**Policy Analysis Focus 25-12**
**Economic Impact of Five Retaliation Scenarios on selected Economies**[1]

**January 2026**

**Katharina Ditte**
**National Graduate Institute for Policy Studies (GRIPS)**

## I. Introduction

On April 2, 2025—dubbed "Liberation Day" by Donald Trump—the United States (US) announced a 10 percent baseline tariff on imports from all trading partners and additional partner-specific "reciprocal" tariffs on trading partners with which the US had been running large trade deficits.[2] Imports from the European Union (EU) were initially subject to an additional 20 percent tariff, which resulted in an effective rate of 30 percent. On June 3, 2025, tariffs on steel and aluminum were increased further, from 25 to 50 percent.[3] Following US–EU negotiations, a July 2025 framework agreement reduced the effective tariff rate on most EU exports to the US to about 15 percent.[4] Steel and aluminum remained subject to 50 percent tariffs for all trading partners except the United Kingdom (UK), which secured a lower rate of 25 percent under a bilateral arrangement.[5] The US–EU deal elicited mixed reactions among EU leaders, with some arguing that a firmer retaliatory stance comparable to that of China could have strengthened the EU's bargaining position. For instance, French President Emmanuel Macron offered a critical assessment of the EU-US agreement, including the statement, *"To be free, you need to be feared. We were not feared enough."*[6]

---

[1] This paper builds on economic modeling techniques introduced in the Spring 2025 GRIPS course "International Economic Policy Analysis," instructed by Professor Kenichi Kawasaki. The views expressed in this article are the author's own and do not represent those of GRIPS or other organizations to which the author belongs.

[2] https://www.whitehouse.gov/fact-sheets/2025/04/fact-sheet-president-donald-j-trump-declares-national-emergency-to-increase-our-competitive-edge-protect-our-sovereignty-and-strengthen-our-national-and-economic-security/

[3] https://www.whitehouse.gov/fact-sheets/2025/06/fact-sheet-president-donald-j-trump-increases-section-232-tariffs-on-steel-and-aluminum/

[4] https://policy.trade.ec.europa.eu/news/joint-statement-united-states-european-union-framework-agreement-reciprocal-fair-and-balanced-trade-2025-08-21_en

[5] https://www.cbp.gov/sites/default/files/2025-08/20250820_tariff_factsheet_0.pdf

[6] https://www.reuters.com/world/europe/frances-macron-criticises-eu-us-trade-deal-sees-it-first-step-sources-say-2025-07-30/

Accordingly, this article uses a computable general equilibrium (CGE) model of global trade to examine the effects of alternative scenarios involving retaliation on the US, China, Japan, UK, and EU member states selected on the basis of economic size (Germany, France, and Italy) and exposure to US trade (Ireland).[7]

## II. Macroeconomic impacts

Table 1 presents the macroeconomic effects on real GDP under five hypothetical scenarios in which the US imposes a 25 percent tariff increase on all goods imports.

In scenario (1) the US tariff increase is applied solely to imports from Germany. While this scenario is unlikely in practice, the results highlight the contrast between country-specific and broad-based tariffs. In scenario (2) a uniform 25 percent tariff is imposed on imports from all US trading partners. Scenarios (3)–(5) involve alternative retaliation responses to Scenario (2): in Scenario (3), only China retaliates, with a 25 percent tariff on U.S. goods (symmetric retaliation); in Scenario (4), only the EU retaliates, symmetrically; and in Scenario (5), both the EU and China retaliate symmetrically, with other economies remaining passive.

The results show that unilateral tariffs would impose substantial losses on the

Table 1 Impact of a 25% Tariff Increase under Different Retaliation Scenarios

| | Real GDP (%) | | | | |
|---|---|---|---|---|---|
| Scenario | 1 | 2 | 3 | 4 | 5 |
| US Tariff applied to | Germany | All | All | All | All |
| Retaliation | no | no | China only | EU only | China & EU |
| US | -0.18 | -2.97 | -3.08 | -3.15 | -3.27 |
| Germany | -0.52 | 0.14 | 0.20 | -0.03 | 0.03 |
| China | 0.01 | 0.03 | -0.17 | 0.08 | -0.12 |
| Japan | 0.01 | 0.11 | 0.19 | 0.20 | 0.30 |
| France | 0.02 | 0.13 | 0.17 | 0.03 | 0.07 |
| Italy | 0.02 | 0.32 | 0.39 | 0.23 | 0.29 |
| UK | 0.02 | 0.01 | 0.03 | 0.06 | 0.09 |
| Ireland | 0.13 | -2.04 | -1.87 | -2.50 | -2.31 |
| Rest of EU | 0.02 | 0.26 | 0.32 | 0.03 | 0.09 |
| ROW* | 0.02 | -0.21 | -0.14 | -0.12 | -0.04 |

Note: Rest of the world.
Source: Author's simulations.

[7] This study employs the Global Trade Analysis Project (GTAP) model based on the GTAP 11c Data Base, which is benchmarked to 2017. The model is solved using RunGTAP (GEMPACK).

targeted country. If Germany alone faces an additional 25 percent tariff, its real GDP falls by 0.52 percent. The US is also negatively affected, though to a lesser degree, with a 0.18 percent reduction in real GDP. By contrast, across-the-board tariffs (2) are most damaging for the US itself: they reduce US real GDP by 2.97 percent. Most other countries in the sample are either not negatively affected overall or even benefit thanks to trade diversion. However, countries that are highly dependent on trade with the US, here represented by Ireland, suffer large losses due to their limited scope for export reallocation.

As for retaliation scenarios 3-5, the simulations show that retaliation is economically costly for the retaliator unless it yields clear bargaining gains. In the worst case, retaliatory measures can escalate into a trade war, substantially amplifying economic damage. Indeed, when China implemented retaliatory tariffs following President Trump's April 2 announcement, subsequent escalation led both countries to raise tariffs to levels exceeding 100 percent within few days.[8]

In this context, the EU's preference for negotiation over symmetric retaliation appears economically rational. In hindsight, however, China's firm response seems to have paid off: under the bilateral agreement announced by the White House in November 2025, China was subject to only the 10 percent baseline tariff, with "reciprocal tariffs" suspended until at least November 2026.[9] Although this suspension is temporary—possibly intended to buy time to reduce economic interdependence and prepare for future policy shocks—it is notable that China is currently subject to lower additional tariff rates than close US allies such as Japan and the EU, despite China's status as a principal strategic rival of the US.

Table 2 presents GDP impacts under the initial tariff regime announced in April 2025 and the post-negotiation regime following the US–China agreement of November 2025. Although steel and aluminum tariffs cannot be implemented directly in GTAP, the dominance of the two metals in global metal production and trade[10] allows an approximation of the impact by applying a uniform tariff increase across the entire metal sector. Since a 25 percent tariff on steel and aluminum was already in place prior to April 2, the simulations incorporate only an additional 25 percent increase, with no tariff increase for the UK. The results indicate that, within the sample, China experiences the

[8] https://www.reuters.com/world/china/china-increase-tariffs-us-goods-125-up-84-finance-ministry-says-2025-04-11/

[9] https://www.whitehouse.gov/fact-sheets/2025/11/fact-sheet-president-donald-j-trump-strikes-deal-on-economic-and-trade-relations-with-china/

[10] https://www.weforum.org/stories/2022/10/all-the-metals-we-mined-in-2021-visualized/

Table 2 “Liberation Day” vs Post-Negotiations Scenarios November 2025

| | “Liberation Day” (Apr. 2, 2025) | | Post-Negotiations (Nov. 1, 2025) | | | Change vs. “Liberation Day” | |
|---|---|---|---|---|---|---|---|
| | US Tariff* all goods | Real GDP (%) | US Tariff: excl. metals | Metal Tariff | Real GDP (%) | US Tariff | Real GDP (%) |
| US | - | -4.11 | - | - | -2.36 | - | 1.75 |
| Germany | 30% | 0.19 | 15% | 25% | 0.23 | -15% | 0.04 |
| China | 44% | -0.23 | 10% | 25% | 0.46 | -34% | 0.69 |
| Japan | 34% | 0.09 | 15% | 25% | 0.22 | -19% | 0.13 |
| France | 30% | 0.16 | 15% | 25% | 0.17 | -15% | 0.01 |
| Italy | 30% | 0.40 | 15% | 25% | 0.39 | -15% | -0.01 |
| UK | 10% | 0.71 | 10% | 0% | 0.22 | 0% | -0.49 |
| Ireland | 30% | -2.58 | 15% | 25% | -1.02 | -15% | 1.56 |
| Rest of EU | 35% | 0.35 | 15% | 25% | 0.31 | -15% | -0.04 |
| ROW** | 35% | -0.33 | 25% | 25% | -0.46 | -15% | -0.13 |

Note: * Tariff rates equal the 10 percent baseline tariff plus country-specific additional tariffs.
** For modeling purposes, it is assumed that post-negotiation reciprocal tariff rates were, on average, about 10 percentage points lower than initial announcements (e.g., declining from roughly 35 percent to around 25 percent). This assumption is adopted for tractability and is not based on a formal averaging of country-specific rates.
Source: Author's simulations.

second-largest improvement in GDP outcomes in the post-negotiation regime, surpassed only by Ireland.

## IV. Concluding remarks

The simulation results underscore that broad-based tariffs—such as those announced by President Trump on April 2—are economically costly primarily for the US itself, whereas unilateral or narrowly targeted measures impose substantial harm on the targeted country. When bargaining gains are absent, retaliation will likely amplify welfare losses for the retaliating party but may generate trade-diversion gains for third countries.

From a policy perspective, the findings suggest that *a priori* symmetric retaliation often appears too costly and risky economically to serve as a viable response strategy for most economies. At the same time, the recent deescalation in US–China trade relations indicates that credible retaliation threats can influence negotiating outcomes positively, even if they entail substantial short-term risks. Taken together, the results attest to the importance of strategic calibration in trade policy responses, and caution against escalation dynamics that could ultimately leave both trade partners worse off.