Europe’s response to the new U.S. administration

New U.S. policies put Europe in a hard place, but the fundamental challenges — and potential solutions — for the region are unchanged.



February 25, 2025

In Trump’s first month in office, the new U.S. administration has threatened tariffs for Mexico and Canada, imposed a 10% levy on Chinese goods and announced a 25% tariff on all steel

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and aluminum imports, which is set to take effect on March 12. However, the most potentially disruptive trade measure so far may be the U.S. plan to implement reciprocal tariffs on each country, factoring in elements such as existing tariffs, exchange rates, trade balances and other policies such as Europe's value-added tax.

At a session analyzing the global economic impact of the U.S. election, IESE professors Nuria Mas and Pedro Videla addressed questions about the consequences of Donald Trump's sweeping and unpredictable executive orders during the early weeks of his presidency.

Videla emphasized the importance of not taking Trump's words at face value — but that does not mean he should not be taken seriously. Navigating this fine balance will be crucial in managing the uncertainty his presidency represents.

Here's what we do know:

More tariffs on the horizon

U.S. allies won't be spared. While his first-term trade war centered on China, Trump 2.0 is now targeting China's trade proxies, such as Mexico and Vietnam. The key question is whether he will impose tariffs broadly or focus on specific sectors. Europe's open economy is particularly vulnerable to trade disruptions. Its trade-to-GDP ratio now exceeds 50%, compared with 37% in China and 27% in the United States.

Fiscal & immigration policies will impact global growth

Tighter fiscal policy risks driving capital outflows to the U.S., weakening local currencies and straining economies worldwide, particularly emerging economies. New policies designed to curb an already negative net immigration rate are expected to further slow global growth, especially in emerging markets.

Trade war as a geopolitical weapon

The U.S. trade war against China is part of a broader geopolitical strategy that could divide allies and trading partners, forcing them to take sides in an increasingly fragmented global economy.

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These policies threaten to undermine globalization, disrupt trade, fuel inflation and dampen economic growth — not just in emerging markets but also within the U.S. itself.

What can Europe do to insulate itself from the impact?

Europe faced **three major systemic challenges** even pre-Trump, but all have been accelerated under his policies. Last fall's Draghi report laid out the nuts and bolts of what needs to change.

1. Productivity

Europe has struggled with stagnant productivity since the early 2000s. Disposable incomes are declining, and the productivity gap with other major economies is widening. Simply put, Europe must step up its game to remain competitive.

The core issue? Europe is stuck in a "mid-tech trap." While it excels in industries like automobiles and pharmaceuticals, it lags in developing the high-tech, high-value innovations emerging from the U.S. and elsewhere.

A look at R&D investment over the past 20 years reveals a clear pattern: Europe has prioritized the auto industry above all else, while the U.S. has shifted its focus to software and cutting-edge technologies.

This must change. Mas urges Europe's leaders to wake up to this reality — before it's too late.

2. Guns or butter?

With the U.S. scaling back support for Ukraine and potentially leaving NATO to focus on military priorities in Iran and Taiwan, Europe faces a stark choice: commit to the green transition or pivot to defense.

If the war in Ukraine ends in a way that emboldens Russia, Europe may have no choice but to redirect significant resources toward defense.

Currently, only 20%-30% of European defense spending stays within Europe, compared with 80% in the U.S. Investing in European defense could serve a dual purpose: keeping more spending within Europe's economy while fostering high-tech innovation to help bridge the

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continent’s productivity gap.

3. Diversification

With U.S. policy becoming increasingly unpredictable and punitive, some countries may consider pivoting toward China, India or other markets. However, the U.S. government has a history of retaliating against such moves — whether through tariffs or military pressure.

The U.S. is Europe’s biggest export market, absorbing 20% of its exports. Ireland is the country with the highest dependency on exports to the U.S. Germany, already suffering from sluggish growth, is the world’s third largest exporter. European exporters to the U.S. crisscross countries and sectors: from cars and other machinery, to pharmaceuticals and chemicals, to luxury goods and food & drink. The potential impact is significant.

Retaliation by Europe will mean higher tariffs on U.S. goods coming into Europe. That will likely mean European consumers end up paying higher prices, nudging up inflation.

Rather than breaking ties with the U.S., Mas advocates for diversification — not just in diplomatic alliances, but also in exports and imports. Shifting suppliers is no simple task. Most countries trade primarily with just three partners, constrained by regulatory and logistical challenges. Similarly, Europe dominates in pharmaceuticals and automobiles for a reason — it has mastered these industries.

But mastery alone is not enough. Mas argues that Europe must develop a new competitive edge: the application of emerging technologies. While innovations like AI hold immense promise, they have yet to be fully integrated into real-world business models. The companies that successfully apply AI and other new tech to products and services will be the ones that thrive in the future.

Weathering the current storm will require focused leadership and for the EU to pull together for the common good — but these are make-or-break times when it comes to preserving the common project and European quality of life.



Nuria Mas

Professor of Economics and holder of the Jaime Grego Chair of Global Healthcare Management at IESE Business School. She is an expert in the economics of healthcare and public sector management.

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Pedro Videla

Professor, head of the Economics Department and holder of the Banco Sabadell Chair of Emerging Markets at IESE Business School.

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