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Insight

Trump's tariffs – how should the EU react?

by Aslak Berg, 26 February 2025

The 'Fair and Reciprocal Tariff Plan' proposed by Donald Trump sounds innocuous but is a roadmap towards an all-out global trade war. To avert one, Europe must act firmly and speedily.

On February 13th, the Trump administration presented the Fair and Reciprocal Tariff Plan (FRTP), signalling that it is ready to end the global trading system as we know it. Financial markets greeted the proposal with a shrug, lost in the flurry of Trump's executive orders. But in terms of consequences for the global economy, it is the most significant and devastating of Trump's proposals.

What is being proposed?

Because of its name, many have interpreted the FRTP as a mirroring exercise in which the US would match its import tariffs with those faced by US exports in the partner country. The combination of countless products across a wide swathe of trade partners would lead to a huge number of different rates. In fact, such an exercise would be unworkable, as the US would have to manage over 2.6 million different tariff rates, depending on the product and the country. Even if the administrative complexity could be overcome, such a proposal would only raise tariff rates by a very modest amount. Trump's plan would hit developing countries such as Vietnam and India hardest, since they tend to have higher tariffs. The consequences for Europe would be limited, as, as the average EU tariff rate on US imports is only half a per cent higher than US tariffs on EU imports. The EU could slightly lower its tariffs to iron out the wrinkle.

The problem is that Trump's actual proposal is both simpler and more radical. According to White House officials, "the expected result is an individual additional tariff rate for each country or trading partner, rather than attempting to set corresponding tariff rates on every product."

Moreover, instead of just mirroring tariff rates, this overall additional tariff rate would be based on a combination of five factors:

1. Tariffs levied on US imports;

2. Taxes deemed unfair, extraterritorial or discriminatory, including value-added tax (VAT);

3. Non-tariff barriers, harmful policies like subsidies and regulatory requirements that impose costs on US businesses operating abroad;

4. Exchange rate policies that interfere with market values; and

5. Any other practice that interferes with market access or fair competition.

The potential scope of these measures is extraordinarily broad and represents a dramatic attempt to intervene in other countries' internal regulation and taxation. It would de facto condition access to the US market on trading partners' compliance with US preferences.

Value-added tax is used by 170 countries around the world to raise revenue for government services – but not in the US. VAT is trade neutral, as it applies equally to imported and domestic products. When goods cross the border, an adjustment is applied so that VAT is levied on imports while a rebate is given on VAT already paid for exported products: this ensures that VAT is only levied on domestic consumption. But in Trump's view, VAT with its border adjustment amounts to a tariff. The idea that VAT should be treated as a tariff is without merit and economically illiterate; viewing VAT as a tariff would target Europe in particular as European countries have high VAT rates of around 19-21 per cent.

The EU is also particularly exposed to Trump's threat of imposing tariffs in response to non-tariff barriers and regulatory requirements. The US has a long list of complaints about EU regulation, from long-standing issues like the EU's sanitary and phytosanitary regulation and the General Data Protection Regulation (GDPR) to more recent regulations such as the AI Act, the Digital Markets Act, the Digital Services Act, the Corporate Sustainable Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDD). All of these can be said to impose costs on US business that trade with the EU – as can virtually any regulation that affects businesses in general.

Europe is less exposed to Trump's threat to retaliate against 'unfair' exchange rates, which is more likely to target Asian countries, particularly China. The euro has a free-floating exchange rate, whereas Asian countries intervene more heavily to steer theirs. The last point of the Trump plan is perhaps the most dangerous: "any other practice that… interferes with market access or fair competition". That is a catch-all that would give the US wide latitude to set tariffs based on its assessment of other countries' economic policy. As with exchange rates, this likely targets Asian practices that lead to wage compression and more competitive exports. But the scope is broad enough for it to also target the EU.

What could this mean in practice?

The FRTP has not been finalised yet. The next steps are a series of reports due on April 1st from the US Trade Representative, the Department of Commerce and other US agencies evaluating the impact of other countries' trade practices. Next, these agencies will send the president joint policy recommendations, and the Office of Management and Budget will provide an evaluation by July.

As there is no obvious way of translating the five factors mentioned in the Plan into a single additional tariff for each country, the actual tariff rate would in practice be at the complete discretion of the presidency. The timeline also means there is time for the EU to prepare and persuade Trump to change course.

If we are to take Trump seriously on VAT, he could impose tariffs of at least 20 per cent on the EU on that basis alone. A 20 per cent tariff would lead to an estimated fall in EU goods exports to the US of some $200 billion per year. This represents a full third of the EU's current goods exports to the US, worth about 1 per cent of the EU's GDP. As the dollar would strengthen and EU services are not affected by tariffs, the fall in goods exports would be somewhat compensated by increased services exports, bringing the net loss down to $166 billion. If regulatory barriers are also penalised, both the tariff and the economic consequences would be greater still.

Given the weakness of the European economy, this would certainly cause a recession. If the US gives all its partners the same treatment, the global effect would potentially be worse than Trump's campaign promises of a 20 per cent general tariff and a 60 per cent tariff on China. In effect, average US tariffs would surge to their highest levels since the Great Depression, stoking inflation while a surging dollar would also harm US exports.

The plan would end de facto US participation in the global trading rules under the WTO, where each country faces the same tariff rate under the so-called most-favoured nation rule, except for free trade agreements with reciprocal commitments. Traders and partner countries would no longer benefit from predictable trading conditions, as US tariffs could change at a moment's notice.

Will the US go through with it?

The question is whether the Trump administration will go through with this plan. Trump has a history of bluffing and cutting deals, as he did with both China and the EU in his first term. However, the second Trump administration should be taken seriously and literally, both on foreign policy and economic policy. The fact that tariffs on Canada and Mexico were suspended for one month pending negotiations is cold comfort. Trump's demands for those countries were related to border enforcement and easier to find compromise on – and the tariffs are still set to go into effect on March 4th. Meanwhile, the 10 per cent tariff hike on China has already been implemented. Trump 2.0 is driving a harder line on trade than in his first term: both the global steel and aluminium tariffs and the tariffs on Canada, Mexico and China are more comprehensive now and do not entail any exemptions as in the past.

The US administration is now making demands that are both specific and unattainable. In 2023, VAT accounted for over 15 per cent of government revenue in the EU, and it is out of question for fiscally pressed European countries to make any concessions on it. Trump also complains about EU tech regulation hitting US big tech, but rolling it back would amount to letting the US dictate the boundaries of acceptable regulation in the EU. Neither practicality nor principle allows for surrender to US demands.

How should Europe respond?

For Europe, a diplomatic approach remains the best solution. The EU should signal its willingness to increase purchases of American natural gas and defence kit – which in any case will be necessary in the short run while Europe builds up its own defence industry. Showing openness to discuss how recent regulation is implemented could help to find a mutually beneficial compromise. The regulatory

simplification effort underway in Brussels, affecting environmental and sustainability regulations like the CSRD and the CSDD, could be packaged as a deal with the US to avoid a trade war and give Trump a 'win'.

The EU could also consider adjusting certain politically significant tariffs. Reducing EU import tariffs on cars from 10 per cent to the US level of 2.5 per cent has already been publicly discussed. While a political 'win' for Trump, this cut in car tariffs could undermine the EU's recent tariffs on Chinese electric vehicles if the EU, in compliance with WTO rules, cuts tariffs for everyone. With the EU and the US now in talks over US steel and aluminium tariffs, the EU should ensure that these talks also cover reciprocal tariffs, so that the EU does not give up concessions for steel and aluminium, only to be forced back to the negotiation table over reciprocal tariffs for yet more concessions.

At the same time, the EU must be firm and cannot show weakness. That means that the EU needs credible retaliatory measures. The threat must be compelling and credible enough to force the US to the negotiating table to conclude a deal – and it should also help mobilise American companies against tariffs. The European Commission will focus its possible retaliation measures on politically sensitive industries in states that are vulnerable for Republicans – past examples include orange juice from Florida, jeans, and Harley-Davidson motorcycles.

In trade wars, the nation that is more reliant on exports has a disadvantage. Tariffs threaten trade in goods, in which the EU has a large and persistent surplus with the US, worth €158 billion in 2023. Given the breadth and magnitude of the tariffs proposed, it would both be economically destructive and mathematically nearly impossible for the EU to respond to US tariffs exclusively with tariffs of its own. With EU goods exports to the US so much higher than US exports to the EU, the EU simply has fewer targets – as long as its response is limited to goods.

The logical step for the EU would therefore be to activate the Anti-Coercion Instrument (ACI) that was passed in 2023, largely as a response to Chinese policies. The ACI is meant to counteract economic coercion from foreign states that seek to force the EU or member-states to change policy. Since the US is explicitly seeking to coerce the EU to change its VAT regimes and regulatory policies, activating the ACI would give the EU wide latitude to design countermeasures. Under the ACI, the EU can enact tariffs, but also outright restrictions on exports and imports, measures affecting trade in services, access to public procurement, foreign direct investment and intellectual property rights. These measures could be generally targeted against the US through the ACI's Article 7, or targeted at specific persons or corporations close to the US government through Article 8. Activating the ACI would allow for more creative and targeted responses to Trump's tariffs, as well as evening the playing field by targeting services where the US runs a trade surplus with the EU of more than €100 billion.

Extending threats beyond tariffs would reduce the EU's tactical disadvantage – but it would also increase the stakes. Under the ACI, the EU could target US services, including financial services or the tech sector. Moreover, the EU could even nullify US intellectual property rights in Europe, for anything from patents to media rights. These are sectors that traditionally have not been touched by trade conflicts. Targeting them would be a significant, but potentially effective threat of escalation.

However, trade remains economically beneficial, and trade restrictions are acts of self-harm for Europe's open economy. The EU will think carefully before taking measures which would also cause severe disruption for the European economy – many Europeans work for US software firms and banks, and many US tech companies deliver services that would be difficult to replace. Although the EU may

threaten some general measures to achieve a proportional response to US tariffs, the EU should focus on surgical strikes on high-visibility targets that would be politically painful, but with limited economic cost to the EU.

For example, Article 8 of the ACI enables the EU to target natural or legal persons "connected to the government." Given his role in the US administration, Elon Musk and his business activities would qualify, including X (formerly Twitter). The EU could for example ban the sale of advertisements on X or the platform's ability to accept paid subscriptions, restrict the use of X by public authorities, or even ban it entirely, similarly to the ban on TikTok passed and then suspended in the US.

Another option could be to exclude American car companies from selling emission credits. The EU requires car companies who do not produce enough zero-emission vehicles to buy credits from other companies. This measure would in practice only affect Tesla, as other American companies build more combustion-engine vehicles and are net buyers of climate credits. For Tesla, this is a significant source of revenue, worth about $1 billion per year. To avoid causing a shortage of credits, unused credits could be distributed to other car-makers. Similarly, US satellite launch companies – like SpaceX, Musk's space company – could be banned from public procurement in Europe. Similar approaches could be extended to other specific political targets and corporations close to Trump.

Meanwhile, the EU will need to diversify its exports away from the US. Ratification of the agreement with Mercosur, seeking closer ties with India and a generous approach to the EU-UK reset could all be elements that help to reduce reliance on the US export market. Similarly, co-operating with other countries in a similar position could enhance the EU's negotiating position. For instance, the EU could co-ordinate counter-measures with Canada, Mexico and other affected countries, to maximise the effect on targeted US industries.

Lastly, the EU needs to prepare for a difficult economic climate by boosting domestic demand and making the reforms that everyone seems to accept in principle, but that immediately run into political difficulties in practice. The Draghi report clearly points out the urgent need for more investment and breaking down single market barriers to let EU firms increase in size. In a recent op-ed, Draghi argues that internal trade barriers within the EU are equivalent to 45 per cent tariffs for goods and 111 per cent tariffs for services. Moreover, the EU now also has urgent needs to boost both defence spending and the required fiscal capacity to do so. There is plenty to do: if we are to have a crisis, the EU must not let it go to waste.

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