnership agreement, because of Mercosur's economic and geopolitical significance. An improvement in trade relations with the UK (García Bercero, 2024) and Switzerland would be a source of stability for the EU at a time when war in Europe requires close cooperation between neighbours.

The other important objective would be to reinforce the EU's presence in the Indo-Pacific area and Africa. The completion of negotiations with Indonesia, Australia and possibly other ASEAN countries could provide the basis for a closer cooperation between the EU and the CPTPP, thereby linking the EU to the world's most dynamic growth pole. An agreement between the EU and the CPTPP countries could include cooperation on WTO reform, developing agreements in areas of common interest, such as digital trade or sustainability, and provide for a joint platform on rules of origin, linking FTAs in the region. Ideally a free trade agreement would also be concluded with India, although this would require flexibility and creativity on both sides. On Africa, new EU Clean Trade and Industrial Partnerships, as proposed in Commission President Ursula von der Leyen's political guidelines for 2024-

14 See European Commission press release of 6 December 2024, 'EU and Mercosur reach political agreement on groundbreaking partnership', https://ec.europa.eu/commission/presscorner/detail/en/ip_24_6244.

15 In April 2020, a number of WTO members agreed on procedures in cases of appeals against dispute settlement panel rulings, pending a solution to the crisis created by the US block on Appellate Body appointments. The MPIAA currently includes the EU and 28 other WTO members.

2029 (von der Leyen, 2024) have the potential to support increased value added domestically while facilitating European investment and diversifying EU sources of supply in the green value chain[16].

The EU response to Trump's tariffs calls for an adaptation of the EU trade policy strategy, along with development of a new economic security doctrine[17]. The European Commission should in particular offer a vision of how the EU can take a leading role in modernising the rules-based trading system in a manner that responds to new challenges, while retaining the commitment to openness.

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16 Simone Tagliapietra and Cecilia Trasi, 'Making the most of the new EU Clean Trade and Investment Partnerships', *First Glance*, 16 October 2024, Bruegel, https://www.bruegel.org/first-glance/making-most-new-eu-clean-trade-and-investment-partnerships.

17 European Commissioner for Trade and Economic Security, Maros Sefcovic, has been tasked with leading the work on a new EU economic security doctrine. See https://commission.europa.eu/document/4047c277-f608-48d1-8800-dcf0405d76e8_en.

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