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Article

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EconPol Forum

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Suggested Citation: Baur, Andreas; Flach, Lisandra; Hillrichs, Dorothee (2024) : German-US trade relations before the election: Implications of a Trump comeback, EconPol Forum, ISSN 2752-1184, CESifo GmbH, Munich, Vol. 25, Iss. 5, pp. 27-31

This Version is available at:

<https://hdl.handle.net/10419/304350>

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Andreas Baur, Lisandra Flach and Dorothee Hillrichs

German-US Trade Relations before the Election: Implications of a Trump Comeback

For months now, the world has been looking eagerly toward the US, where a presidential election is due this November. Former President Donald Trump is once again running for the White House on behalf of the Republican Party. He announced his trade policy agenda early on in his election campaign speeches: following the example of his first term in office, Trump intends to impose a 20 percent tariff on all US imports, while imports from China would be subject to a blanket 60 percent tariff across the board. Tariffs of this magnitude would not only trigger numerous chain reactions in the US economy but could also significantly disrupt the global economy. Import tariffs of this magnitude would make all foreign products more expensive for US consumers and companies (Clausing and Lovely 2024). A decline in US demand for foreign products is therefore to be expected. Given that the US is a very important market for German exports, what would be the effects of the Trump's new tariff proposals for the German economy?

In this article, we begin by examining Germany's current economic ties with the US. The US is one of Germany's most important trading partners, both in goods and services. Overall, Germany has a significant trade surplus with the US, which is primarily attributable to large increases in goods exports in recent years. Against this background, we conduct a counterfactual analysis using an economic model to assess how German exports would change if the US actually imposed import duties of 60 percent on Chinese imports and 20 percent on all other imports. The model simulation accounts for global interdependencies arising from global value chains. This means that not only is the direct effect of an increase in the price of German products for US consumers taken into account, but also indirect effects that would affect Germany via other economies like China or Canada. Our findings indicate that while German exports to its two largest trading partners, the US and China, would drop significantly, German exports as a whole would only fall by around 2 percent. This suggests Germany can partially compensate for the reduced demand from the US through increasing exports to other countries.

THE US IS GERMANY'S LARGEST TRADING PARTNER

The United States has traditionally played a central role as a trading partner for Germany. With a volume

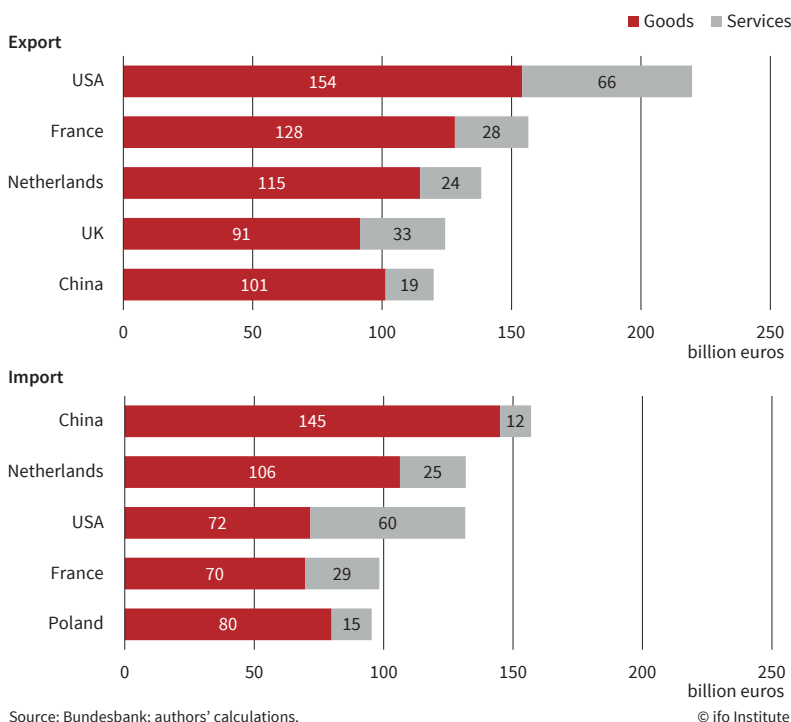
KEY MESSAGES

- **The US is Germany's largest trading partner, accounting for 11 percent of German exports and 7 percent of imports in 2023. Services comprise nearly 50 percent of German imports from the US and 30 percent of exports to the US, underscoring their significance in bilateral trade**
- **Germany maintains a large trade surplus with the United States, equivalent to approximately 2.1 percent of Germany's GDP in 2023. One major driver of the surplus is a substantial increase in German goods exports to the US in recent years while German goods imports from the US have stagnated**
- **In terms of value-added, around 7 percent of Germany's manufacturing value-added is exported to the US, compared to only 0.8 percent of US value-added exported to Germany, highlighting the importance of US market access for the German economy**
- **A simulation exercise shows significant decreases in German exports to the US and China in response to potential new tariffs that Presidential candidate Donald Trump announced in his campaign. However, trade diversion in form of increasing trade between Germany and other countries partially offsets the negative direct effect of US tariffs, resulting in a 2 percent overall decrease in German exports**
- **Germany and the EU should prioritize deepening its single market, especially in services, to remain an attractive US trade partner. Simultaneously, the EU should pursue new trade agreements to mitigate risks from potential US protectionist measures**

of more than EUR 220 billion, the US was once again the largest purchaser of German goods and services exports in 2023 (see Figure 1). This accounts for 11 percent of total German exports. Imports from the US amounted to around EUR 132 billion in the previous year, making the United States one of Germany's most important suppliers as well (share of total imports: 7 percent, third largest supplier). With a total volume of around EUR 351 billion, the US was by far Germany's largest trading partner last year, clearly ahead

Figure 1

German International Trade by Partner Countries in 2023



of China (EUR 277 billion) and the Netherlands (EUR 270 billion).¹

Two features of trade relations with the US stand out from a German perspective. First, services play a crucial role in bilateral trade relations between Germany and the United States. They account for nearly 50 percent of German imports from the US and approximately 30 percent of German exports to the US, significantly exceeding the German average share for services trade in total trade (imports: 26 percent, exports: 20 percent). Given this prominence, it is essential to consider both goods and services trade when analyzing German-US trade relations. In addition, the persistent German trade surplus with the United States is particularly noteworthy, amounting to around EUR 88 billion or approximately 2.1 percent

¹ However, even the US does not come close to the importance of the European single market for the German economy: if one considers German trade with all EU member states as a whole, this was more than five times as large as German-US trade, with a volume of more than EUR 1.9 trillion

of German gross domestic product (GDP) in 2023. This represents Germany's largest bilateral trade surplus globally. In comparison, even Germany's trade deficit with China, its largest bilateral deficit, stood much lower at around EUR 34 billion or 0.9 percent of German GDP in the same year. From an economic standpoint, bilateral trade surpluses or deficits are not inherently positive or negative. However, Germany's substantial trade surplus with the US could become problematic, as Donald Trump and his inner circle view US trade deficits as indicators of unfair trade practices, and an explicit goal of Trump's trade policy is to achieve a balanced trade balance (Lighthizer 2023). Germany ranks fourth among countries with which the US has its largest trade deficits, behind China, Mexico, and Vietnam. Consequently, should Trump return to the White House, Germany could become a primary target of an increasingly protectionist US trade policy.

GERMAN GOODS EXPORTS TO THE US HAVE RISEN SIGNIFICANTLY IN RECENT YEARS

In particular, German goods exports have been an important driver of the German trade surplus with the US in recent years (Figure 2). After a brief slump during the Great Recession in 2008/2009, German goods exports to the US grew significantly not only in relation to German GDP, but also in comparison to German goods imports from the US. As a consequence, German exports of goods to the US were already more than double the value of German imports from the US in 2023 and contributed more than 90 percent to Germany's trade surplus with the US. German services exports to the US have also risen continuously in relation to German GDP in recent years. However, services imports from the US have followed a similar growth trend, implying that the bilateral trade balance in services is close to be balanced.

CARS, MACHINERY AND PHARMACEUTICALS DOMINATE GERMAN-US EXPORTS

German goods exports to the United States are dominated by three product groups: cars, machinery, and pharmaceuticals (see Figure 3). Taken together, these



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Figure 2
German Trade with the US



product groups account for almost 60 percent of German goods exports to the US. It is striking that in particular for pharmaceutical products from Germany the US market plays a disproportionately large role: more than 20 percent of all German pharmaceutical exports are sold to the US. In contrast, the corresponding share for cars or machinery is significantly lower at 10 percent. On the import side, pharmaceutical products are also the largest group of goods Germany imports from the United States. Moreover, imports in the aerospace sector (which are classified as other vehicles) as well as oil and natural gas imports play an important role.

TRANSATLANTIC RELATIONS SHOW ASYMMETRY IN MUTUAL ECONOMIC IMPORTANCE

In the age of global value chains, conventional trade statistics can only provide an incomplete picture of the US market's economic importance to the German economy, as they fail to account for indirect trade links. For example, more than 50 percent of German exports are intermediate products that are further processed in third countries and potentially re-exported to the US. Similarly, German exports do not only consist of German value-added, but also incorporate foreign intermediate inputs. To capture these indirect interdependencies, measuring trade flows on a value-added basis is crucial – a method also used in GDP calculations. Based on data for 2022, Figure 4 shows that Germany directly or indirectly exports around 7 percent of its entire manufacturing value-added to the United States. In contrast, German demand plays a comparatively limited role for the US, accounting for 0.8 percent of value-added in US manufacturing. These asymmetries narrow slightly when considering the EU as a whole, but significant differences persist: over 8 percent of value-added in EU manufacturing is exported directly or indirectly to the United States, while only about 3.3 percent of value-added in US manufacturing depends on EU demand. Overall, transatlantic trade relations exhibit therefore a significant imbalance: access to the US

market is far more important for Germany and Europe than access to German or European markets is for the United States. This asymmetry in mutual economic importance could provide leverage to the incoming US administration in trade policy negotiations with its European partners.

THE IMPACT OF US TARIFFS ON GERMAN EXPORTS

The previous descriptive analysis illustrates the role of the US economy as Germany's largest trading partner.

Figure 3
German Trade with the US by Product Group in 2023

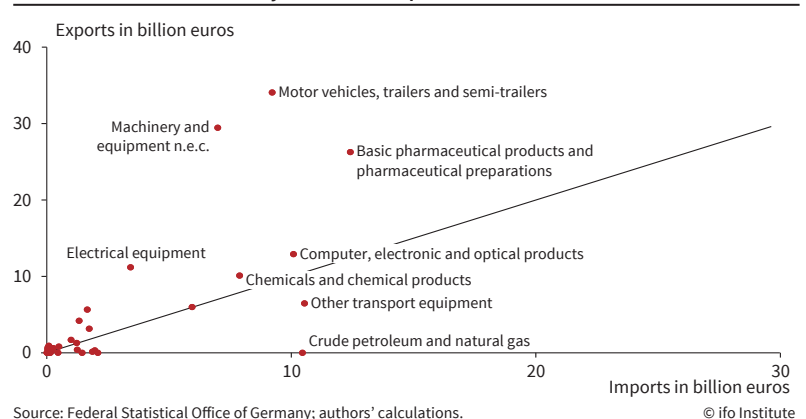


Figure 4
Value-added Exports by Destination
in % of value-added in manufacturing (2022)

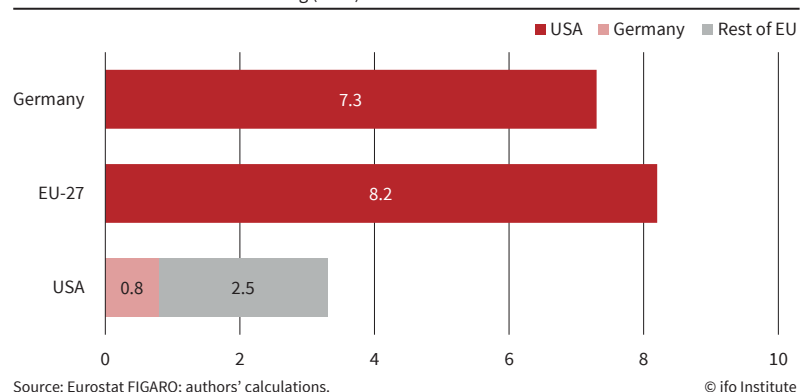
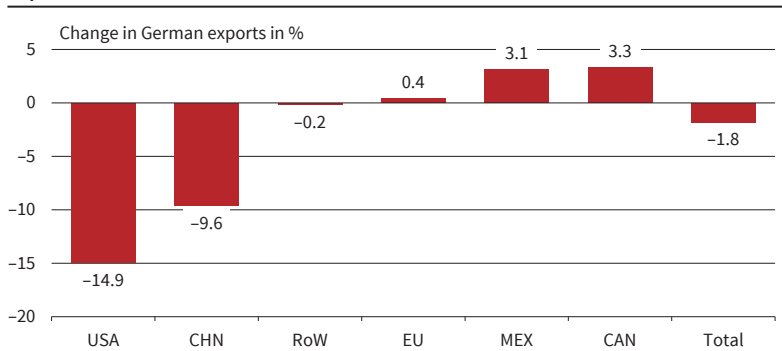


Figure 5
Export Effects of Tariff Increase



Note: The figure shows the effect of the announced tariffs on German exports. Destinations abbreviated with ISO Codes. RoW = Rest of the World.
Source: Authors' calculations using GTAP data.

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In view of this importance, it is crucial to be able to assess the impact of Republican presidential candidate Trump's tariff proposals on the German economy in advance. To quantify these effects, we make use of the ifo Trade Model to examine and simulate the impact that the tariff increases announced by Trump in his campaign speeches could have on German trade.

The ifo Trade Model is a static general equilibrium model that is able to identify the long-term level effects of such tariff increases. This provides insights into the potential response of trade flows, trade volumes, sectoral value-added as well as real gross domestic product and gross household income effects.² The results outlined below focus on the effects on German foreign trade. The analysis with a general equilibrium model includes not only direct exports to the US, but also trade along the value chain as well as possible trade diversion effects to other target markets in response to higher US tariffs. In this way, it offers a comprehensive picture of a new global economic equilibrium.

Figure 5 shows the trade effects for Germany if the US imposes tariffs of 60 percent on goods from China and 20 percent on goods from all other countries, including Germany. German exports to both the US and China decrease significantly. The sharp decline in exports to the US reflects the direct negative demand effect of rising import prices. The sharp decline in exports to China can be explained in part by the interdependencies within production networks: China is facing a sharp rise in US tariffs, which is significantly curbing US demand for Chinese products. This in turn has a negative impact on Chinese demand for intermediate products from all over the world. While some German exports are being diverted to Canada and Mexico, exports to other EU member states and

² The quantification can be carried out at a disaggregated level and allows to derive trade and output effects for 65 sectors. The ifo Trade Model covers more than 120 countries and 65 economic sectors. It covers more than 90 percent of global value-added. All data required for the simulation (e.g., international value-added linkages) come from the global input-output database GTAP 10. As the model accurately represents global value chains and country-specific parameters at the sectoral level (e.g., sectoral productivity), the adjustments caused by a tariff increase can be appropriately approximated. The technical details of this model are described in several studies by the ifo Institute (see e.g., Aichele et al. 2016; Baur et al. 2024).

the rest of the world are hardly changing on average. Overall, German total exports fall by close to 2 percent, which shows that at least some of the direct export losses on the US market can be offset by rising exports to other countries.

The overall effect on German exports calculated in the simulation conceals major sectoral differences within the German economy. In particular, German exports in manufacturing would decline significantly as a result of Donald Trump's tariff proposals. The German automotive industry (-4.9 percent) and pharmaceutical industry (-4.7 percent) would see the largest declines in exports, driven in particular by the direct decline in exports to the US (automotive: -32 percent; pharmaceutical: -35 percent). On the other hand, the German service sector could even slightly increase its total exports, as German service exports would partly replace US services in third markets and in the US itself, since US services become more expensive as a result of protectionist trade policies.

POLICY IMPLICATIONS

The United States remains a crucial partner for Germany and Europe, both politically and economically. Strengthening and future-proofing transatlantic trade relations is therefore vital for Europe's interests. Regardless of the outcome of the upcoming US. presidential election, European policymakers should focus on making these relations resilient for the future.

A key prerequisite for enhancing the EU's attractiveness as a trading partner is a flourishing European single market. The more comprehensive and integrated the EU single market becomes, the more appealing the EU is to the United States as a trading partner, and the greater the EU's influence in geoeconomic competition. For this reason, further deepening the single market is crucial for the future of transatlantic economic relations. Due to the comparative advantage of the US in the services sector, prioritizing a far-reaching liberalization of services trade in the single market is essential (for the growth potential of cross-border services in the single market, see Dorn et al. 2024).

Even though the chances of success currently seem slim, a transatlantic trade agreement could significantly strengthen trade relations with the United States, while also providing new impetus for growth on both sides of the Atlantic. The upcoming change in government in the US could present a good opportunity for the EU to renew its efforts towards an agreement on eliminating tariffs for industrial goods with the US. Corresponding negotiations were initiated in 2018 by then US President Trump and EU Commission President Juncker. Given that the EU's average tariff level is higher than that of the US, the EU could present an attractive offer for a transatlantic 'level playing field' in import tariffs.

Nevertheless, Germany and the EU should also prepare for the risk of reduced US market access due

to protectionist trade barriers. As demonstrated in our simulation study, alternative export and import markets can at least partially mitigate the negative economic impact of a protectionist US trade policy. To this end, concluding new EU trade agreements, such as with the South American Mercosur states, offers a crucial opportunity to diversify European companies' market access and reduce vulnerability to potential US protectionist measures.

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