



# What if Trump is re-elected?

Trade policy implications

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## **JEL-Classification**

E17 – Forecasting and simulation: Models and application

F14 – Empirical studies of trade

F17 – Trade forecasting and simulation

F52 – National security, economic nationalism

F68 – Economic impacts of globalisation: Policy

## Abstract

A possible re-election of Donald Trump as US president in November 2024 could entail a significant upheaval for the world trading order, if he fulfills his announcements to raise tariffs, mainly in order to reduce the US trade deficit. Such steps would not only have a negative effect on the world economy – and this at a time of significant global strains. They would also deal a further blow to the WTO, as the envisaged tariff increases would clearly violate international trade rules. Transatlantic relations with the EU are also likely to suffer. First, old trade disputes that were largely settled with the Biden administration could flare up again, e.g. regarding steel and aluminum. Second, Trump could abolish co-operative measures by the Biden administration that mitigate the protectionist elements of the US Inflation Reduction Act for EU exporters. Third, the future of the EU-US Trade and Technology Council (TTC) might be jeopardised.

This report simulates the impact of two scenarios. Scenario 1 entails an increase of US tariffs to 10 per cent on all US imports and to 60 per cent on US imports from China in 2025. These threats have been publicly envisaged by Donald Trump and his former trade advisers. In scenario 2, in reaction to scenario 1, China would retaliate with a tariff increase of 40 percentage points on imports from the US. The following results of a simulation of the two scenarios with the Global Economic Model of Oxford Economics for the four years of a potential second Trump term from 2025 to 2028 stand out:

The US economy, i.e. the real US GDP level, would be negatively affected in the first years in the range up to minus 1 to minus 1.4 per cent in the two scenarios compared to the baseline scenario. This is in part due to a simulated temporary confidence shock in the short term that has adverse effects on private investment and consumption. Moreover, private consumption decreases also as a result of higher consumer prices and higher unemployment. Cumulated GDP losses (in constant prices) over the 4-year horizon amount to nearly 600 billion US dollars in scenario 1 and nearly 1,000 billion US dollars in scenario 2. In scenario 1, however, the US GDP level would remain only marginally negative compared to the baseline in 2028. This is mainly because of the temporary nature of the confidence shock and the improvements of the trade balance, the fiscal balance and the terms of trade relative to the baseline scenario. However, in case of a retaliation by China in scenario 2, the US would suffer GDP losses also in the medium term, in the range of about half a percentage point of GDP with a slowly decreasing trend after 2028.

Regarding the US trade balance, it is striking that the tariff shocks would improve it only relative to the baseline scenario; in absolute terms the trade balance would decline further. This is because other trends like the high US government deficit are more important macroeconomic drivers of the trade balance than tariffs. Moreover, the US loses competitiveness due to an appreciation of the real effective exchange rate which tends to raise imports and reduce exports. This shows that the approach of Trump and his advisers, to raise tariffs in order to reduce the US trade deficit, is fundamentally flawed from an economic point of view, particularly if the US and particularly the government continue to be large net borrowers in a global context. The same was basically true for Donald Trump's first term when generous tax reductions contributed to further increasing the US government deficit. As a result, the US trade balance hardly changed between 2016 and 2019 (and remained at 2.7 per cent of GDP) despite significantly higher tariffs against China.

The world economy would be hit harder than the US by the simulated tariff shocks. In scenario 2, the level of world GDP would be more than 1 per cent lower than in the baseline scenario in 2028. Moreover, world trade would be negatively affected as well. This can be illustrated by looking at Germany as an example of a

rather export-oriented economy. In scenario 2, the demand of Germany's main export partners would decline by about 5.5 per cent relative to the baseline scenario in 2028. This translates into a decline of German exports of 4.5 per cent. As a result, private investment declines considerably in Germany. In absolute values, it would be 27 billion euros lower in scenario 2 and would thus contribute more than half to the total GDP loss of about 50 billion euros in 2028 (in constant prices). This is equivalent to a decline in the German GDP level of about 1.4 per cent relative to the baseline scenario. However, also in scenario 1 a GDP loss of 1.2 per cent would result in 2028, a significantly larger decline than for the US. In absolute terms, the cumulated GDP losses (in constant prices) over the 4-year time horizon amount to more than 120 billion euros for Germany in scenario 1 and to nearly 150 billion euros in scenario 2. The main reasons for the difference to the US lie in the fact that Germany is more export-oriented and that its trade balance would deteriorate while the US trade balance improves. The EU would also be hit harder than the US.

Given the negative effect of a potentially renewed protectionism under Donald Trump, the EU should proceed along two lanes: First, the EU should prepare for such a scenario now. Before all, the EU should use the remaining term of President Biden to put the trade relations with the US on a more solid footing. In the best case, this could be achieved by institutionalising the TTC (Benson, 2024) and by convincing the Republican party in Congress that the TTC is a key forum to coordinate trade policies vis-à-vis China with the EU. Moreover, signing a critical minerals agreement and a Global Arrangement on Sustainable Steel and Aluminum would be important steps to reduce the likelihood of a backlash of Donald Trump with regard to transatlantic trade relations. A further step should be for the EU to foster its relations with other trading partners by signing more free trade agreements, such as with Australia, the Mercosur, Indonesia, or India. Second, if Trump was elected and would threaten to implement new trade barriers against the EU, the EU should be able to react. To counter such a threat, the EU should be willing to also threaten credible retaliation measures. For such purposes, the Anti Coercion Instrument was recently implemented and could provide the framework for possible retaliatory measures of the EU. While it is true that retaliation would aggravate the trade war and also the detrimental economic effects, it appears necessary to have a counterstrategy founded in *Realpolitik*.

## 1 Introduction

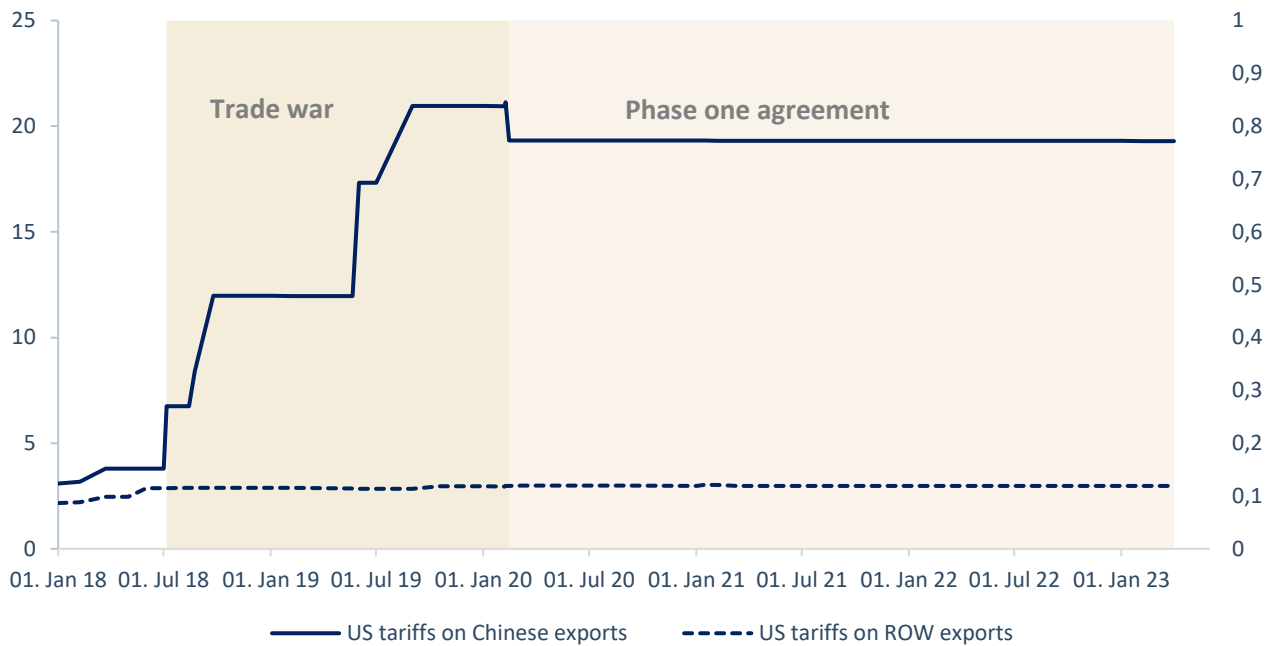
A possible re-election of Donald Trump in the US presidential election on 5 November 2024 would very likely have serious consequences for international trade policy and transatlantic trade relations. Current polls indicate that the likelihood of Trump being re-elected appears to be high currently. Trade policy was a focus area of Trump's first term in office, which was particularly characterised by a major trade war with China. Trump and his trade advisers aimed at reducing the large US trade deficit with China and were also critical of trade deficits with other trading partners like the EU. In their view, trade deficits were a sign that the US is at a disadvantage and that they represent a threat to US employment. It is not yet clear how the Republican party would position itself under a new Trump presidency. However, there are ominous signs that a second term in office could be even more detrimental to global trade policy than his first term.

In fact, Trump's first presidency was characterised by numerous new trade barriers and severe irritations in transatlantic and global trade:

- The US imposed tariffs of 25 per cent on steel exports and of 10 per cent on aluminum exports from many countries – EU exporters were also affected. The tariffs relied on Section 232 of the Trade Expansion Act of 1962 and on an allegation that these metal imports threatened US national security. The EU retaliated – as did many other countries – with punitive tariffs on exports from the US. Later, a panel of the World Trade Organization (WTO) dispute settlement system ruled against the US section 232 tariffs, but the US appealed into the void as the WTO's Appellate Body is currently not functional (see below).
- The US levied (legal) tariffs against certain EU exports based on a WTO ruling in reaction to unlawful EU Airbus subsidies. About a year later, the EU was also allowed to raise tariffs on US exports because the US had been found to have illegally subsidised Boeing.
- During his presidency, Donald Trump continually threatened to impose higher tariffs on European car exports. Such a step would have hurt German car exporters in particular.
- Donald Trump waged a trade war with China by increasing tariffs on Chinese imports from 3.1 per cent in January 2018 to up to 21 per cent in September 2019 (see Figure 1-1). They decreased again slightly to 19.3 per cent in February 2020 under the Phase-one trade agreement between the US and China. Among structural and reform and other changes, this agreement also required China to increase its imports from the US in order to rebalance trade relations between the US and China (Office of the United States Trade Representative, 2019). However, the agreement has hardly been consequential.
- In the trade war with China, the administration acted almost entirely unilaterally and did not seek to close ranks with like-minded Western countries.
- In addition, the US refused to reappoint members of the Appellate Body at the WTO Dispute Settlement Body, thereby paralysing its jurisdiction.

**Figure 1-1: US tariff rates towards China and rest of world**

in per cent



Source: Bown, 2023

## 2 Expectations for trade policy after a Trump re-election

It is likely that during a second term Donald Trump would stick to his protectionist trade policy (Bade, 2023a; The Economist, 2023). But with the experience of his first term in office, he and his team would be better prepared. The Heritage Foundation has prepared a kind of template for a Republican government with its 2025 Presidential Transition Project (Heritage Foundation, 2023). The chapter on trade has been jointly written by Peter Navarro and Kent Lassmann (Lassmann/Navarro, 2023). Navarro's argument centers around the notion that trade is not fair and, therefore, the US suffers from large trade deficits with most of its trading partners. This contrasts with the view of Lassmann, who argues in favour of free trade and trade agreements. Thus, it is not yet entirely clear, which direction trade policy will take. Yet, given that Navarro was already Director of the Office of Trade and Manufacturing Policy in the first Trump administration and that it is speculated that he will hold a key position in a second Trump term, it is likely that the protectionist agenda will prevail. Moreover, Robert Lightizer, former US Trade Representative during Trump's first presidency and potentially again a future trade official or at least an influential adviser, also favours raising tariffs to reduce the US trade deficit (Bade, 2023b).

It is true that the Biden administration has kept most of Trump's measures against China in place. However, the trade policy stance against China could become even harsher under a future Trump administration. This is also related to the fact that the Chinese economy is currently under strain due to the distress in the real estate sector, which had long been the country's growth engine. This has played an important role in making Chinese consumers cautious to spend. The relatively weak economic growth in China is also due to the fact that there have been no significant fiscal stimuli yet. The Chinese government is therefore keen to expand exports as a key driver of growth. In order to shield themselves from the Chinese production surplus, many



countries are likely to protect their markets against Chinese competition and overcapacities. A potential Trump administration is likely to follow this course with even more vigour.

Some of the looming threats during a second Trump term for **global trade policy** include:

- Trump has threatened that he would levy a duty of at least 10 per cent on all imports (FoxBusiness, 2023). The explicit aim of this would be to reduce the US trade deficit. The revenues could be used to finance tax reductions.
- In line with the above-mentioned economic trends, China could face an even higher import duty of 60 per cent (Picciotto, 2024). As mentioned above, the still large US trade deficit with China is the key bone of contention for Trump and his potential advisers.
- Trump might even raise tariffs above 10 per cent on countries that levy higher tariffs on imports from the US, such as India, Brazil and many emerging market countries. The aim of such a step, which is propagated e.g. by Peter Navarro (The Economist, 2023), would be to establish reciprocity (FoxBusiness, 2023), i.e. a similar tariff level on both sides.

There are also threats to **transatlantic trade relations**:

- Under the Biden administration, it was possible to calm the trade dispute over US tariffs on steel and aluminum and prevent further escalation. Despite significant relief, however, some restrictions on EU steel exports remained in place, as only previous export volumes were made duty-free again, meaning that tariffs continue to apply to EU exports beyond this threshold. Furthermore, it was not possible to find a lasting solution to the steel dispute. Donald Trump could revoke the relief. The EU would very likely respond to this with the retaliatory measures it had already prepared, which it had also only temporarily postponed following the agreement with the Biden administration. Ideally, this potential threat could act as a sufficient deterrent. Moreover, if the EU should manage to conclude the current negotiations with the Biden administration on a Global Arrangement on Sustainable Steel and Aluminum, this could also act as a certain safeguard against a renewed escalation of the steel dispute under a Trump administration. However, the negotiations are difficult for the EU as the Biden administration wants the EU to largely ban the imports of Chinese steel and aluminum from the EU market, even if there might be serious doubts that the instruments to achieve this aim do adhere to international trade rules.
- Another potential trade policy risk for the EU is that a Trump administration could revoke the relief for EU exports in terms of access to the support measures of the US Inflation Reduction Act (IRA). An important issue here is the export of electric vehicles (EVs) from the EU. Many of these vehicles would not be eligible under the original IRA rules. However, the Biden administration has aimed for pragmatic solutions to accommodate the EU's interests in the course of implementing the IRA. To this end, it has for example allowed leased vehicles to be classified as commercial vehicles that are not subject to the IRA access restrictions. A Trump administration could reverse this rule and thus make the exports of European EVs considerably more difficult. The EU could hardly do anything to counter this. However, a certain safeguard could be the critical minerals agreement which is currently negotiated between the EU and the US. To explain: The IRA stipulates that for electric vehicles to be eligible for financial support an (over time increasing) minimum percentage of the critical minerals in the batteries must come from the US or from a country that has a free trade agreement with the United States. Should the EU and the US succeed in concluding a critical minerals agreement, this could be interpreted as a free trade agreement so that exported EVs from the EU would be eligible. While this interpretation could be revoked by a Trump administration, the existence of an agreement could be a certain disincentive to do so.

### 3 General consequences for the WTO, the EU and global trade

By imposing a universal tariff of 10 per cent on all imports, the USA would fundamentally violate international trade rules. For numerous product groups, for which the US has bound its tariffs in the WTO at a lower level, an increase beyond this level is not permitted in general. Violating this restriction would presumably provoke immediate retaliatory measures from many trading partners. This is also because the normal legal process of filing a complaint with the WTO would not be effective, as the USA would very likely not abide by a ruling by the WTO arbitration panel and such a procedure would also take too long. As a result, many countries are likely to respond with direct retaliatory measures and impose higher tariffs on US products. As a rule, they would likely also violate WTO law because they would not initiate WTO proceedings and wait for the outcome. The consequences would be a trade war between the US and many of its trading partners and a further weakening of the WTO.

The EU market would come under pressure due to trade diversion effects. Products that were previously exported to the USA by other countries would look for new markets. As the EU is a similar market to the US, import pressure is likely to increase in Europe (and also in many other countries). In the case of steel and aluminum, the EU imposed protective measures against steel and aluminum imports from other countries in response to Trump's tariffs and the resulting diversion effects in order to limit import pressure in the EU metal markets. A similar reaction might be needed in other fields in case of a universal tariff of 10 per cent. For example, in the case of EVs, it is already clear that Chinese vehicles in particular have hardly any sales opportunities in the US due to high US tariffs and other barriers and are therefore pushing even harder for the EU market. For many other products, a universal US tariff of 10 per cent is also likely to lead to this, with US tariffs for Chinese products of 60 per cent all the more so. If the import pressure becomes too strong, the EU may also resort to general protective measures here, as with steel and aluminum.

The incentives for EU companies to relocate their production to the US would increase significantly. This is because higher tariff barriers, a trade war and the uncertainty as to whether the conflicts will escalate even further would make exports from the EU more difficult. If European companies want to serve the important US market under these more difficult conditions, they could do so more safely if they produce locally in the USA. Such a relocation would cost jobs in Europe. Donald Trump, on the other hand, would feel vindicated, because investments, added value and employment in the USA would increase.

In general, transatlantic relations would also be significantly affected. Under the Biden administration, the Trade and Technology Council (TTC) succeeded in establishing an intensive exchange between the EU and the US administration at various levels. It seems questionable whether this format can be maintained under Donald Trump. As the TTC is also used by the EU and the US to coordinate trade and technology policy activities vis-à-vis China, this would also be in the interests of the Trump administration. However, it is entirely conceivable that Donald Trump will once again reject cooperation with like-minded countries and act unilaterally, as he did during his first term in office.

## 4 Empirical analysis of US tariff increases

### 4.1 Model and assumptions

In the following, the effects of US tariff increases are simulated using the Global Economic Model of Oxford Economics, which is a macroeconomic model of the global economy. It is based on both theoretical relationships and empirically determined parameters. In the long term, the model is monetarist, meaning that long-term economic development is determined by supply-side factors such as labour supply and capital stock. In the short term, it is primarily demand-side driven. Trade policy mainly influences the demand of private households and companies for foreign goods. The model includes the trade relations between the US and its largest trading partners China, Canada, Mexico, Japan, Korea, Taiwan and the EU-28 (including the United Kingdom). The model captures both the direct effects of the modelled changes and the associated second-round multiplier effects at home and abroad. This means that the economic effect of increased import tariffs can be analysed for the two countries of interest here, the US and Germany. Furthermore, it allows an understanding of the effects on global GDP. However, it should be mentioned that the model covers only 85 economies in detail and six regional blocs are linked through trade, prices, exchange rates and interest rates. The model does not cover China's various trade relations with its trading partners, but mostly only with the US. For this reason, the effects on the Chinese Economy are not considered in this analysis. Moreover, the macroeconomic model does not contain detailed trade data on a disaggregated basis, so only the effects of average tariff changes can be considered.

Two scenarios for a possible change in US trade policy are analysed in the following model simulations:

- **Scenario 1:** An increase of average US tariffs to 10 per cent on all trading partners' imports (except China) and an increase to 60 per cent of the average US tariffs on Chinese imports. This implies different tariff increases for different countries depending on the current average level of US tariffs on the imports of the respective countries. For China, for instance, this implies an increase of average US tariffs of about 40 percentage points compared to the current level of close to 20 per cent.
- **Scenario 2:** Identical increases of average US tariffs as in scenario 1; in addition, China retaliates with an increase of its average tariff on US imports by 40 percentage points.

In both scenarios presented here, it is assumed that changes in import tariffs in the US and China leave the Federal Reserve's monetary policy unchanged.

In the first scenario, the average US tariffs are raised by 10 percentage points on US imports from Canada, Mexico, and Korea, as the average most-favoured nation (MFN) tariff rate is currently zero. This is because the US has free trade agreements with these countries. For the EU-28, Japan and Taiwan, the current MFN US import tariffs are currently at levels between 1 and 2 per cent. Therefore, the average tariff rates are raised to 10 per cent. For the EU-28 this means, for instance, that the average US import tariff is increased by 8.55 percentage points. In 2025 the respective increases are introduced, and the new tariff level is kept until the end of the time horizon regarded here. The exogenous tariff shock is modelled through various transmission channels, these include confidence shocks in the short run that plausibly result from the aggressive trade policy measures by the US. American consumer and business confidence, as well as US equity prices are hence negatively affected. However, the confidence shock is modelled to fade out after a few years while the economic impact of the tariff shock remains.

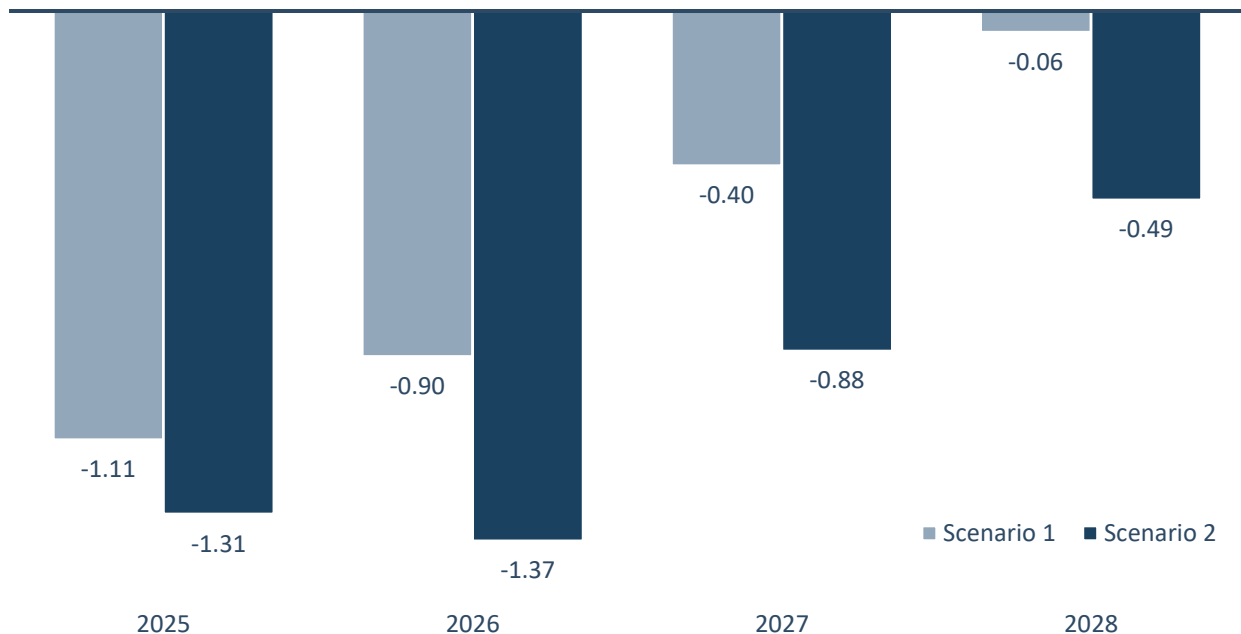
## 4.2 Effects on the US economy

Figure 4-1 illustrates the economic effects of scenario one and scenario two in the US for the time horizon chosen here, i.e. the 4-year period of a potential Trump presidency from 2025 to 2028. The results for the two scenarios are compared to the baseline scenario without tariff increases. Hence, the exogenous shocks are introduced as outlined above under ceteris paribus conditions which makes the baseline scenario the reference point. Figure 4-1 outlines several important economic effects:

- The GDP level deviation (in per cent) from the baseline is generally stronger in scenario 2 than in scenario 1 because China retaliates with a 40-percentage point increase on US imports to China.
- The adverse GDP effects reach a maximum of  $-1.1$  per cent in scenario 1 in 2025 and  $-1.4$  per cent in scenario 2 in 2026. It is plausible that the peak of the negative effect comes later in scenario 2 than in scenario 1, since it takes time for the impact of China's retaliation to materialise through the accelerator and multiplier effects that are relevant in the model.
- The negative GDP effects are strongest in the first two years but diminish over time. In scenario 2, the GDP level in the US remains negative with  $-0.49$  per cent in 2028 and in scenario 1 reverses almost back to 0. The main drivers behind the reduction of the negative impact in both scenarios are the temporary nature of the confidence shocks as well as the improved trade balance in the US. Further explanations are provided below.

**Figure 4-1: Economic impact of envisaged tariff increases by Donald Trump – in the US**

Comparison of two scenarios with baseline, GDP level deviation in the respective year in per cent



Note: Baseline: Scenario without tariff increases; scenario 1: US levies a 10 per cent tariff on all trading partners' imports (except China) and a 60 per cent tariff on US imports from China, which equals a tariff increase of 40 percentage points; scenario 2: US tariff increases as in scenario 1 and, additionally, China retaliates by increasing its tariff on US imports by 40 percentage points.

Sources: Oxford Economics; German Economic Institute

There are additional economic effects behind the GDP impact illustrated in Figure 4-1:

- First, because of the significant real GDP decline, total employment in the US would fall by 535 thousand in scenario 1 and 720 thousand in scenario 2 at its peak in 2026. Like the GDP effect, the employment losses would decline afterwards.
- Second, the consumer price level in 2025 would increase by about 0.9 per cent in scenario 1 and by 0.8 per cent in scenario 2 compared to the baseline scenario, as higher tariffs raise import costs that are passed on to consumers. The level of consumer prices remains elevated in 2028 indicating a durable loss of purchasing power.
- Third, the terms of trade, i.e. the relation between export and import prices, would improve in the US. This effect fades out after 2028.
- Fourth, the federal budget balance would improve significantly due to higher revenues from increased import taxes. In scenario 1, the annual budget balance in 2025 would be 14 per cent lower than in the baseline scenario, with the overall effect increasing to 24 per cent in 2028. Gross government debt in 2028 would be almost 3 per cent lower than in the baseline scenario, which amounts to a reduction of 1.3 trillion US dollars. In scenario 2 the effects on the federal budget balance and gross government debt would still be positive, but less strong. Gross government debt would be 2.4 per cent lower in 2028 than in the baseline scenario. The improvement in the federal budget balance would be 22 per cent in 2028.

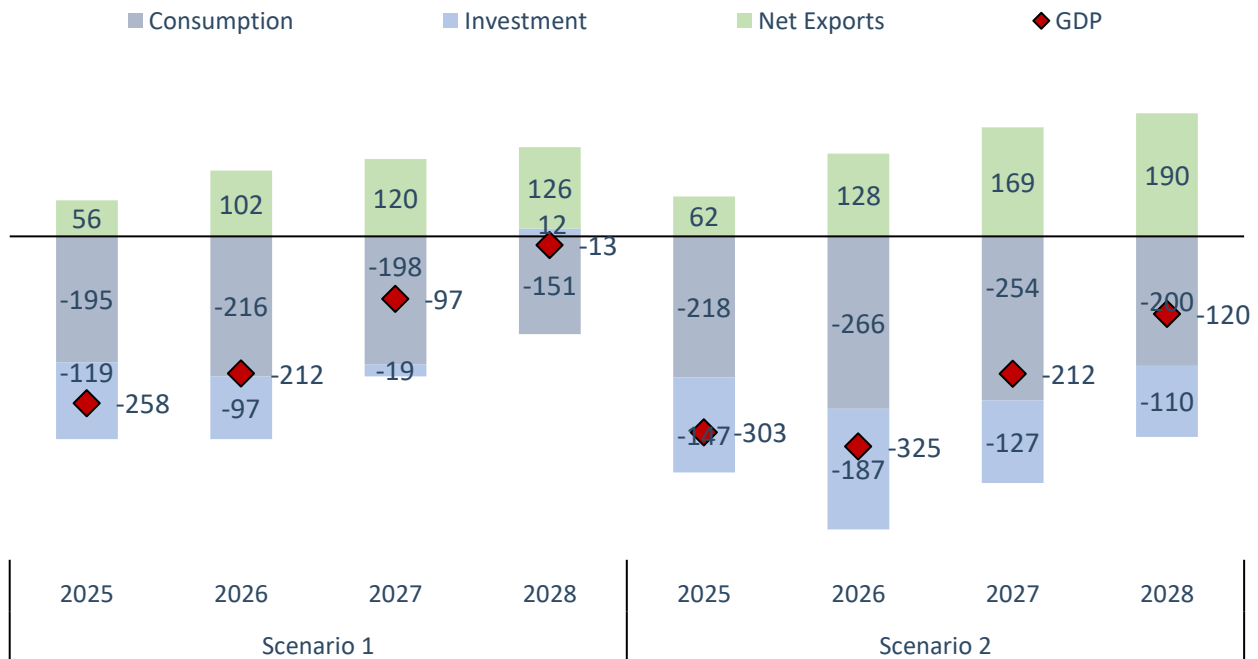
The model results show that the simulated US import tariffs increases lead to significant adverse effects for the US in the short term. In the medium term, however, the US is hardly affected in scenario 1 and moderately negatively affected in scenario 2. This result broadly corresponds to former research on a US-China trade war during Donald Trump's first presidency (Felbermayr/Steininger, 2019): The study found that the US would benefit from moderate tariff increases on China, if China does not retaliate. This finding is based on the optimal tariff argument from economic trade theory, which postulates that moderate unilateral tariff increases of a large country can lead to an improvement in the country's terms of trade because the tariff reduces the country's demand for imports and thus, under normal conditions, the country's import prices. However, also in line with the results of this report, the study by Felbermayr and Steininger (2019) found that US GDP would decline if China retaliates.

To gain a better understanding of what is driving the results in the US, a disaggregation of GDP into the main components of aggregate demand is considered: private consumption, private investment, and the trade balances. It is not necessary to consider government spending, as the tariff changes do not lead to a deviation from the baseline in the model.

Figure 4-2 shows these three components of real GDP in the US between 2025 and 2028 for both scenarios. In contrast to Figure 4-1 the deviations from the baseline scenario are considered in billions of US dollars (at constant prices). The red diamond shows the total GDP effect. In scenario 1, the total loss of real GDP amounts to 258 billion US dollars (–1.1 per cent in Figure 4-1) in 2025, with the effect declining to a loss of real GDP of only 13 billion US dollars (–0.06 per cent in Figure 4-1) in 2028. Over the 4-year period, the cumulated GDP loss amounts to 580 billion US dollars (in constant prices). In scenario 2, the total loss is significantly higher with 960 billion US dollars (in constant prices) and would further increase in the following years after 2028.

**Figure 4-2: Impact drivers of envisaged tariff increases by Donald Trump – in the US**

Comparison of two scenarios with baseline, deviations in billion US dollars, in constant prices



Note: Baseline: Scenario without tariff increases; scenario 1: US levies a 10 per cent tariff on all trading partners' imports (except China) and a 60 per cent tariff on US imports from China, which equals a tariff increase of 40 percentage points; scenario 2: US tariff increases as in scenario 1 and, additionally, China retaliates by increasing its tariff on US imports by 40 percentage points.

Sources: Oxford Economics; German Economic Institute

These effects can be explained by looking at the components of aggregate demand:

- The main reason for the rather limited negative GDP effects lies in the substantial and increasingly positive effect of the tariff shocks on the **US trade balance**. In 2025, the shock-induced difference to the baseline scenario amounts to 56 billion US dollars and increases to 126 billion US dollars in 2028. In both – the baseline and the first scenario – the trade balance is thus deteriorating but it remains 11 per cent less negative in scenario 1 compared to the baseline. In total, in scenario 1 the US trade balance would remain below 1 trillion US dollars with minus 938 billion US dollars in 2025. In the baseline scenario it deteriorates faster and almost reaches that threshold with roughly 994 billion US dollars in the same year. In scenario 2 (when China retaliates) the trade balance improves even more than in scenario 1 – up to 190 billion US dollars or 17 per cent in 2028. The US trade balance would hence improve to minus 922 billion US-Dollars, compared to the baseline where the US trade balance deteriorates to 1.11 trillion US dollars. The improvement of the trade balance results from the fact that US imports decline more than US exports. This is particularly true for scenario 2. The import decline mainly results from the tariff increases. The export decline is a result of the fact that the world economy is also negatively affected and, thus, also the demand for US exports declines (see chapter 4.3). This negative effect on US exports is even more pronounced in scenario 2. However, in all three scenarios the overall US trade balance declines further and reaches minus 1 trillion US-dollars in the longer term, in the baseline scenario in 2026, in scenario 1 in 2029 and in scenario 2 in 2030. Hence, the tariff shock does not lead to a sustainable improvement in the trade balance but only slows down its deterioration. The negative trade balance is mainly due to the fact that the US economy has an overall financing deficit which is the macroeconomic mirror of a current account deficit. As long as the US remains a large net borrower in a global context, any attempts to significantly reduce the US trade deficit with tariffs tends to be in vain. Moreover, it has

to be taken into account that the US effective exchange rate is likely to appreciate to a certain extent. This – together with tariff-induced higher prices in the US relative to its trading partners – tends to counterbalance the improvement in the trade balance as a real appreciation of a currency usually raises imports and decreases exports.

- **Private consumption** is the main driver of the negative overall GDP effect. Figure 4-2 shows that the negative consumption effect is substantial with –216 billion US dollars in scenario 1 and more than –266 billion US dollars in scenario 2 compared to the baseline scenario in 2026. While the adverse effect remains until 2028, it becomes somewhat less negative over time. This finding can be explained by several factors: Private consumption would decline mainly due to the higher consumer price level (and a resulting lower purchasing power of private households), higher unemployment, lower personal incomes due to the GDP decline, and the components of the temporary confidence shock, i.e. the decline in consumer confidence and the negative wealth effect of lower equity prices. As mentioned above, the confidence shock is assumed to fade out over time which contributes to the reduced extent of the negative effect on private consumption. Endogenous effects also work in this direction: As the GDP effect and the employment effect become less negative over time, this feeds back also to private consumption.
- **Private investment** also contributes to the negative GDP effects, but to a lesser extent than private consumption. In scenario 1, the negative effect amounts to almost 120 billion US dollars in 2025 and in scenario 2 and to nearly 190 billion US dollars in 2026 compared to the baseline scenario. The extent of the negative effect, however, declines even more than for private consumption. In scenario 1, the effect on private investment even turns slightly positive in 2028. This development can be explained by several factors. First, as with private consumption, two factors contribute to this: the temporary nature of the confidence shock and the reversal of the negative effect on GDP and thus on personal disposable incomes over time. Second, private investment profits from the improvement of net foreign demand that is reflected in the improved trade balance as well as from a falling world oil price due to falling global demand. Third, private investment will benefit from lower financing costs, i.e., lower corporate bond yields and real corporate borrowing rates, in the medium term. While financing costs initially increase in 2025, they decline after 2026 due to lower governments capital demand (less crowding out), which reflects the improvement in the fiscal budget balance. Finally, there is also a small reduction in capital costs (non-labour costs) as falling export prices (fuel and non-fuel exports) lead to lower producer prices.

### 4.3 Effects on the world economy and German economy

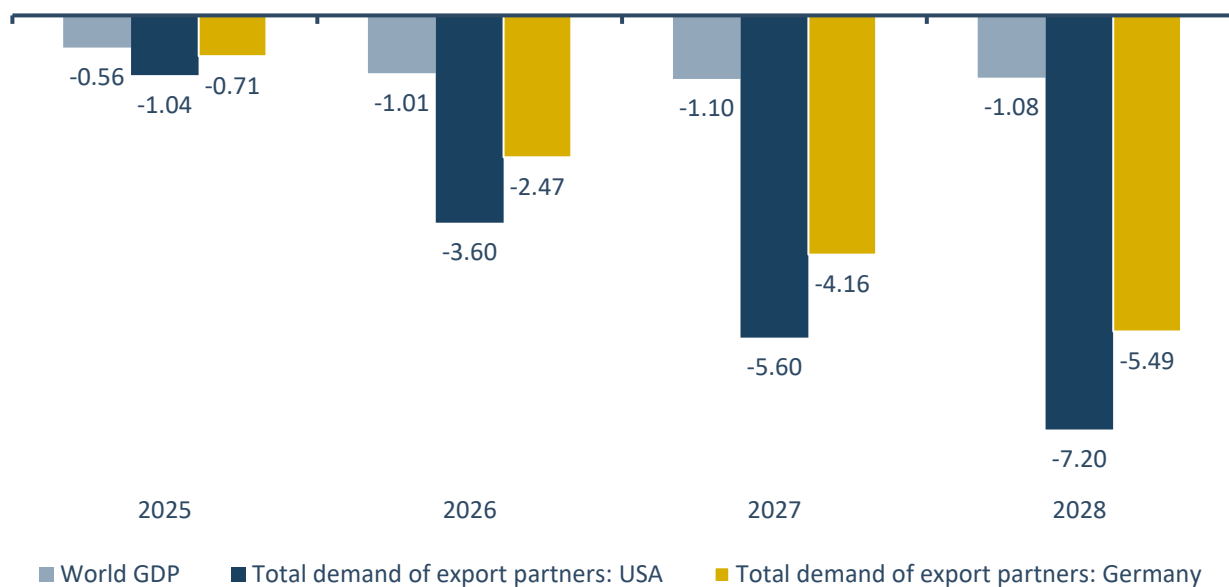
The Global Economic Model of Oxford Economics also allows for an estimation of economic effects on the world economy. However, as mentioned above the model covers only 85 economies in detail linking six regional blocks with each other.

Figure 4-3 illustrates the effect on the global economy as well as on world trade from the perspective of the US and Germany for scenario 2, in which China retaliates. The results for scenario 1 are very similar, hence only the results of scenario 2 are considered here. World GDP (in constant prices) would clearly suffer from the tariff shock. Compared to the baseline scenario, it would be almost 0.6 per cent lower in 2025, with the effect peaking at 1.1 per cent in 2027.

Looking at external demand, i.e. the demand of the respective export partners<sup>1</sup> of the US and Germany, there are significant adverse effects following the US tariff increases. The US experiences larger adverse effects on its external demand than Germany. The demand from US export partners declines by 7.2 per cent compared to the baseline scenario in 2028, while it decreases by roughly 5.5 per cent from a German perspective. Two intertwined aspects play a role here: On the one hand, external demand decreases by less for Germany because the US, as one of Germany’s main trading partners, is less affected than the world economy so that there is no mitigating effect for the external demand from the US perspective. On the other hand, as the US is a large and relatively closed economy, it naturally suffers less from external demand shocks.

**Figure 4-3: World economic development in scenario 2**

Comparison of scenario 2 with baseline, deviations from baseline in per cent



Note: Baseline: Scenario without tariff increases; scenario 1: US levies a 10 per cent tariff on all trading partners’ imports (except China) and a 60 per cent tariff on US imports from China, which equals a tariff increase of 40 percentage points; scenario 2: US tariff increases as in scenario 1 and, additionally, China retaliates by increasing its tariff on US imports by 40 percentage points.

Sources: Oxford Economics; German Economic Institute

The effects in Germany are also analysed below. Germany is chosen as an example of a rather open and export-oriented economy that could potentially suffer particularly from unilateral US tariff increases and a more severe trade war between the US and China. Figure 4-4 shows the GDP level deviation in Germany for both scenarios between 2025 and 2028. In comparison to the US, the economic impact is negative in both scenarios, and the effects become increasingly negative as the exogenous trade shock takes time to materialise in the German economy. In 2028, German GDP is about 1.2 per cent lower in scenario 1 and about 1.4 per cent lower in scenario 2 than in the baseline scenario. The negative effect is therefore slightly larger than the maximum negative effect in the US. The cumulated GDP losses (in constant prices) over the 4-year time

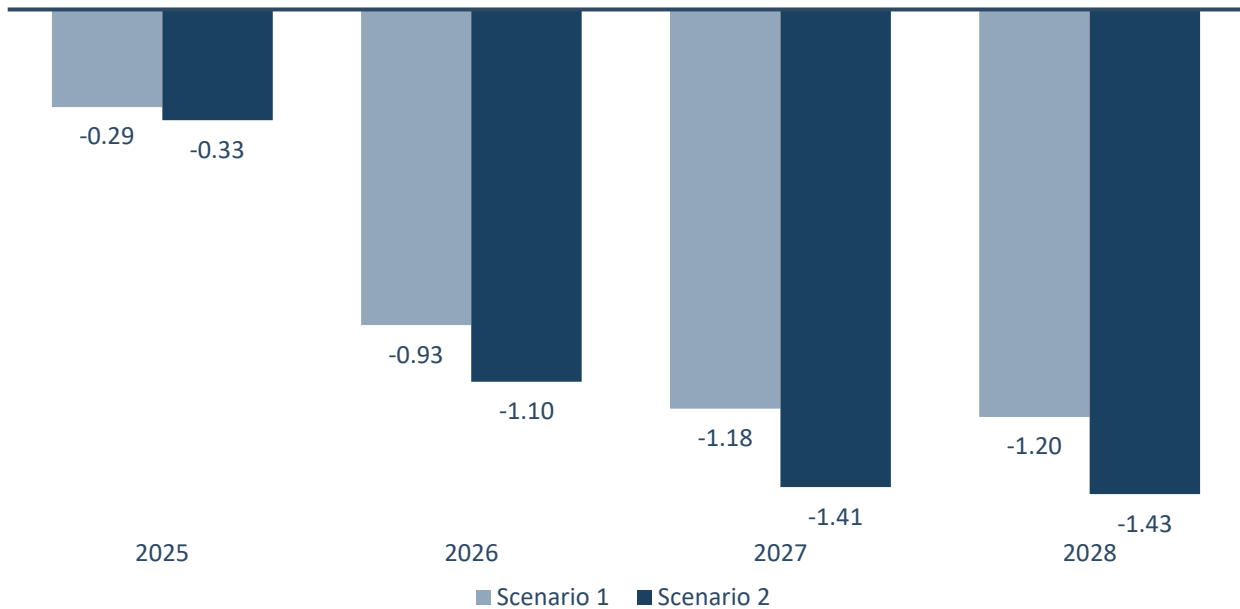
<sup>1</sup> The model incorporates external demand from a country’s perspective through a variable called world trade index. It relates only to non-fuel goods; but reflects the bulk of trade. It takes into account the demand for exports by a country’s trading partners weighted by those partner countries’ shares in the exports of the given country, e.g., the US or Germany.



horizon amount to approximately 123 billion euros in scenario 1 and 146 billion euros in scenario 2. Besides, the model shows that the EU would also be hit harder than the US.

**Figure 4-4: Economic impact of envisaged tariff increases by Donald Trump – in Germany**

Comparison of two scenarios with baseline, GDP level deviation in the respective year in per cent



Note: Baseline: Scenario without tariff increases; scenario 1: US levies a 10 per cent tariff on all trading partners' imports (except China) and a 60 per cent tariff on US imports from China, which equals a tariff increase of 40 percentage points; scenario 2: US tariff increases as in scenario 1 and, additionally, China retaliates by increasing its tariff on US imports by 40 percentage points.

Sources: Oxford Economics; German Economic Institute

The following additional effects (not illustrated here) are also relevant:

- Total employment in Germany would decline compared to the baseline scenario in 2028: by 195,000 persons in scenario 1 and by 233,000 persons in scenario 2. This is equivalent to an increase of almost half a percentage point in the unemployment rate.
- The level of the consumer price index falls slightly in both scenarios compared to the baseline scenario. For instance, in scenario 2 the annual inflation rate would be 1.77 per cent instead of 2 per cent in the baseline scenario in 2028.

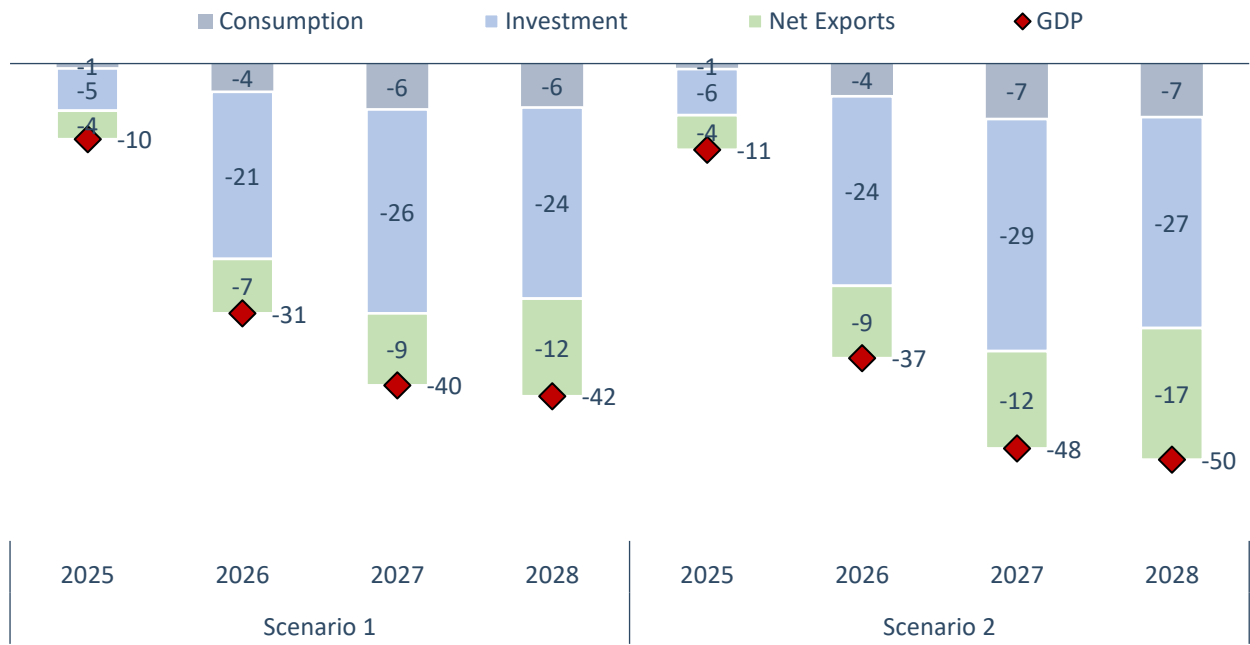
As figure 4-5 shows, the German economy would experience a loss in real GDP of 42 billion euros in scenario 1 and 50 billion euros in scenario 2 compared to the baseline scenario in 2028. A closer look at the components of aggregate demand helps to understand what is causing the total GDP effect. Remarkably, the effect on all depicted components is negative:

- In contrast to the US, the impact on the German **trade balance** is negative – and this effect even increases over time. The deterioration in the German trade balance is substantial with 12 billion euros in scenario 1 and 17 billion euros in scenario 2 compared to the baseline scenario in 2028. German **exports** fall more sharply than German imports in both scenarios. The export decline amounts to 3.7 per cent in scenario 1 and 4.5 per cent in scenario 2 in 2028 (not depicted in the figure here). This is mainly reflects the negative

impact of the US tariff increase on the world economy and the resulting significant decline in external demand for German exports from its main trading partners (see figure 4-3).

**Figure 4-5: Impact drivers of envisaged tariff increases by Donald Trump – in Germany**

Comparison of baseline with two scenarios, real GDP aggregates deviations in billions of euros



Note: Baseline: Scenario without tariff increases; scenario 1: US levies a 10 per cent tariff on all trading partners’ imports (except China) and a 60 per cent tariff on US imports from China, which equals a tariff increase of 40 percentage points; scenario 2: US tariff increases as in scenario 1 and, additionally, China retaliates by increasing its tariff on US imports by 40 percentage points.

Sources: Oxford Economics; German Economic Institute

- Private investment** is the main contributing factor to the decrease in Germany’s GDP. In scenario 1, private investment declines by up to 26 billion euros and up to 29 billion euros in scenario 2 in 2027. This decrease accounts for more than half of the GDP decline. One of the main drivers for this negative impact is the considerable decline in exports and thus GDP, which matters for investment demand in the short term. In addition, the increase in tariffs on US imports from Germany – as well as the confidence shocks in the US – lead to a negative confidence shock on equities, consumption and investment. However, whereas the adverse effects on equity and consumption are lower than in the US, they are higher for private investment in Germany.
- Private consumption** also makes a negative contribution, but only to a small extent. The negative GDP effect implies a decline in personal disposable income which is the key factor explaining the consumption decrease. Another factor is the deterioration of the net wealth position of German households due to falling share prices caused by the equity shock. A counterbalancing factor, albeit limited, is the lower consumer price level, which slightly raises real disposable incomes.

## 5 Summary and conclusion

A possible re-election of Donald Trump as US president in November 2024 could entail a significant upheaval for the world trading order, if he fulfills his announcements to raise tariffs, mainly in order to reduce the US

trade deficit. Such steps would not only have a negative effect on the world economy – and this at a time of significant global strains. They would also deal a further blow to the WTO, as the envisaged tariff increases would clearly violate international trade rules. Transatlantic relations with the EU are also likely to suffer. First, old trade disputes that were largely settled with the Biden administration could flare up again, e.g. regarding steel and aluminum. Second, Trump could abolish co-operative measures by the Biden administration that mitigate the protectionist elements of the US Inflation Reduction Act for EU exporters. Third, the future of the EU-US Trade and Technology Council (TTC) might be jeopardised.

This report simulates the impact of two scenarios. Scenario 1 entails an increase of US tariffs to 10 per cent on all US imports and to 60 per cent on US imports from China in 2025. These threats have been publicly envisaged by Donald Trump and his former trade advisers. In scenario 2, in reaction to scenario 1, China would retaliate with a tariff increase of 40 percentage points on imports from the US. The following results of a simulation of the two scenarios with the Global Economic Model of Oxford Economics for the four years of a potential second Trump term from 2025 to 2028 stand out.

The US economy, i.e. the real US GDP level, would be negatively affected in the first years in the range of up to 1 to 1.4 per cent in the two scenarios compared to the baseline scenario. This is in part due to an assumed temporary confidence shock in the short term that affects private investment and consumption. Moreover, private consumption decreases also as a result of higher consumer prices. Cumulated GDP losses (in constant prices) over the 4-year horizon amount to nearly 600 billion US dollars in scenario 1 and nearly 1,000 billion US Dollars in scenario 2. In scenario 1, however, the US GDP level would be only marginally negative in 2028 compared to the baseline. This is the case mainly because of the temporary nature of the confidence shock and the improvements of the trade balance, the fiscal balance, and of the terms of trade. However, in case of a retaliation by China in scenario 2, the US would suffer GDP losses also in the medium term, in the range of about half a percentage point of GDP with a slowly decreasing trend.

The US economy, i.e. the real US GDP level, would be negatively affected in the first years in the range of minus up to minus 1 to minus 1.4 per cent in the two scenarios compared to the baseline scenario. This is in part due to a simulated temporary confidence shock in the short term that has adverse effects on private investment and consumption. Moreover, private consumption decreases also as a result of higher consumer prices and higher unemployment. Cumulated GDP losses (in constant prices) over the 4-year horizon amount to nearly 600 billion US dollars in scenario 1 and nearly 1,000 billion US Dollars in scenario 2. In scenario 1, however, the US GDP level would remain only marginally negative compared to the baseline in 2028. This is mainly because of the temporary nature of the confidence shock and the improvements of the trade balance, the fiscal balance, and of the terms of trade relative to the baseline scenario. However, in case of a retaliation by China in scenario 2, the US would suffer GDP losses also in the medium term, in the range of about half a percentage point of GDP with a slowly decreasing trend after 2028.

Regarding the US trade balance, it is striking that the tariff shocks would improve it only relative to the baseline scenario; in absolute terms the trade balance would decline further. This is because other trends like the rising US government deficit are more important macroeconomic drivers of the trade balance than tariffs. Moreover, the US loses competitiveness due to an appreciation of the real effective exchange rate which tends to raise imports and reduce exports. This shows that the approach of Trump and his advisers, to raise tariffs in order to reduce the US trade deficit, is fundamentally flawed from an economic point of view, if the US and particularly the government continue to be large net borrowers in a global context. The same was

basically true for Donald Trump's first term when generous tax reductions contributed to further increasing the US government deficit. As a result, the US trade balance hardly changed between 2016 and 2019 (and remained at 2.7 per cent of GDP) despite significantly higher tariffs against China.

The world economy would be hit harder than the US by the simulated tariff shocks. In scenario 2, the level of world GDP would be more than 1 per cent lower than in the baseline scenario in 2028. Moreover, world trade would be negatively affected as well. This can be illustrated by looking at Germany as an example of a rather export-oriented economy. In scenario 2, the demand of Germany's main export partners would decline by about 5.5 per cent relative to the baseline scenario in 2028. This translates into a decline of German exports of 4.5 per cent. As a result, private investment declines considerably in Germany. In absolute values, it would be 27 billion euros lower in scenario 2 and would thus contribute more than half to the total GDP loss of about 50 billion euros in 2028 (in constant prices). This is equivalent to a decline in the German GDP level of about 1.4 per cent relative to the baseline scenario. However, also in scenario 1 a GDP loss of 1.2 per cent would result in 2028, a significantly larger decline than for the US. In absolute terms, the cumulated GDP losses (in constant prices) over the 4-year time horizon amount to more than 120 billion euros for Germany in scenario 1 and to nearly 150 billion euros in scenario 2. The main reasons for the difference to the US lie in the fact that Germany is more export-oriented and that its trade balance would deteriorate while the US trade balance improves. The EU would also be hit harder than the US.

Given the negative effect of a potentially renewed protectionism under Donald Trump, the EU should proceed along two lanes: First, the EU should prepare for such a scenario now. Before all, the EU should use the remaining term of President Biden to put the trade relations with the US on a more solid footing. In the best case, this could be achieved by institutionalising the TTC (Benson, 2024) and by convincing the Republican party in Congress that the TTC is a key forum to coordinate trade policies vis-à-vis China with the EU. Moreover, signing a critical minerals agreement and a Global Arrangement on Sustainable Steel and Aluminum would be important steps to reduce the likelihood of a backlash of Donald Trump with regard to transatlantic trade relations. A further step should be for the EU to foster its relations with other trading partners by signing more free trade agreements, such as with Australia, the Mercosur, Indonesia, or India. Second, if Trump was elected and would threaten to implement new trade barriers against the EU, the EU should be able to react. To counter such a threat, the EU should be willing to also threaten credible retaliation measures. For such purposes, the Anti Coercion Instrument was recently implemented and could provide the framework for possible retaliatory measures of the EU. While it is true that retaliation would aggravate the trade war and also the detrimental economic effects, it appears necessary to have a counterstrategy founded in *Realpolitik*.

## Zusammenfassung

Eine mögliche Wiederwahl von Donald Trump zum US-Präsidenten im November 2024 könnte der Welthandelsordnung erheblich schaden, falls Trump wie angekündigt die US-Zölle anheben würde, um vor allem das Handelsdefizit der USA zu verringern. Ein solches Szenario würde sich nicht nur negativ auf die Weltwirtschaft auswirken – in einer Zeit erheblicher globaler Spannungen. Auch die Welthandelsorganisation (WTO) würde einen weiteren Schlag erleiden, da die von Trump vage angekündigten Zollerhöhungen klar gegen die internationalen Handelsregeln verstoßen. Auch die transatlantischen Beziehungen zur Europäischen Union (EU) dürften darunter leiden. Erstens könnten alte Handelsstreitigkeiten wieder aufflammen, die mit der Biden-Administration weitgehend beigelegt wurden, zum Beispiel in Bezug auf Stahl und Aluminium. Zweitens könnte Trump die kooperativen Maßnahmen der Biden-Regierung aufheben, die die protektionistischen Elemente des US Inflation Reduction Act (IRA) für EU-Exporteure abschwächen. Drittens wäre die Zukunft des EU-US-Handels- und Technologierats (Trade and Technology Council TTC) womöglich gefährdet.

In diesem Report werden die Auswirkungen von zwei Szenarien simuliert, die per Annahme Anfang 2025 umgesetzt werden könnten. Szenario 1 beinhaltet eine Erhöhung der US-Zölle auf 10 Prozent auf alle US-Einfuhren und auf 60 Prozent auf US-Einfuhren aus China, was einer Zollerhöhung um 40 Prozentpunkte entspricht. Diese Drohungen wurden von Donald Trump und seinen früheren Handelsberatern öffentlich in Aussicht gestellt. In Szenario 2 würde China als Reaktion auf Szenario 1 mit einer Zollerhöhung um 40 Prozentpunkte auf seine Einfuhren aus den USA antworten. Diese beiden Szenarien werden mit dem Global Economic Model von Oxford Economics für die vier Jahre einer möglichen zweiten Amtszeit Trumps von 2025 bis 2028 simuliert und ergeben folgende Ergebnisse.

In beiden Szenarien würde das Niveau des realen US-Bruttoinlandsprodukts (BIP) der USA in den ersten Jahren in einer Größenordnung von bis zu etwa 1 bis 1,4 Prozent geringer ausfallen als im Basisszenario ohne Zollerhöhungen. Dies ist zum Teil auf einen angenommenen vorübergehenden Vertrauensschock zurückzuführen, der sich vor allem auf die privaten Investitionen und den privaten Verbrauch auswirkt. Darüber hinaus sinkt der private Verbrauch auch aufgrund höherer Verbraucherpreise. Die kumulierten BIP-Verluste (in konstanten Preisen) über den 4-Jahres-Horizont belaufen sich in den USA auf fast 600 Milliarden US-Dollar in Szenario 1 und fast 1.000 Milliarden US-Dollar in Szenario 2. In Szenario 1 würde der BIP-Effekt im Jahr 2028 allerdings kaum noch negativ sein. Dies ist hauptsächlich zurückzuführen auf den temporären Charakter eines angenommenen Vertrauensschocks sowie auf eine Verbesserung der Handelsbilanz, des staatlichen Haushaltssaldos und der Terms of Trade. Im Fall einer Vergeltung Chinas in Szenario 2 würden die USA jedoch auch mittelfristig BIP-Verluste in der Größenordnung von etwa ½ Prozentpunkt des BIP erleiden mit leicht abnehmender Tendenz über die Folgejahre.

Die Weltwirtschaft, besonders die exportorientierten Länder, wären von den simulierten Zollschocks stärker betroffen als die USA. In Szenario 2 würde das weltweite BIP im Jahr 2028 um mehr als 1 Prozent niedriger liegen als im Basisszenario. Darüber hinaus würde der Welthandel negativ beeinflusst werden. Die Wirkungen dieser Effekte lassen sich am Beispiel Deutschlands verdeutlichen als einer relativ handelsoffenen und exportorientierten Volkswirtschaft. In Szenario 2 würde die Nachfrage der wichtigsten Exportpartner Deutschlands im Jahr 2028 um etwa 5,5 Prozent niedriger ausfallen als im Basisszenario ohne Zollerhöhungen. Dies entspricht einem Rückgang der deutschen Exporte von 4,5 Prozent. In der Folge fallen die privaten Investitionen deutlich geringer aus. In absoluten Werten wären sie in Szenario 2 um 27 Milliarden Euro niedriger und würden damit mehr als die Hälfte des gesamten BIP-Rückgangs von rund 50 Milliarden Euro im Jahr

2028 (in konstanten Preisen) ausmachen. Dies entspricht einem Rückgang des BIP-Niveaus um etwa 1,4 Prozent gegenüber dem Basisszenario. Aber auch in Szenario 1 wäre das BIP im Jahr 2028 um 1,2 Prozent niedriger, ein deutlich stärkerer Rückgang als in den USA. In absoluten Zahlen belaufen sich die kumulierten BIP-Verluste (in konstanten Preisen) über den 4-Jahres-Zeithorizont auf mehr als 120 Milliarden Euro für Deutschland in Szenario 1 und auf fast 150 Milliarden Euro in Szenario 2. Die wesentlichen Gründe für den Unterschied zu den USA liegen in der Tatsache, dass Deutschland stärker exportorientiert ist und sich seine Handelsbilanz verschlechtern würde, während sich die Handelsbilanz der USA verbessert. Auch die EU wäre stärker betroffen als die USA.

Angesichts der negativen Auswirkungen eines möglichen erneuten Protektionismus unter Donald Trump sollte die EU in zwei Richtungen vorgehen: Erstens muss sie sich auf ein solches Szenario vorbereiten. Die EU sollte dazu die verbleibende Amtszeit von Präsident Biden nutzen, um die Handelsbeziehungen mit den USA auf eine beständigere Grundlage zu stellen. Im besten Fall könnte dies durch die Institutionalisierung des TTC gelingen sowie die Unterzeichnung der derzeit verhandelten Abkommen über kritische Mineralien und nachhaltigen Stahl. Ein weiterer Schritt sollte darin bestehen, dass die EU ihre Beziehungen zu anderen Handelspartnern fördert, indem sie mehr Freihandelsabkommen ratifiziert, etwa mit Australien, dem Mercosur, Indonesien oder Indien. Zweitens sollte die EU in der Lage sein zu reagieren, wenn Trump mit neuen Handelsbarrieren gegen die EU droht. Dazu sollte die EU ihrerseits bereit sein, glaubhafte Vergeltungsmaßnahmen anzudrohen. Das von der EU kürzlich geschaffene Anti Coercion Instrument könnte den Rahmen für den Beschluss und die mögliche Umsetzung solcher Maßnahmen bieten. Während Vergeltungsmaßnahmen den Handelskrieg verschärfen und die ökonomischen Effekte verschlimmern würden, erscheint ein Gegenstrategie aus realpolitischer Perspektive nötig.

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