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Policy Brief

The EU's Art of the Deal: Shaping a unified response to Trump's tariff threats

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#Trade
#TransatlanticRelations
#Trump

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Donald Trump's re-election as US president presents the European Union with significant economic and political challenges. The prospect of unilateral and aggressive US trade policies risks undermining the EU's collective economic interests and fragmenting its unity. However, the EU is better prepared to navigate these challenges than during Trump's first term. This policy brief explores the economic vulnerabilities the EU is exposed to by Trump's foreign economic policy and investigates the expanded tools at the EU's disposal to fend off this threat. Through a mix of deterrence strategies and targeted incentives such as increased energy and defence procurement, the EU can bolster its negotiating position, which strength will fundamentally rest on its unity. Moreover, the brief advocates for structural diversification of trade relationships to safeguard its long-term economic resilience.

Donald Trump's re-election as the United States President poses significant challenges to the international trade order, especially through his declared go-it-alone approach. The militarisation of economic policy through aggressive tariff measures and the weaponisation of economic policy are geared to ram home his idea of US interests. For the European Union this raises significant economic and political risks. This holds especially true as the EU is economically weaker and more dependent on the US market than it was during his first term. However, today the EU also has more tools at its disposal to strategically respond to threats, both via its bigger range of deterrent measures and its strengthened ability to engage in joint negotiations. This policy brief analyses the vulnerabilities the EU faces, both economically in the form of credible tariff threats, and politically, as the EU's ability to act as one will be challenged. It spells out how the EU should position itself in the upcoming negotiations.

The president-elect has opted for tariff threats from the off

It is highly likely that the new Trump administration will make extensive use of tariffs. Declaring tariffs "the most beautiful word in the dictionary", the president-elect sees them as a *Wundermittel* **to achieve a broad range of objectives.** These include rebalancing trade deficits, imposing trade reciprocity, decoupling from China, guaranteeing the dollar remains the world's reserve currency, and leveraging the US's sheer market size for broader geopolitical goals, including third countries' defence spending and regulation of US Big Tech.

In late November, the president-elect proclaimed one of his immediate executive orders after taking office on January 20 would be the imposition of a 25% tariff on all imports from Canada and Mexico. Ostensibly aimed at addressing drug trafficking and illegal migration, these measures are a reminder that tariffs will be used for a variety of non-economic purposes, regardless of existing agreements, such as the Trump-negotiated US, Mexico, Canada free trade agreement. It further demonstrates a calculated strategy to close circumvention routes into the US market and bolster the effectiveness of future tariffs. A few days later, he doubled down and threatened the BRICS countries with 100% tariffs if they dared to undermine the dollar's dominance.

While China remains a primary target of Trump's trade rhetoric, floating potential tariffs as high as 60% for its goods, **Trump has frequently criticized the EU** – which he considered already in 2018 "as bad as China but smaller" – **for its significant trade surplus with the US:** evidence for him of unfair trade practices. While the EU saw itself confronted with tariffs the last time around, it must brace itself for an escalation of possible trade restrictions: he has threatened to impose a universal import duty of 10–20% on all goods to reduce the US trade deficit. Alternatively, he advocated for reciprocal tariffs where the EU imposes greater tariffs than the US and sector specific charges, with a particular focus on the automobile industry, but also on steel and aluminium imports and other goods spanning wine, cheese, handbags and industrial machinery goods.

Hidden reefs and uncharted obstacles

Even though the US Constitution grants Congress control over trade, **Trump has extensive executive powers at hand** to bypass Senate and House and override trade agreements with sweeping tariffs and trade restrictions on grounds of national security, economic emergency measures, and actions to clamp down on unfair trade practices. As many observers have already commented, Trump's Cabinet will play a critical role in shaping his trade agenda. Bringing together opposing voices, its ultimate stance remains uncertain. Hardline China hawks, amongst them chief protectionist Robert Lighthizer's former chief of staff Jamieson Greer as US Trade Representative, are likely to push for aggressive trade defence measures and economic decoupling. In contrast, the nomination of Wall Street's Scott Bessent as Treasury Secretary and Howard Lutnick as Commerce Secretary, who have both advocated for using tariffs as negotiation tools rather than a policy per se, has fuelled speculation that they could restrain overly excessive tariff use in favour of market stability and US stock performance. However, Bessent's penchant for correcting macroeconomic imbalances could result in the US pressuring surplus countries towards greater domestic consumption, with low demand and high savings seen as the primary cause of over-capacities that lead to the US trade deficit. This could further pressurise third countries to engineer currency adjustments and demand-boosting investments and adds another layer of unpredictability to US foreign economic policy.

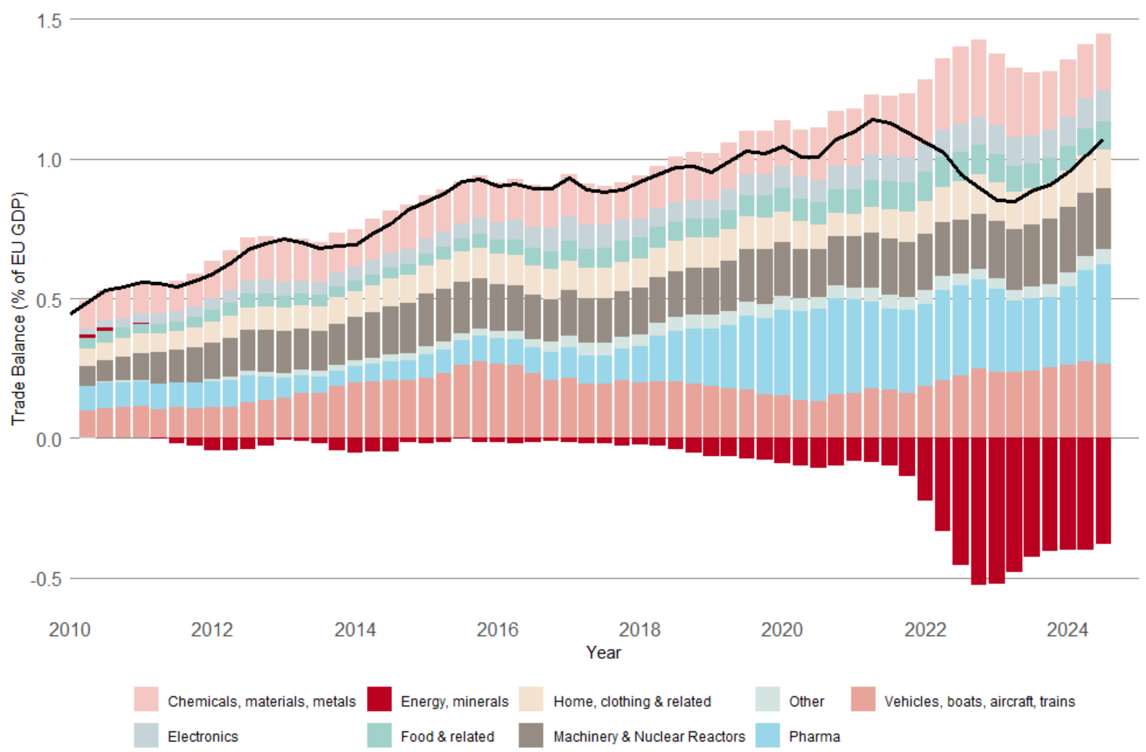
More uncertainty stems from fundamental contradictions between Trump's various policy goals: his desire to reduce the US trade deficit requires a weaker dollar, yet he is committed to maintaining the dollar's global reserve currency status. Since the election, the dollar has appreciated, highlighting such tensions. Numerous economists have warned of the impact on output and inflation of across-the-board tariffs, with S&P estimating that a universal 10% duty would add as much as 1.8% to US inflation and reduce GDP by 1%. While inflation remained contained during Trump's first term due to trade rerouting through countries like Mexico and Vietnam, a broader tariff regime would likely worsen inflationary pressures. With US inflation already rising to 2.7% year-on-year in November 2024, further increases could amplify domestic discontent, particularly given the importance of cost-of-living concerns in the recent election. Recently, Trump conceded the difficulty to bring down everyday costs and shielding consumers from cost impacts from his tariff plan.

What may await the EU and its 27 members

Whatever the shape of US trade policy over the next four years, the EU is confronted with significant economic risks. The worst-case scenario would be the imposition of universal 10–20% flat tariffs on all (EU) imports, which would seriously hurt the European economy. Currently, around 20% of EU goods exports go to the US, accounting for 3% of GDP, up from 2.4% in 2016. While these calculations come subject to caveat, economists have estimated that the tariffs Trump pondered during his campaign could shrink the EU's GDP by 0.5–1.0%.

Due to the heavy economic costs this would incur also on the US, a universal tariff hike remains possible but unlikely to be the first escalatory step of the Trump administration. **Washington more likely will focus at first on sectors in which the US trade deficit with the EU is especially pronounced.**

Figure 1: The EU-US trade balance since 2010 (Source: Oxford Economics, Haver Analytics)



A sectoral breakdown of the trade balance **reveals that the pharmaceuticals, chemicals, machinery, and vehicles sectors are the primary drivers of the EU's surplus** with the US. While pharmaceuticals generate the largest surplus, both this sector and chemicals are likely to have broader and more immediate inflationary effects, with direct cost increases in healthcare and industrial manufacturing, affecting both businesses and consumers. Further, to an extent, the US remains strategically dependent on essential goods imports for critical medicines and industrial chemicals with limited short-term substitutes. Given the sensitivity of healthcare affordability for US households, such measures would likely provoke significant domestic backlash.

By contrast, tariffs on vehicles and automotive components would create a more sector-specific and delayed inflationary impact. Higher costs for imported vehicles would hit discretionary purchases, reducing affordability for consumers. However, substitution effects offer some mitigation, as US automakers could temporarily benefit from reduced competition. Trump has repeatedly floated the idea of reciprocal tariffs, emphasizing the disparity between the EU's 10% tariff on US car imports and the US's 2.5% tariff on EU vehicles. Additionally, the EU's surplus in agriculture goods – where EU tariffs are on average 4% higher than US tariffs – could face scrutiny.

Whether the US imposes sector-specific tariffs or goes for an all-round duty hike, **exposure varies considerably among member states:**

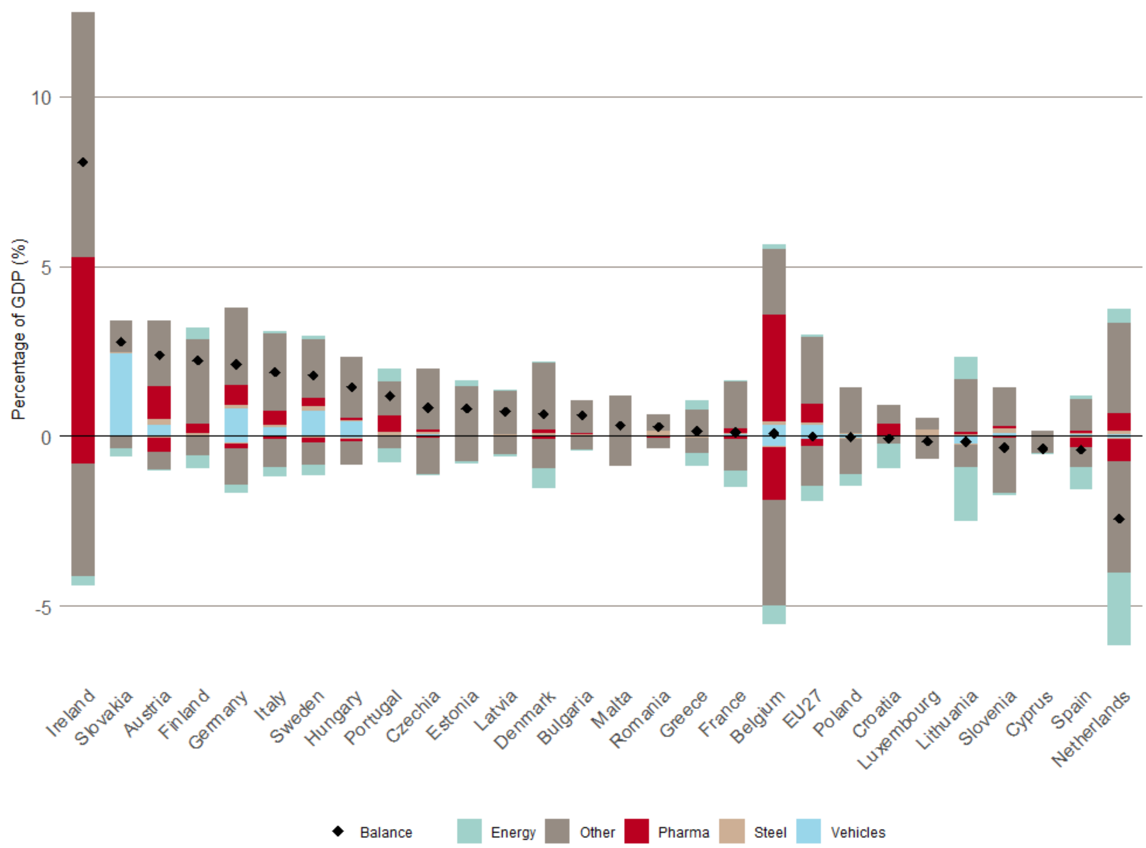


Figure 2: The EU's trade goods with the US by sector Q2 2023–Q2 2024
(Source: Oxford Economics, Haver Analytics)

The figure highlights that **Ireland, Slovakia, Austria, Finland, Germany, Italy, Sweden, and Hungary are particularly exposed to potential trade restrictions,** both due to the economic significance of their exports to the US relative to their GDP and the significant trade surpluses they run across the Atlantic. If Trump were to target the automobile sector, Germany *(quelle surprise),* Slovakia and Hungary would be hardest hit. **Yet the broad geographical distribution of the automotive industry across Europe makes it a collective concern** and could hit those member states, which may not enjoy a trade surplus but are heavily integrated with the EU's automotive sector as suppliers of intermediate goods. US tariffs on European cars would disrupt this value chain, creating significant indirect exposure and amplifying economic risks across the region.

Beyond the direct effects, significant US tariffs on Chinese goods and those of other third countries, coupled with retaliatory measures, risk triggering substantial trade diversion that could turn the EU into a dumping ground for Chinese overcapacities. This influx would intensify competition in key sectors such as machinery, electronics, and consumer goods, placing significant pressure on European producers and potentially eroding market share. The challenge could be further exacerbated by a devalued renminbi, as China strives to maintain its export competitiveness. Historically, Beijing has actively intervened in currency markets, purchasing dollars to weaken the renminbi. A devalued currency would not only make Chinese exports more competitive in the US but also across global markets, including the EU. Given China's reliance on exports to counteract weak domestic demand, Europe stands as a key alternative market for its redirected goods, heightening risks for European industries.

The EU's Art of the Deal

Even if the precise outline of US trade policy under Trump's second term remains uncertain, **the varying economic vulnerabilities among EU member states could exacerbate competing interests within the bloc.** Trump's preference for bilateral negotiations with individual capitals poses a significant challenge by undermining the EU's collective bargaining power and exploiting internal divisions. This approach **risks fragmenting the Single Market** by creating differential tariff rates through bilateral exceptions. The Dutch government's "proactive outreach" to Trump's administration, including Economy Minister Dirk Beljaarts' meeting with Robert Lighthizer, underscores the validity of these concerns.

To counteract this, the priority for the newly formed Commission should be to **establish a clear, unified framework for responding to US trade actions,** preventing individual member states from pursuing separate deals. Lessons from the Brexit negotiations highlight the primacy of buttressing the cohesion of the 27. The Commission maintained unity by establishing protection of the EU's internal market's integrity as the ultimate goal. This was made possible by a process of permanent dialogue with the member states throughout all the negotiations, at various levels of stakeholders and constant information sharing. This has lessons for the upcoming trade talks with Trump as set out below.

I. Credible negotiating tactics built upon expanded deterrence

The initial step in establishing a strong EU position is having a **credible deterrence strategy** at hand and knowing what the EU can offer in negotiations before Trump's inauguration on 20 January 2025. Preparatory work by the Commission's Task Force, bringing together DG Trade and the European External Action Service (EEAS) since May, has laid the groundwork.

The first line of defence is the Commission's list of possible retaliatory tariffs, kept under wraps to leverage strategic ambiguity. The EU may be running a trade surplus but US goods exports to the EU are still worth around €350 billion. To be able to utilise the countermeasures available under the World Trade Organisation (WTO) framework, the EU should formally launch complaints against any breach of WTO rules. In 2018, it did so just six days after US tariff announcements. With the WTO's appellate body rendered dysfunctional since 2019 – due to the US blocking new appointments and preventing decisions from becoming legally binding if appealed – **Europe has responded by strengthening its response capabilities through the EU Enforcement Regulation.** This mechanism allows the EU to impose countermeasures unilaterally when the WTO finds a breach of international trade rules, even if the US escalates the case to the defunct appellate body, leaving it unresolved. The regulation also broadens the EU's retaliatory scope beyond goods to include services and trade-related aspects of intellectual property rights (TRIPs). This is particularly significant given the US's trade surplus in services with the EU, valued at approximately €120 billion, making it a credible target for countermeasures. Preparatory work must include a comprehensive assessment of the costs that such measures would impose on the US and EU, broken down by national, sectoral, and employment levels. Figure 2 highlights the different levels of import reliance of member states on the US. While the ultimate aim of countermeasures is to limit the economic impact of an escalating trade war, the EU must anticipate significantly higher costs than in 2018 and prepare compensation

mechanisms that will ensure overall economic resilience.
As for the long-standing Boeing-Airbus dispute, where the legality of subsidies remains contested,the Commission could further deploy the **Foreign Subsidies Regulation (FSR),** if the five-years truce agreed in June 2021 were to be nullified. By investigating whether Boeing benefits from foreign subsidies that distort competition in the EU market, the Commission could impose corrective measures to limit the US plane-maker's market share in Europe. Here, the Commission enjoys full discretion over the instrument's use. Threatening to block US firms from accessing the EU's vast procurement market could also be reinforced through the **International Procurement Instrument (IPI).** The IPI allows the EU to restrain firms' access in the absence of reciprocal access to public procurement tenders and could especially be used against the 13 US states not having signed the WTO Agreement on Government Procurement.

Born out of experiences from Trump's first term, one of the most transformative developments in withstanding economic pressures is the EU's novel **Anti-Coercion Instrument (ACI).** The ACI provides a structured framework, allowing the EU to impose countermeasures against third countries that attempt to put the squeeze on European policymaking. A credible use case could be if Trump attempts to use tariffs to pressure the EU into exempting the US from the EU's Carbon Border Adjustment Mechanism (CBAM) or modify the Digital Markets Act and its antitrust provisions. The ACI's procedural steps envision a "cooperative engagement" with the offending party as a first step, but if this fails, the EU can deploy a wide range of countermeasures. These include import and export restrictions on goods and limitations on financial market access or participation in public procurement tenders. The ACI is adopted under qualified majority voting (QMV), enhancing the credibility of its deterrence, as individual member states cannot veto its activation.

II. Carrots work alongside sticks

With a credible deterrence strategy on the table, **the EU would be in a stronger position to negotiate** with the US. A key component of this strategy would be to offer **targeted incentives.** Here, the Commission must persuade the various stakeholders to coordinate their clear political backing for any such proposals.

Liquefied natural gas (LNG) imports

US LNG imports have already played a notable role in mitigating the overall US trade deficit with the EU. Boosting **energy purchases would remain an important carrot in negotiations,** as Trump aims to significantly increase the amount of oil and gas produced domestically. While ACER, the EU's energy watchdog, forecasts that the EU's demand for LNG will have peaked in 2024 as it transitions to greener alternatives, there remains scope to boost the US share of LNG imports. In the first half of 2024, the US accounted for 48% of the EU's LNG imports, compared to Russia's 16%. Commission President von der Leyen has already floated the idea of replacing a portion of Russian imports with US LNG following Trump's re-election. While the benefits of such an option would contradict the EU's Green Deal trajectory, reducing reliance on Russian LNG remains a critical goal for the EU and this option should be explored as the EU moves towards renewable energy.

This approach mirrors the successful tactics of former Commission President Jean-Claude Juncker, who brokered a truce during Trump's first term by pledging increased EU imports of US LNG and soybeans, thereby averting escalating tariffs, including on the EU's auto industry. Despite the Commission's limited authority to mandate corporate purchasing decisions, Juncker's strategy relied on market trends indicating growing imports of US soybeans and LNG. Trump embraced the agreement, enabling both sides to claim a win while avoiding further trade tensions. Today, the EU's joint procurement platform for gas, established in 2022 under the EU Energy Platform, enhances this approach by pooling demand and negotiating collectively. This initiative strengthens the bloc's bargaining power, ensures better pricing, and integrates private sector participation.

Defence Procurement as a Strategic Lever

Similarly, **increased defence procurement could be used in negotiations to avert US tariffs.** While the EU's defence industrial strategy, unveiled in March 2024, underscores the need to reduce reliance on non-EU suppliers, aiming to procure at least 50% of its defence from within the bloc by 2030, there is potential flexibility to increase US procurement. Recent granular data shows that 52% of procurement between June 2022 and June 2023 went to European manufacturers, with only 34% allocated to the US.

Regardless of the percentages, realising the EU's goals of enhanced military capability will require significantly higher overall defence spending. This opens the door for greater US purchases, especially in areas where the EU lacks production capabilities, such as advanced combat aircraft and extended-range air-defence systems. These gaps will persist in the medium term, making US imports indispensable even as the bloc works to strengthen its defence autonomy. France's recent decision to support a proposal under the European Defence Investment Plan (EDIP) to allow up to 35% of EU-funded incentives to be spent on non-EU suppliers illustrates a pragmatic shift based on thresholds of foreign components in military equipment. This plan, while modest with an initial allocation of €1.5 billion, is expected to expand significantly.

Targeted cooperation on China

The **Trump administration is likely to pursue more aggressive decoupling from China** than the technological variety pursued under Joe Biden. To maximise its effectiveness, the US will pressure allies, foremost the EU, to fall into line with that policy. Bessent suggested a "clearer segmentation of the international economy" and threatened that "the cost of remaining outside the perimeter would be high". While the EU has made it clear that it will not fundamentally decouple from China, instead pursuing its own de-risking agenda in line with its Economic Security Strategy, it may offer strategic concessions to US interests in areas where there is broad political support. This could include exclusion of Chinese providers in critical infrastructure, if the EU has learnt its lesson from the Huawei saga, and data transfer from autonomous cars, following US advances on restricting Chinese providers.

III. It's diversification, stupid!

The current economic importance of the US is beyond question, with no credible immediate substitute available. But the need to shield the EU against economic coercion calls for ending or seriously **mitigating over-dependencies** on individual export markets. While the EU should seek to become more autonomous by prioritising a deeper Single Market, such efforts will equally require a diversification of trade relationships.

A **critical test of the EU's ability to broaden its market access** and strengthen its global economic clout will be the implementation of the **EU-Mercosur** free trade agreement. On 6 December 2024, von der Leyen declared the conclusion of the agreement's negotiations. Ratification, however, remains fraught. The Council, using QMV, must approve the agreement. Should longstanding French opposition succeed in forming a blocking minority the EU would miss an opportunity to achieve its strategic goal of diversification and underline its genuine commitment to global and rules-based free trade. The Mercosur agreement will serve as a litmus test for the EU's willingness to prioritise collective interests over sectoral concerns. It also provides a valuable lesson for future trade negotiations: **the EU should focus on pragmatic trade-only agreements** to maintain credibility with external partners, as advocated by the new Trade Commissioner Maroš Šefčovič.

Looking ahead, the EU should continue engaging in negotiations with Australia, ASEAN countries and India, while recognising that such agreements will take years to conclude. In the interim, the EU must work to reduce trade barriers with economies already deeply integrated into its market, such as the UK, Switzerland, and Turkey. It also needs to sign sectoral agreements focused on securing access to strategic resources by actively developing and co-financing projects under its Global Gateway and Critical Raw Materials Act initiatives. In the short term, as proposed by Pascal Lamy and Arancha Gonzalez, the EU should collaborate with other countries affected by Trump's tariffs—including China—to establish a coordinated approach that minimises the collateral impact of retaliatory measures on one another, when countering US actions. Such an approach would prevent escalating beggar-thy-neighbour policies and signal the EU's commitment to upholding the battered multilateral WTO principles.

Conclusion

Donald Trump's re-election heralds a turbulent period for the European Union in the face of aggressive US trade policies. Trump's unilateral approach threatens to inflict significant economic disruption and exploit divergences among member states, potentially fragmenting EU unity. However, structurally, the EU is better positioned to defend its collective interests than during his first term. With an upgraded toolbox that allows it to respond to transgressions swiftly and a trade policy that is firmly under EU competence with key decisions requiring only qualified majority approval in the Council, the bloc has a strengthened institutional framework to respond strategically and cohesively. What is now needed is the united political will to do so.

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