

International trade under attack: Policies to better defend the EU from a tariff war

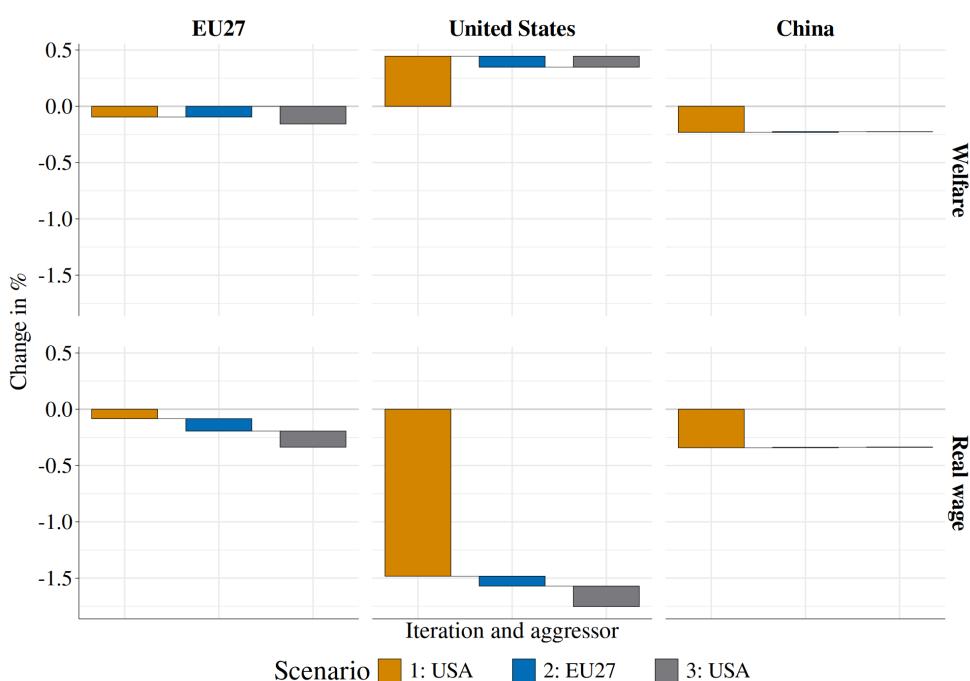
The global trade context has changed fundamentally and rapidly in the last decade. Under the second Trump presidency, the US are using the threat of new tariffs towards third countries as leverage to obtain political concessions, and as a coercive power to shape international relationships by exploiting dependencies.

Today, the big issue is: what are the costs of this strategy, for both US and EU citizens and how should the EU react? The TWIN SEEDS project addressed this issue by forecasting what happens to welfare of European citizens in a trade war and how the EU could best riposte. Researchers modelled a retaliatory escalation of a tariff war between the US and the EU after the mid-April 2025 "Liberation Day", where the US administration announced an additional 20 percentage point tariff rate on imports from the EU to the US.

NOBODY WINS IN A TRADE WAR

The results of the scenario exercise are shown in Figure 1, which shows the income and welfare effects of the Liberation Day tariffs (factual scenario), as well as the impacts of potential bilateral retaliation. It emerges clearly that **nobody is winning in a trade war**.

Figure 1: Real Income and Welfare effects for the big players ('factual' US scenario; EU27 retaliation; US counter-retaliation).



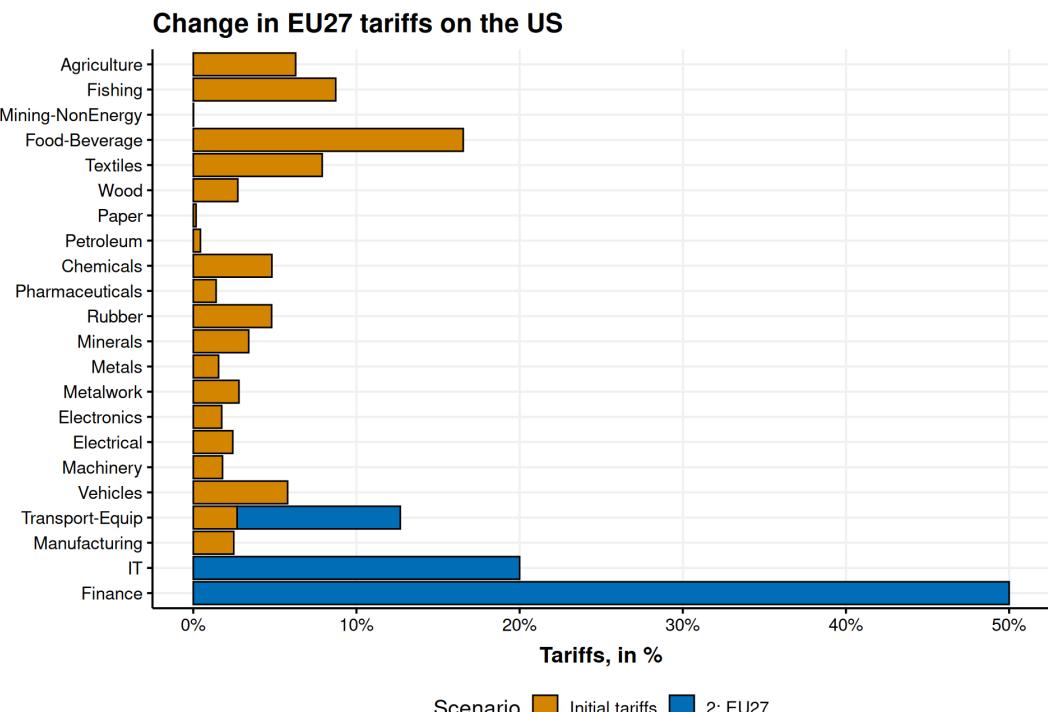
The EU loses, both in terms of welfare (defined both as real income and tariff income) and real wages. Loses occur in the first step, when US imposes higher tariffs (in orange), in the second step, as a result of retaliation that it can put in place (in blue), and in the last step, if the US retaliates against the EU (in grey), with an increasing trend. This holds also for China, although the effect reduces in the second and third retaliation steps.

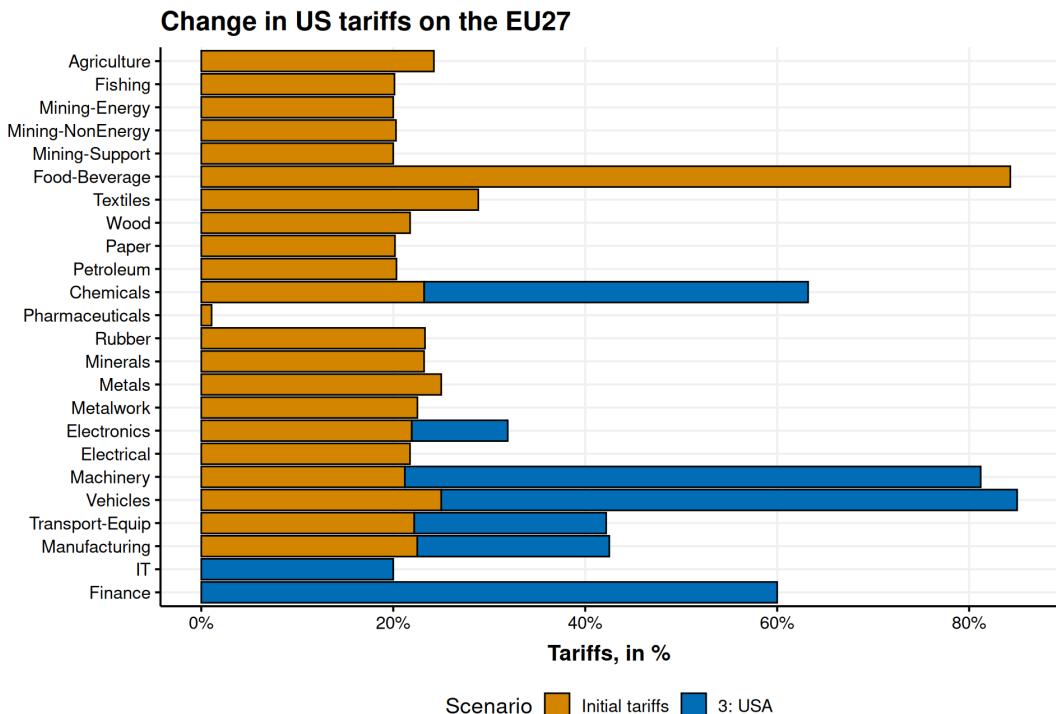
For the US, results are different. The US registers an increase in welfare (mainly thanks to the increase in tariff income) but they lose dramatically in terms of real wages, such that US consumers are the biggest losers from the tariffs.

THERE IS A SMART WAY TO REACT TO A TRADE WAR

Although the EU-US agreement in July paused the trade conflict, the threat of tariffs has not disappeared. EU has to look for "optimal" strategic retaliatory tariffs in its search for leverage with the US. It can address these threats in a smart way, by identifying those counter tariffs that maximize damage to US welfare and minimize welfare losses in the EU27. TWIN SEEDS identified such optimal strategic retaliatory tariffs in the case where they are imposed on goods imports and on services from two industries (IT services and finance) (Figure 2).

Figure 2: Results from strategic tariff setting (EU27 tariffs on the US – top graph; and US tariffs on the EU27 – bottom graph) by industry – always from 'factual' scenario.





The optimal strategic tariff structure from the EU27 on the US clearly involves the two services industries, IT and Finance. Amongst additional tariffs on goods imports from the US, only the transport equipment industry is part of an 'optimal retaliatory tariff' strategy.

The EU therefore should target its retaliation strategies on IT or Finance rather than only imposing additional tariffs on goods imports. By the same token, for the US it would be more effective to retaliate on a range of manufacturing EU industries (chemicals, machinery, vehicles, transport equipment and other manufacturing). These are thus the vulnerable sectors for the EU.

All this suggests **two key policy messages**. Firstly, if the EU does decide to retaliate against the US, it should do so in a targeted way, so as to impose a huge cost on the initiator of the trade war and discourage future actions of this kind. More broadly, a steady fall in EU exports to the US is inevitable in this context. The EU has to build stronger international trade integration with a diversified set of partners, in order to protect the advantages in terms of welfare and wages and enable firms to continue to develop new markets and sources of key inputs,

PROJECT IDENTITY

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LINK TO THE RESEARCH AND DETAILED RESULTS

<https://twinseeds.eu/wp-content/uploads/2025/09/New-Normal-Scenarios-Twin-Seeds-WP6.pdf>

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