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Trade War and Peace

Three Scenarios and Policy Options Available to the EU and the German Government in Negotiations with President Trump

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The United States (US) and European Union (EU) are at risk of entering a full-blown trade war. Three months ago, on "Liberation Day", US President Donald Trump imposed high import tariffs on almost all countries, including the EU. He then suspended them at short notice to negotiate with over 90 of the affected trading partners. At the beginning of July, when the tariffs were due to come into force, Trump again postponed the tariffs on the EU and other countries by an additional month. In a letter to the EU, Trump threatened higher tariffs, namely 30 per cent, from 1 August. This back and forth shows that Member States must prepare for an escalation of the conflict – one that could go far beyond tariffs and even jeopardise the security of the EU.

On "Liberation Day", 2 April 2025, President Trump imposed very high new import tariffs. He introduced a base tariff rate of 10 per cent on all goods imported from over 180 countries, with very few countries exempted, Russia among them. He also announced "reciprocal tariffs" for the EU and 56 other countries that have a trade surplus with the US in goods. He imposed a 20 per cent import tariff on goods from the EU and even threatened tariffs of up to 50 per cent on other countries. The tariff dispute between the US and China escalated in the following days, with both governments raising their tariffs perpetually. If this had continued, this would have made continued trade in goods virtually impossible. On 9 April, Trump suspended the "reciprocal tariffs" imposed a week earlier and announced a three-month negotiation period. In the meantime, the base tariff rate of 10 per cent has already come into force.

The Trump administration concluded deals with only three trading partners before the negotiation deadline of 9 July: China, the United Kingdom (UK), and Vietnam. The agreement with China only provides for a halt to the tariff escalations that began in early April and set out negotiations on a possible new agreement on tariffs, export controls, and other issues by mid-August. The UK and Vietnam, on the other hand, each signed a joint statement with the US. In the May agreement, the British agreed with the US to maintain a 10 per cent tariff, combined with preferential treatment for automobile and aircraft engines, which are of central importance to

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the British economy. Vietnam accepted a general US import tariff of 20 per cent after Trump threatened 46 per cent. No agreement has yet been reached with the EU, despite the European Commission's attempts to make a deal before 9 July. Instead, Trump has followed up with further threats. If no agreement is reached in the coming weeks, high tariffs could come into force in full on 1 August.

Endless tariffs

Trump is resorting to both traditional and unorthodox instruments in his tariff policy. The latter category includes tariffs that Trump justifies on the basis of "national emergencies" that he himself has declared under the International Emergency Economic Powers Act (IEEPA). These "emergencies" form the legal basis for the "reciprocal tariffs" that are to come into force on 1 August. It is controversial whether the law allows such comprehensive executive measures without the approval of Congress. Two federal courts banned the IEEPA-based tariffs at the beginning of June, but an appeals court overturned the ruling a few days later. Whether or not the Supreme Court will ultimately rule against Trump's tariffs remains to be seen.

Regardless of how the dispute over Trump's executive authority is resolved, further comprehensive tariffs are likely to be imposed beginning in autumn. This is because in order to impose so-called sectoral tariffs, the US government can resort to another law: the Trade Expansion Act of 1962. It is one of the US' traditional trade instruments and has never been challenged by Congress or the courts.

When Trump took office in January, he instructed his cabinet to prepare tariffs on individual product groups. As with previous "sectoral tariff" decisions on aluminium, steel, cars, and car parts, Trump could now impose further tariffs on EU pharmaceutical products, semiconductors, semiconductor manufacturing equipment, critical raw materials, medium- and heavy-duty trucks, and aviation goods on the basis of Section 232 of the Trade Expansion Act due to a "threat to national security". After the regular review process, which requires involving the US Congress and stakeholders who would be affected by the tariffs, has been completed for those goods, recommendations for new sectoral tariffs by the Commerce Department could be send to the President at any time between now and 270 days after the start dates of the investigations in early April and early May 2025, respectively. Public comment periods customary in the review process have already been completed and Trump is thus authorised to decide on new tariffs and other measures on his own once the Secretary of Commerce submits his report on the proceedings. The US President has up to 90 days to do so, meaning that some of the tariffs on EU exports could be imposed as early as 1 August while others could follow in the next 12 months.

In addition, the Trump administration could impose further tariffs on individual trading partners, including EU member states, on the basis of Section 301 of the Trade Act of 1974 for alleged unfair trade practices. If the Trump administration concludes, for example, that the digital services taxes (DSTs) imposed by individual EU Member States constitute practices that are "unjustifiable, unreasonable, or discriminatory" and burden or unduly restrict US companies, the EU could face further tariffs, which Trump can raise at will and impose without any time limit. In his first presidency Trump used this measure, which was previously considered a "nuclear option", only against China, but not against close allies. However, he had already launched a Section 301 process in response to DSTs in several countries, including some EU Member States.

More than just a battle plan

The EU has so far managed to stay united in its response to Trump's tariff threats and actual imposed measures. Its strategy is aimed at limiting economic and political damage. The EU should continue to consider several scenarios, including the following: that the tariff dispute is interlinked with the conflict over future distribution of defence burdens within NATO and that Trump is apparently prepared to put his geo-economic interests above international law. Trump is also using security policy levers in tariff negotiations to increase pressure on individual Member States and thus divide the EU. Three scenarios outline possible developments.

Scenario 1: Early deal

In the “early deal” scenario, the talks, which have been extended until 1 August, lead to a loose trade agreement similar to the one between the US and the UK. First, the European Commission would suspend the counter-tariffs it already decided on for a trade volume of €21.5 billion, which were intended as a response to the US steel and aluminium tariffs. Second, it would refrain from imposing further counter-tariffs on trade worth €95 billion, which it threatened at the beginning of May in response to the tariffs imposed by Trump on cars and car parts. Brussels would show goodwill and not lodge a complaint with the World Trade Organisation (WTO) against the steel and aluminium tariffs introduced by Trump or against car tariffs.

As part of the early agreement, the EU would accept a general US import tariff of 10 per cent on most goods from the EU, but would be granted fixed quotas for duty-free imports of certain goods (tariff rate quotas [TRQs]), such as certain steel and aluminium products. However, tariffs on most steel and aluminium products would remain at 25 per cent. The US government could indicate that it could reduce the 25 per cent tariffs on cars that have been in place since the beginning of April to 10 per cent if the EU is prepared to make concessions on the regulation of digital companies. The 25 per cent US tariffs on small vans, which have been in place for decades, would remain in force. In addition, the Commission would agree with the Trump administration on new targets for increased imports of liquefied natural gas (LNG) and agricultural products from the US.

Brussels would follow the example of the agreement between the US and the UK, offering Trump close coordination on economic security issues with China. The Commission would explain that it is in the process of tightening EU-wide investment screening and will take decisive action against Chinese mass exports from subsidised overproduction with the help of the anti-subsidy instrument. Furthermore, preparations would be made to use the Anti-Coercion Instrument (ACI) against China to defend against economic coercion measures, such as a renewed embargo on rare earths.

To calm financial markets and counteract a rapprochement between the EU and China at the EU Summit at the end of July, Trump would agree to the deal. Both sides would declare that they want to continue negotiations on outstanding issues, such as the regulation of digital companies.

There remains a significant risk for the EU that a quick deal with Trump would provide only a temporary respite. Further tariffs are looming in the fall and there is a danger that Brussels will make too many concessions too early, without securing permanent exemption from US tariffs for the EU. A fundamental objection to such concessions is that a bilateral trade agreement is incompatible with WTO rules. If the EU were to agree to this, it would be implicitly legitimising the US’s departure from the most-favoured-nation (MFN) principle.

There are two reasons why the EU might nevertheless agree to an early deal. First, economically strong exporting countries in the EU are pushing to avoid higher losses from a tariff escalation with Trump. Second, a majority of EU Member States may oppose a conflict with Trump on two fronts — trade and security. A comprehensive, financially and politically costly trade war would be at odds with the EU’s desire to quickly put itself in a position to take fundamental security policy decisions and finance its own military capabilities. An "economic truce" could buy Member States time and immediately spare them the high costs of a tariff escalation.

Scenario 2: In purgatory

The "purgatory" scenario describes likely agonising negotiations without any discernible compromise. Trump, dissatisfied with the EU's offers, would impose "reciprocal tariffs" of 50 per cent on 1 August.

The European Commission will do everything possible to reach a deal with Trump before 1 August by making minor concessions on tariffs, agreeing to higher LNG and agricultural imports from the US and making a general promise to relax regulation of platform companies in the EU. However, shortly before an agreement were to be reached, US negotiators would demand further dismantling of digital legislation, which the Trump administration believes suppresses free speech and serves only to harm US companies. The US government might demand an end to EU content moderation requirements, arguing that these rules have created a non-tariff trade barrier that disadvantages US digital companies.

In response, the European Commission, in consultation with the heads of government of EU Member States, would impose for the time being the counter-tariffs already decided upon in response to the US steel and aluminium tariffs: a 25 per cent tariff on goods worth €21.5 from 1 August, intended to put pressure on Trump. However, they would refrain from filing a complaint with the WTO and continue intensive negotiations with the US government throughout July.

During the stop-and-go negotiations, Trump would use several political provocations to divide EU Member States, which have so far acted in unison. After taking over the Council Presidency, the Danish government could work with other EU members in July on a proposal for a "better deal with Trump" instead of responding to Trump's demands. Trump and other officials of his administration might once again announce their intention to strengthen Greenland's economic ties to the US for reasons of national security. Speculation would resurface about Trump's plans for a territorial expansion of the US into Danish territory, in presumable violation of international law. The Danish government would have its hands full appealing to the solidarity of other EU and NATO member states in case Trump gets serious, forcing trade issues to take a back seat.

Trump would resort to oppose US sanctions against Russia and again hold back on arms deliveries to Ukraine. Poland, Germany, and the Baltic states would be concerned that the US President might next announce plans to pull US troops out of Germany. Afraid this would send a signal of an "open flank" to Russian President Vladimir Putin, they would therefore call on the European Commission to quickly present Trump with a new, more attractive offer in the trade dispute. At the same time, a group of countries advocating tougher trade measures, led by France, would call for more European sovereignty.

At an ad hoc Council meeting, some EU members may call on the Commission to consider using the ACI against the US, arguing that Trump's latest statements on tariffs more than fulfil the criterion of "threat of economic coercion". Trump could be expected to react angrily on social media to the EU countries' discussions on using the ACI. After heated debates among the EU Member States, a vote would be taken. The vetoes of several Member States would prevent the qualified majority required to initiate the ACI (at least 15 of the 27 Member States, representing at least 65 per cent of the EU population) from being reached. Trump then could announce an imposition of the full range of tariff measures — sectoral and country-specific tariffs — against the EU.

The Commission would continue negotiations with Trump. Instead of the ACI, it would impose outstanding counter-tariffs on goods imported from the US worth €95 billion from 1 September. It had already brought these tariffs into play in May in response to Trump's car tariffs. However, considerable doubts would have arisen about the unity of the EU countries in the trade dispute with Trump. The economic costs of the tariffs already imposed are rising for the EU, which continues to "feel its way" through the tariff dispute with the US President. However, the pressure to act would be insufficient to implement initiatives already launched by the European Commission that are intended to contribute to greater foreign policy sovereignty, such as ReArm Europe, the Capital Markets Union, strengthening the global role of the euro, Global Gateway, and more targeted and more quickly implemented trade agreements with other countries.

Scenario 3: Trade and economic war

In the "trade and economic war" scenario, the tariff dispute between the US and EU completely escalates over the summer. The EU would have accepted a general 10 per cent import duty on all US imports, but not the abolition of its digital laws nor the suspension of Carbon Border Adjustment Mechanism (CBAM) intensive goods from other countries planned for 2026. The President of the European Council would declare that the EU will only negotiate with the US on an equal footing or "not at all". Trump decides to make an example of the EU for all other countries. They are to see how harshly the US President punishes even close allies if they do not accept his demands. In response, he increases the "reciprocal" import duty on the EU to 75 per cent.

From the perspective of the EU countries, Trump's hostility and threats cross several "red lines" in foreign and security policy. Several members of the US government might denounce the EU for suppressing the right of "conservative" parties' freedom of expression with rules on content moderation on social media platforms. The EU has shown no willingness in joint talks to abolish its "discriminatory" laws as demanded. The US President would claim that the EU's Digital Markets Act (DMA) and Digital Services Act (DSA) were only enacted to "rip off" US companies and he would demand that these acts be abolished.

Trump would also claim that the EU is preventing "peace in Ukraine." He would block Congress's plan to tighten economic sanctions against Russia. Instead of agreeing with the EU, he arranges a meeting with Putin. To accommodate the Russian President, Trump would halt further important military support for Ukraine.

Pressure will mount on European NATO members to develop a strategy for continuing to support Ukraine without the US. At the same time, as a meeting between the heads of government of Germany, France, the UK, and Poland with Ukrainian President Volodymyr Zelensky, the US government would announce plans for a significant troop withdrawal from Europe by the end of the year.

A little later, Trump will discuss plans for a "beautiful economic zone" with Greenland. China's activities around the island threaten US national security. The EU is too weak to guarantee Greenland's security, so the US would take control of the territory. Since Greenland belongs to Denmark, the EU would interpret this announcement as a violation of international law. In the view of the European Commission, there would therefore be sufficient evidence to use the ACI measures against the US. As stated in Annex 1 of EU Regulation 2023/2675, the ACI process allows for a whole range of countermeasures, which are not limited to tariffs, but could also affect digital services and the use of intellectual property rights in the EU.

At a Council meeting at the end of July, EU Member States would discuss withdrawing banking licenses and visas for US citizens and would activate the ACI with the necessary qualified majority. The Commission would then inform the US government of the decision and offer talks. At the same time, it launches a consultation process with stakeholders, in particular companies from Member States that could be severely affected by the EU measures and possible US countermeasures.

To put pressure on the EU, Trump would threaten financial sanctions under the IEEPA against the Commission President, the Council President, and other senior EU officials. Trump would also announce a halt to LNG supplies and initiate export controls on software produced by US companies. The trade dispute by this point would long since have escalated into a full-blown economic conflict and diplomatic crisis.

Increased alert

The outcome of the EU's trade conflict with Trump remains open. The three scenarios outlined above are not mutually exclusive. It is possible that the situation could slide from one scenario to another — i.e., from purgatory to economic war — or that there could be an abrupt change, such as from an early agreement to economic war. Trump's erratic decisions make it difficult to prepare for the future of the conflict and to find "safe" paths to a solution. One major difficulty for the Commission is that Trump's objectives for his tariff policy are not clear. If his sole aim is to impose import duties out of a conviction to offset trade deficits, the EU could possibly prevent a tariff war by increasing its imports from the US and giving US companies even better access to the single market. It could lower its tariffs even further and remove certain non-tariff barriers that have been hampering US companies for many years. Finally, there is the option of importing more LNG and/or more expensive military goods from the US. However, it remains unclear to its trading partners whether balancing trade accounts is the Trump administration's sole or decisive goal — is it also about replenishing the treasury, protecting its own industries, or all at once?

The EU and Germany, its economically strongest Member State and political heavyweight, must be prepared in case no agreement is reached in the tariff dispute. Even if a peaceful agreement on an early deal is reached, it must always be borne in mind that Trump could call the agreement into question again. Several conditions are emerging for the confrontation with Trump. Although these are not positive, they are relatively predictable. They therefore provide points of reference for developing policy approaches.

1. The US will maintain its tariffs at a high level. US economic policy is highly likely to remain protectionist for the foreseeable future, as this is in line with the political preferences of both the Republican and Democratic parties. The tariffs already introduced, export controls, and other coercive economic measures, all of which are already having a negative impact on free trade, are unlikely to be the last measures taken. Trump is preparing a barrage of national security-related tariffs that are likely to be upheld by the Supreme Court if challenged at lower courts. In addition, legislative proposals calling for even tougher economic measures against China are gaining support in the US Congress. It now seems inevitable that the US will abandon the WTO's MFN principle and strive for a new economic order in which it, as the centre of the global trading system, will grant other countries preferential access to the US market on a "case-by-case" basis.

2. The separation of powers does not prevent the US President from using "unorthodox" economic coercive instruments. So far, neither US Congress nor the courts have been able to prevent Trump from resorting to the IEEPA emergency law to introduce what appear to be arbitrary "reciprocal tariffs". In the end, the Supreme Court, with its conservative majority, could side with the US President. Even among the ranks of CEOs from the largest US companies, no leader has yet dared to enter into open conflict with Trump on this issue.

3. The EU cannot rely solely on financial markets. Experienced negotiators have advised the EU in recent months to wait for Trump's tariff decisions and not to make too many concessions in advance. There was hope that sharp market reactions would dissuade him from imposing excessive tariffs. In fact, it was primarily anonymous financial market players whose sales of US government bonds and US dollars prompted Trump to back down from his extreme tariff demands in early April. Their reaction expressed doubts about the long-term creditworthiness and strength of the US economy. However, it remains to be seen whether market reactions will prevent the US President from starting a tariff war with the whole world. Waiting and not preparing any effective countermeasures would be a risky strategy.

4. The costs of a trade war with the US are unevenly distributed across the EU and threaten to divide the EU. The direct economic costs of US tariffs are unevenly distributed across the EU, as its Member States vary in their dependence on exports. Export-oriented Member States with high sales in the US, such as Germany, Ireland, and Italy, are particularly affected. If they were to be tempted into bilateral agreements with Trump, the single market would be weakened and the future of the EU as a whole would be at stake.

5. Trump will not stop linking economic and security policy in order to divide the EU. Beyond the use of various trade instruments, further political escalation is also conceivable. The US could use security policy levers — such as its support for NATO or the nuclear umbrella — to assert its economic interests. The problem for the EU is that individual Member States perceive the military threat posed by Russia and other actors very differently. While states on the eastern flank see a potential withdrawal of the US from Europe as an existential threat, others consider the security implications to be less dramatic. This heterogeneity of priorities within the EU could continue to further weaken Europe's ability to respond to Trump's threats.

Recommendations

The German government should continue to take initiatives within the EU to act as a unifying force between economic strength and security. This requires not only financial contributions, but also political leadership in prioritising and coordinating joint European projects. The following measures should be addressed as soon as possible within the EU:

- Establish a mini-lateral coordination format: Set up a strategic coordination mechanism between the economically strongest Member States (including Germany, France, Italy, and the Netherlands) and the states most vulnerable in terms of security policy, i.e., the "frontline states" (Poland, the Baltic states, and Finland). The aim would be to coordinate priorities and avoid blockades to counter Trump's attempts to drive wedges between Europeans.
- Establish a politically supported compensation mechanism for companies: To cushion economic hardship and ensure acceptance, an EU-wide compensation mechanism should be created to provide targeted support to companies in sectors that are potentially most affected by trade and economic wars — in particular, companies involved in security-related transformation, such as ReArm Europe and energy supply or semiconductor production companies.
- Continuing and focusing of investment programs for ReArm Europe: The modernisation and standardisation of European armed forces should be driven forward through targeted investments and joint procurement projects.
- Continuation and strengthening of European investment programmes: Strategic investments in critical infrastructure, technology promotion, and trade diversification should be accelerated and given a stronger geostrategic focus, such as in the form of an expansion of Global Gateway or a strengthening of EU trade with other countries.

For the first time since the Second World War, Americans and Europeans could find themselves not only as economic competitors, but as adversaries with incompatible geopolitical visions. The escalation steps outlined in the above “purgatory” and “trade and economic war” scenarios affect areas that go far beyond tariffs. Not least for domestic political reasons — to distract attention from problems in the US — a tariff war with the EU could benefit Trump. Once the conflict has broken out openly, it will be difficult to dissuade the US President from using further leverage, such as escalating the Greenland issue, withdrawing from NATO, or abandoning security guarantees. It should always be taken into account that for Trump, backing down on threats could mean losing face domestically unless he follows through on some of his threats every now and then.

The EU should therefore avoid open confrontation with the US government in the trade dispute for as long as possible. In anticipation of a situation such as that outlined in the “trade and economic war” scenario, the governments of EU Member States should define for themselves in the coming weeks where they draw the line when it comes to provocation by the Trump administration. If international law is violated and the territorial sovereignty of a Member State is disregarded, the EU should not shy away from using its sharpest “economic sword”, the ACI.

This Comment reflects the author’s views.

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