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Research Report

Rethinking EU tariffs on China: Objectives and trade-offs

EconPol Policy Brief, No. 87

Provided in Cooperation with:
Ifo Institute – Leibniz Institute for Economic Research at the University of Munich

Suggested Citation: Baur, Andreas; Flach, Lisandra (2026) : Rethinking EU tariffs on China: Objectives and trade-offs, EconPol Policy Brief, No. 87, CESifo GmbH, Munich

This Version is available at:
https://hdl.handle.net/10419/344403

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Policy Brief

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Volume 10

Rethinking EU Tariffs on China: Objectives and Trade-Offs*

Andreas Baur and Lisandra Flach

- EU tariffs on China are no silver bullet. They carry economic costs and unintended side effects
- Tariffs might raise the cost of imported inputs, weakening export-oriented manufacturers compared to foreign rivals
- The reach of countervailing duties is limited: they do not apply in third markets, where European manufacturing sells around a quarter of its output and still faces Chinese competition
- Rather than shaping its China policy on its own, the EU should actively seek allies; it should therefore avoid measures that hit the very partners it needs

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EconPol Policy Brief

Publisher and distributor: CESifo GmbH
Poschingerstr. 5, 81679 Munich, Germany
Telephone +49 89 9224-0, Email office@cesifo.de
EconPol Europe: www.econpol.eu

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Rethinking EU Tariffs on China: Objectives and Trade-Offs*

Andreas Baur
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Additional EU tariffs on Chinese imports are currently under discussion as a response to the "China Shock 2.0." Their effectiveness, however, depends on the objective they are meant to serve. In an era of global value chains, tariffs can reduce import dependencies only up to a point. They might burden export-oriented industries and are unlikely to reduce trade imbalances. Nor can they substitute for measures to strengthen competitiveness and innovative capacity. This policy brief sets out the trade-offs at stake and argues for coordinated action with allies rather than acting unilaterally.

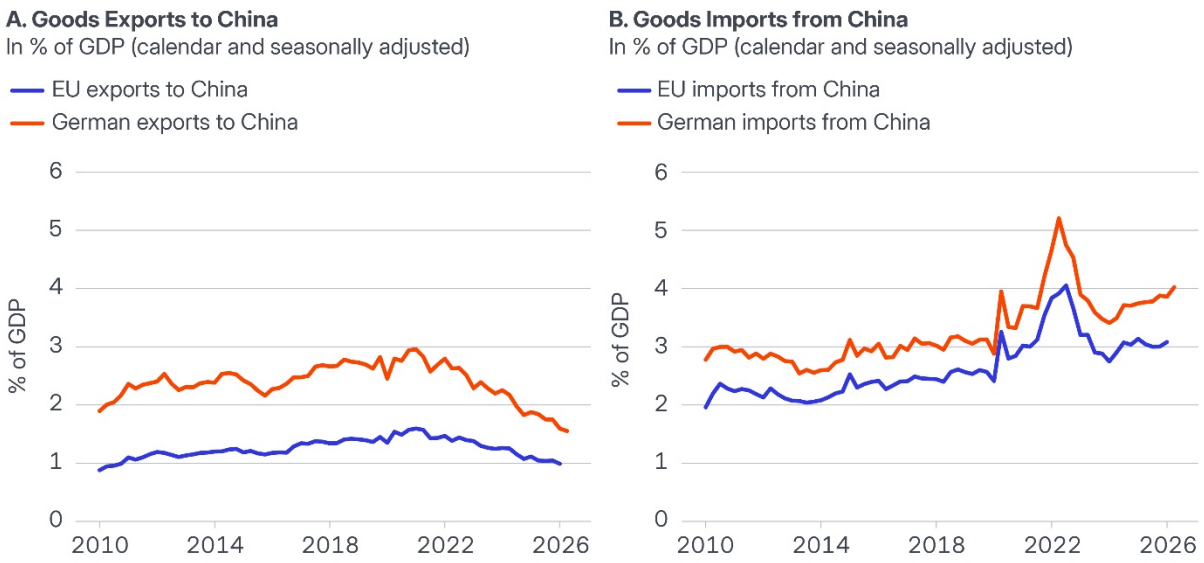
* This Policy Brief is based on the German-language article "Europäische Zölle gegen China auf dem Prüfstand" (Baur and Flach 2026), *Wirtschaftsdienst* 106(9), 1–6.
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Introduction

China will remain one of the biggest trade policy challenges facing Germany and Europe for years to come. Three reasons stand out. First, China now dominates the supply of many important products and intermediate inputs, which poses a risk to European economic security. Its recent export controls on rare earths show that Beijing is willing to leverage this dominance for geo-economic purposes. Second, competitive pressure from China is building across a wide range of core European industries. This raises the question to what extent European firms face predatory competition, underwritten by extensive state subsidies in China and an undervalued Chinese currency. Third, trade imbalances with China are widening fast: for Germany and the EU alike, imports from China are climbing while exports to China are falling (**Figure 1**).

Figure 1

German and EU Exports to and Imports from China



Source: Eurostat (2026a, 2026b); Destatis (2026a, 2026b). © ifo Institute

Bundled together under the label "China Shock 2.0," these challenges make some form of EU policy response hard to avoid. The current debate about potential countermeasures increasingly centers on new EU import tariffs on Chinese goods (Benner 2026; Tordoir and Setser 2026; VDMA 2026). In parts of that debate, tariffs are treated as something close to a silver bullet: a single instrument that can cut critical dependencies, restore a level playing field, and shrink the trade deficit all at once. There is a case for making tariffs part of a European package of measures. But depending on how they are designed, tariffs can carry significant economic costs and have unintended consequences. These trade-offs are the subject of this brief.

Reducing Dependencies in the Era of Global Supply Chains

Germany's imports of many critical goods are highly concentrated, and China is frequently the dominant supplier. Tariffs are therefore increasingly discussed as a tool to reduce those dependencies. In an expert report on security of supply, the Scientific Advisory Board at the German Ministry for Economic Affairs and Climate Action (BMWK) raised the idea of introducing a diversification tariff for this purpose (Scientific Advisory Council at the BMWK 2023): additional duties would be levied on imports of critical goods once a single supplier country's share crossed a given threshold. This would give firms an incentive to further diversify their supply relationships. Part of the appeal is that such a tariff would not formally target any particular country, even if in practice it would often apply to imports from China.[1]

At first glance, US trade policy under Donald Trump seems to confirm that tariffs can reduce economic dependence on China. At the start of his first term, China was by far the largest source of US imports, accounting for 21 percent of the total. Following the introduction of new US tariffs, this share fell sharply to 13 percent by 2024 and was around 8 percent in the fourth quarter of 2025 (Alfaro and Chor 2026). In an era of global supply chains, however, dependencies do not arise through direct import relationships alone. Chinese value added also reaches the United States indirectly, embedded as intermediate inputs in exports from third countries. Several studies find that indirect US exposure to China has in fact risen in recent years: Alternative suppliers such as Vietnam and Mexico have significantly expanded their own imports from China, and Chinese firms have substantially stepped up investment in these countries since the US tariffs came into force. As a consequence, direct US dependence on Chinese imports has fallen, but indirect dependence via global supply chains has increased (Alfaro and Chor 2023; Freund, Mattoo, Mulabdic and Ruta 2024; Garred and Yuan 2025; Wang, Wei, Yu and Zhu 2025). Calculations by the Peterson Institute for International Economics show that China's share of US imported value added has barely moved overall, despite the fall in direct imports (Lovely and Wan 2026). US tariffs have therefore contributed more to reshaping the structure of global supply chains than to reducing dependence on China itself: Chinese value added now reaches the US market by longer and more complex routes.

The current US administration is aware that conventional import tariffs quickly reach their limits when it comes to indirect dependencies, as a recently published report on third-country tariff evasion ("The Great Transshipment Scam") illustrates. It might be possible to design tariffs that capture indirect trade linkages, at least in part. Options include stricter and more comprehensive rules of origin, as foreshadowed in many of the Trump administration's "reciprocal" trade deals, or component-specific tariffs, as introduced by the US for drones in August 2026. But the administrative burden is substantial, and trade with third countries not directly involved can suffer as collateral damage.

All of this points to the limits of acting unilaterally. The more countries pull together in reducing economic dependencies, the more effectively the problem of indirect dependencies can be contained. The efforts of the current US administration to build a broad international alliance for critical raw materials, thereby enabling diversification on a global level, should be read in this light. The EU should therefore not pursue de-risking from China on its own, but in coordination with like-minded countries. Doing so would make de-risking both more effective and less costly. Tariffs should also be weighed against the other instruments

[1] Whether such a tariff is compliant with WTO rules remains an open question: thresholds and tariff rates apply equally to all trading partners, so there is no ex-ante discrimination. Ex-post, however, treatment diverges depending on market share. A justification based on the security exception of Article XXI GATT is conceivable but untested (Felbermayr 2026).

available for strengthening economic security. This includes increased stockpiling and strict requirements for software and components where critical infrastructure and cyber risks are at stake.

Countervailing Duties for Export-Oriented Manufacturing

Alongside economic security and resilience, global market distortions created by China's state-capitalist system are drawing increasing attention. A recent OECD study attributes about 60 percent of the market share gains made by Chinese firms since 2005 to state subsidies (OECD 2026). A growing number of voices also point to an artificially undervalued Chinese currency. The International Monetary Fund (IMF) puts the undervaluation at around 20 percent (IMF 2026); other assessments go further still, putting it at over 30 percent (Setser 2026). The losers from the resulting market distortions are obvious: domestic firms that compete head-on with Chinese suppliers and that, in the worst case, are driven out of the market by cutthroat price competition. How far this risk extends is disputed: the French High Commission for Strategy and Planning concludes that, over the medium term, around 70 percent of German industrial production is exposed to fast-growing import pressure from China (Grjebine, Lefebvre and Torres 2026). The consequences for public support for economic openness should not be underestimated either. If the impression takes hold that there is no level playing field in competition with Chinese firms and that jobs are being lost due to unfair trading conditions, the resulting resentment can quickly turn against the open economic model and rules-based global trade as a whole. The United States is a case in point (Colantone, Ottaviano and Stanig 2022).

WTO law explicitly provides for anti-dumping and countervailing duties as remedies against competition-distorting trade practices and the economic harm they cause. The EU has also made frequent use of these trade defense instruments against China in the past. A prominent example of this is the company-specific countervailing duties on Chinese electric vehicles imposed in the fall of 2024.

From a purely economic standpoint, however, it is not obvious that subsidized imports should be subject to tariffs as a matter of principle. Janet Yellen, former Fed Chair and US Treasury Secretary, once observed that the textbook response to subsidized Chinese products would be to write a thank-you note.[2] Ultimately, such foreign subsidies are a gift to European buyers – whether households or firms using subsidized products as intermediate inputs. It follows that this same group bears the cost when countervailing duties are imposed. And where buying subsidized products is desirable for the economy as a whole because of positive externalities – as may be the case for solar panels or electric vehicles – countervailing duties add further costs (Rodrik 2025).

The tariffs of the first Trump administration, aimed largely at Chinese imports, are a cautionary tale here. Tariff costs do not stop at consumers; they also ripple through value chains on the producer side. Empirical studies find that US tariffs, on net, harmed domestic manufacturing and cost manufacturing jobs, because imported intermediate inputs became more expensive (Flaaen and Pierce 2026; Handley, Kamal and Monarch 2025; Ossa and Redding 2026). Export-oriented firms are hit especially hard by this channel, as costlier inputs erode their competitive position against foreign rivals. When imposing tariffs, costs and benefits should therefore be carefully weighed, even if one looks exclusively at the producer side. From this perspective, there is little to recommend a blanket tariff on Chinese imports.

[2] Yellen herself said in 2024 that she would no longer do so: "People like me grew up with the view: If people send you cheap goods, you should send a thank-you note. That is what standard economics basically says. I would never ever again say, 'Send a thank you note.'" (Duehren 2024).

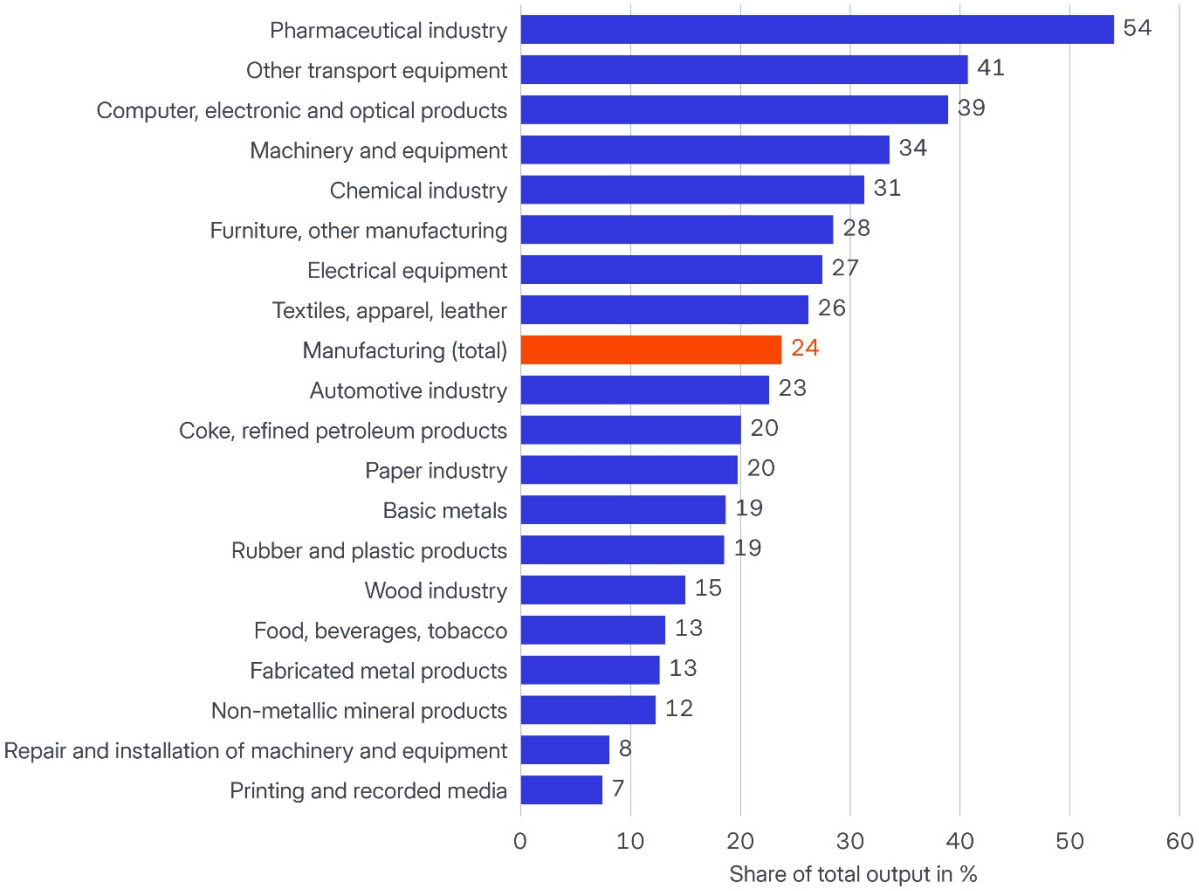
The current debate sometimes leaves the impression that competitive pressure from China stems almost entirely from state subsidies and an undervalued currency. But what if Chinese suppliers outcompete their European rivals even once countervailing duties have restored a level playing field? Tariffs may temporarily relieve competitive pressure on the domestic market. Over the longer run, they are no substitute for strengthening Europe's own capacity to innovate and compete. Weaker competitive pressure can even blunt the innovation incentives of the industries being protected (Akcigit, Ates and Impullitti 2026). The role of Chinese investment in Europe, and the scope it creates for technology transfer, belongs in this discussion as well.

There is also a limit to how far countervailing duties can level the playing field. Beyond the indirect imports of Chinese value added discussed above, there is a further gap: such duties do not reach third markets. They may offset distortions within the European single market, while European suppliers continue to meet subsidized Chinese competition abroad.[3] This matters greatly for European manufacturing, since it sells around a quarter of its output in markets outside the EU, and considerably more in some sectors (**Figure 2**). This is precisely why "Europe Alone" would be ill-advised when addressing global market distortions created by the Chinese economy. The EU should instead work to win allies for a coordinated approach. It is far from alone in facing the challenges of Chinese market distortions: many other countries like Japan, South Korea, and the United Kingdom are grappling with largely the same questions. And even with the United States currently on an isolationist course, scope for coordinated action may yet open up again (Campbell and Doshi 2026). To avoid undermining such efforts, the EU should make sure its own measures do not fall on potential allies. Examples include "Buy European" clauses that exclude even partners with EU trade agreements or safeguard measures that do not differentiate according to the origin of the imports. Were such measures to set an international precedent, export-oriented European manufacturing would be the ultimate loser.

[3] Chowdhry, Erhardt and Hinz (2026) document market share losses for European suppliers in third markets over the past decade, but also show that these can only partially be traced back to Chinese export growth (in Germany's case, to about a third).

Figure 2

Output Sold to Non-EU Countries by Manufacturing Industry
Sales in Non-EU Countries by Industrial Sector (2024)



Source: Eurostat (2026c); authors' calculations.

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Addressing Trade Imbalances with European Section 301 Tariffs?

Given growing trade deficits and their systemic causes, another option being discussed is to respond not with product-specific duties under WTO law, but with a blanket tariff on all Chinese imports (Grjebine et al. 2026) or, at the very least, to create a more flexible instrument that could be applied to entire sectors rather than individual products, along the lines of US Section 301 (Tordoir and Setser 2026). However, the hope that this would directly reduce a bilateral trade deficit rests on shaky ground. From an economic perspective, there is little to suggest that permanent tariffs can reduce trade imbalances, which ultimately reflect intertemporal saving and investment decisions (Gourinchas et al. 2026). Furthermore, it is a difficult balancing act, particularly from a German perspective: when defending its own surpluses with the United States, Germany has emphasized that the bilateral trade balance is not in itself a meaningful objective for economic policy – and there are good reasons for that view (Obstfeld 2025; Ossa and Redding 2026). Treating the bilateral deficit with China as a fundamental problem does not sit easily with that.

Nevertheless, one could still argue that tariffs of this broader kind can serve as leverage, pushing China to address the structural causes of global imbalances at home, such as weak domestic demand or its exchange rate policy (Setser and Vallée 2026). A further argument is that Brussels might lack the administrative capacity to impose product-specific WTO-compliant tariffs on a sufficient scale. Against this backdrop, is WTO compliance merely a "nice-to-have" for tariffs on Chinese imports? Does the EU need a more flexible tariff instrument modeled on US Section 301?

Even if such an instrument could be legislated quickly, one crucial difference from the US would remain: The EU is subject to a binding dispute settlement mechanism at the WTO level. The Section 301 tariffs introduced against China under the first Trump administration, for example, were found by a WTO panel to be inconsistent with WTO rules (WTO 2020). Due to the blocked WTO Appellate Body, however, the US was able to appeal into the void and thus prevent a binding ruling. It was precisely to close off that escape route that the EU co-founded the MPIA (Multi-Party Interim Appeal Arbitration Arrangement), of which China is also a member. Unlike the US, the EU and China have therefore committed themselves to binding appeal arbitration. Beijing would therefore have good reason to bring WTO proceedings against Section 301-style EU tariffs. It is anything but unlikely that an MPIA arbitration tribunal would then find such tariffs inconsistent with WTO rules. Anyone arguing for a European Section 301 instrument should therefore think through such longer-term consequences now and confront the difficult questions regarding the future of the multilateral trading system. Can the EU hold on to imperfect but WTO-compliant tariff instruments?[4] The advantages of the multilateral trading system are undisputed. At the same time, economists at multilateral organizations themselves (including current WTO Chief Economist Robert W. Staiger) acknowledge that the existing rulebook is reaching its limits under rising geopolitical tensions and that reform is needed, for example, in the form of geopolitically justified exceptions to most-favored-nation treatment and reciprocity (Mattoo, Ruta and Staiger 2026). But how realistic is such a reform over the medium to long term? And if it fails to materialize, would the US path of organizing trade relations with China outside the WTO framework then be the only option left? What would such a step mean for rules-based trade with third countries and for the multilateral system as a whole? What is clear is that stumbling unprepared into a binding MPIA arbitration award would be the worst of all answers to these questions.

Chinese Retaliation?

The experience with US tariff policy makes one thing clear: China will respond to new European import restrictions. Retaliatory tariffs are one option, but so are tightened export controls on critical raw materials or coercive measures against European firms operating in China. Any calculation about import tariffs has to factor these responses in. Staying within WTO rules could prove an advantage here as well: it would signal that the EU is not trying to shut out Chinese imports across the board, but is acting in a targeted and measured way. A series of product-specific proceedings has the further advantage of being less visible, case by case, than a comprehensive, high-profile "China tariff." It would thus provide less cause for demonstrative retaliatory measures.

Possible countermeasures are not the only reason to keep seeking dialogue with China. Even if it seems unpromising at present, the EU should explore whether common guardrails can be agreed upon within which de-risking measures and targeted countervailing duties against market distortions are mutually accepted. It should also be in China's interest not to stumble into uncontrolled decoupling. However,

[4] It is also not clear, however, that all possibilities within the WTO framework to counter Chinese market distortions have already been considered. Lester (2026), for instance, points out that the EU could also launch a WTO case against China's currency policy, which, due to China's MPIA membership, could potentially result in a binding arbitration award. Article XV:4 GATT prohibits members from undermining the objectives of the agreement through exchange rate interventions. This provision has so far been untested, however, so its interpretation remains open.

current signals from Beijing, and its response to the European electric vehicle tariffs discussed above, give little grounds for optimism in this regard. Ever since its recent experience with the Trump administration, if not earlier, the Chinese leadership appears to believe it holds all the cards in dealings with the EU. Here too, a "Europe Alone" approach carries the greater risk. In an alliance with other countries, the EU has far more negotiating power, and China would find it harder to start a trade war through aggressive countermeasures.

Policy Implications

Tariffs are no silver bullet. They come with economic costs and unintended consequences, and the resulting trade-offs should not be waved away. Furthermore, the suitability of tariffs depends crucially on the objective being pursued. Using them therefore requires a precise justification, careful calibration, and an honest weighing against other instruments. In all its responses to the China Shock 2.0, the EU should avoid a "Europe Alone" approach: it needs to actively seek out allies – and not alienate them with unilateral protectionism. Above all, the debate should not be narrowed down to tariffs. The challenges arising from economic relations with China are multidimensional. Accordingly, the EU's response should draw on the full toolkit of economic and trade policy.

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