

# EU defense spending and trade outlook

## Navigation Trump's second term

→ President Donald Trump's second term will be even more disruptive to transatlantic relations than his first, as Trump has already threatened to impose tariffs on the EU, which could be more severe if the bloc does not significantly boost defense investments and U.S. imports.

→ EU leaders must manage the difficult task of maintaining unity within the weakened 27-member bloc as they explore negotiating strategies, evaluate proposals for increasing defense spending, and responsibly reduce the trade deficit while ensuring strategic autonomy, competitiveness, and fiscal stability; however, reaching the latest proposed targets for boosting EU defense spending does not appear feasible.

Donald Trump's second term is expected to be even more disruptive to transatlantic relations than his first, as he will feel empowered and face fewer constraints

### Trump's EU criticisms

Relative to Donald Trump's first term, the president will feel empowered and emboldened to overhaul U.S. and global policy, challenge conventional norms, and face fewer constraints.

Defense and trade issues are some of Trump's biggest complaints about the EU. Trump has criticized Europe for relying too heavily on the United States for security guarantees. He repeatedly criticized NATO members for not meeting their defense spending target of 2 percent of GDP. After winning the November 2024 election, he told NATO leaders he would now demand they increase spending to 5 percent of GDP, although it remains to be seen if such a harsh demand is real or in part a negotiating strategy.<sup>1</sup> Trump also put Europe on notice by complaining it was not purchasing enough U.S. goods and threatened to impose a 10 to 20 percent tariff on imports. As of November 2024, the U.S. monthly trade deficit increased to \$78.2 billion, up from \$73.6 billion in October, with about \$20 billion of this deficit corresponding to the EU.

### EU's defense spending options

European countries spent over 3 percent of their GDP on defense during the Cold War.<sup>2</sup> After the war, Europe experienced relative peace and security, which led countries to decrease defense investments, increase social program spending, and rely on the U.S. security umbrella.

European defense budgets grew in 2014 after Russia annexed Ukraine's Crimea region in 2014 and accelerated after Russia's 2022 invasion of Ukraine. However, only 23 of NATO's 34 Member States were expected to meet the 2 percent target in 2024.<sup>3</sup>

By comparison, the U.S. government allocated USD \$916 billion for defense in fiscal year 2023, representing around 3 percent of GDP.<sup>4</sup> The U.S. defense budget represents 40 percent of global military spending and is higher than nine of some of the major powers' spending (China, Russia, India, Saudi Arabia, UK, Germany, Ukraine, France and Japan) combined.<sup>5</sup> For instance, considering other NATO members' spending, the UK spent \$74.9 billion, Germany \$66.8 billion, and France \$61.3 billion in calendar year 2023, approximately 2.2%, 1.5%, and 2% of GDP, respectively. While specific data is not available on the portion of this spending that is earmarked for U.S. military equipment, recent trends have shown that although there is some U.S. procurement, these countries do rely substantially on their domestic industries.

European Commission President Ursula von der Leyen believes the EU needs to invest at least €500 billion over the next ten years to meet the bloc's security needs.<sup>6</sup> However, there is no official target or consensus among EU nations, nor has NATO set such a goal. In 2024, the Commission created the post of Defense and Space Commissioner, and its first commissioner proposed increasing the defense budget from €10 to €100 billion in the EU's next seven-year budget.<sup>7</sup>

EU leaders agree the 2 percent defense spending target should be the floor, not the ceiling, but the 5 percent threshold Trump now demands will be extremely difficult to meet. The idea that most European countries would, willingly, spend 5% of GDP on defense anytime soon is difficult to imagine. It is hard enough for many of them to get to 2%, and as pointed out previously, not even the U.S. spends 5% of its GDP on defense right now.<sup>8</sup> Moreover, such a jump will be tough for many countries, given low growth, limited fiscal space due to high debt, different perceptions of risk, and domestic pressure for increased spending on other priorities areas, such as social welfare, as well as for investment in key areas such as decarbonization.

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The most straightforward approach would be to offset increases in defense spending with decreases in non-defense or fund them through tax hikes. However, finding €500 billion would be challenging. Germany's government, which met the 2 percent target, recently collapsed amidst disputes about how to pay for its budget. France's government also fell apart as it sought to approve its 2025 budget. In the case of Spain, apart from the fiscal difficulties to meet even the 2% target, (Spain's defense spending reached 1.29% of GDP in 2023 or 18 billion euros), it would be even more difficult to envision at present given parliamentary gridlock to approve the General State Budget.<sup>9</sup> Moreover, seven countries, including Italy, are in an excessive deficit procedure, limiting their ability to increase defense spending.<sup>10</sup>

Some have argued the EU should exempt defense spending from the national budget to skirt EU fiscal spending rules that limit Member States from having a fiscal deficit of more than 3 percent of GDP and a public debt ceiling of more than 60 percent. Doing so would normally be difficult. However, the expected winner of the February 2025 German election indicated openness to increased defense spending, which could weaken opposition from fiscally conservative states. Nevertheless, this would also be controversial, as it would imply decreased transparency. As well, such a move would weaken the recently approved fiscal framework, and in any case, the extra spending would still require financing.

One new proposal that was initially well received was that of a voluntary joint fund, open to non-EU countries, of at least €500 billion for common defense projects and arms procurement. It would issue bonds backed by national guarantees from participating countries.<sup>11</sup> Its voluntary nature would avoid opposition from countries that previously blocked joint borrowing for defense Eurobonds. This approach could provide the necessary resources to strengthen Europe's defense infrastructure and close capability gaps, but political, policy, and legal challenges must still be addressed. Indeed, some countries have already come out against it. Complicating such an initiative even further, given that the EU does not have a regional army, it would be difficult to envision how the military goods acquired would be allocated across the bloc and how cooperation would be reached in this area. Europeans spend around half as much as America does on defense, but fragmentation means that European military capabilities are considerably less than half of America's. Emblematic of this is the fact that there are currently two programmes to develop next generation fighters in Europe: one is Franco-German-led and the other involves Italy, Japan and the UK.<sup>12</sup> Relatedly, some countries, including Spain, have proposed that the European Investment Bank (EIB) fund defense investments.

### **EU's trade options**

Trade tensions between the U.S., Canada, and Mexico have escalated, but a temporary truce has been reached. President Trump has agreed to delay hefty tariffs on imports from Canada and Mexico for 30 days in exchange for increased border security commitments from both countries. However, broader trade frictions remain, as tariffs on Chinese imports are still set to proceed. This pause signals ongoing negotiations but does not resolve underlying trade and security disputes. Along these lines, Trump's frustrations with Europe lie in the fact that the trade deficit stems from barriers that make it harder for U.S. exports to compete in Europe. The average U.S. tariff rate was 3.3 percent in 2023 compared to the EU's 5.0 percent rate.<sup>13</sup> Trump has long criticized the 10 percent EU tariff on passenger cars. By comparison, the U.S. tariff rate is 2.5 percent. U.S. farmers have also complained about tariffs and other barriers, like substantial EU subsidies and strict food standards. The U.S. agricultural tariff is 4.8 percent, while the EU rate is 11.3 percent.

The EU is reportedly evaluating tariff options that would respond to U.S. tariffs.

This approach makes sense as a possible negotiating tactic but could trigger a larger trade war. In the case of higher tariffs on EU exports to the U.S., Ireland would be the most affected, followed by Germany and Italy. In terms of goods, chemicals, machinery and equipment industries would be the most vulnerable, and to a lesser extent, services too would be affected.<sup>14</sup>

An EU commitment to buy more U.S. goods, such as weapons, LNG (the potential buyers of LNG or agricultural products will be individual Member States or private companies, not the EU), or agricultural products, or address perceived barriers, like tariffs, subsidies, and product standards, would give Trump an important public relations win and show him the bloc is taking his concerns seriously. However, delivering on some of these commitments would be difficult.

European companies could explain how the proposed tariffs would affect their U.S. operations, though most do not have a U.S. presence. Firms could also shift production to the United States, (in fact they have been doing so to benefit from IRA) but to expand these initiatives would take time and be challenging for those trying to balance against any changes in Chinese trade.

### **Conclusion**

Brussels may benefit from a two-pronged approach to negotiating with Trump: develop a bold plan to increase defense spending and prepare a comprehensive response to his trade concerns. It should also consider other measures that appeal to Trump, such as aligning China policy responses.

Brussels should also do everything possible to ensure the 27-member bloc negotiates as one to increase its leverage.<sup>15</sup> During Trump's first term, he preferred to negotiate bilaterally. EU leaders who think they could receive a better deal in a bilateral negotiation, like Hungary's Viktor Orbán and Italy's Giorgia Meloni, may see little interest in working as a bloc. On the other hand, an EU-U.S. negotiation would be preferred by vulnerable countries like Germany and Ireland, which rely significantly on the U.S. market for their exports. It would also likely benefit Belgium and Spain, which have some of the lowest defense spending levels in NATO.<sup>16</sup> As well, the EU needs to ensure that its actions serve to preserve a functioning rules-based multilateral trading system. Finally, the block should expand its networks of bilateral and regional preferential trade agreements, including Mercosur, among others.<sup>17</sup>

## Notes

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- <sup>1</sup> <https://www.ft.com/content/35f490c5-3abb-4ac9-8fa3-65e804dd158f>
- <sup>2</sup> <https://www.politico.eu/article/nato-secretary-general-mark-rutte-cold-war-military-spending-defense-budgets-russia/>
- <sup>3</sup> <https://www.politico.eu/article/defense-spending-target-nato-joe-biden-jens-stoltenberg/>
- <sup>4</sup> <https://www.defense.gov/News/Releases/Release/Article/3703410/departments-of-defense-releases-the-presidents-fiscal-year-2025-defense-budget/>
- <sup>5</sup> <https://www.pgpf.org/article/the-united-states-spends-more-on-defense-than-the-next-9-countries-combined/>
- <sup>6</sup> [https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT\\_24\\_3541](https://ec.europa.eu/commission/presscorner/detail/en/STATEMENT_24_3541)
- <sup>7</sup> <https://www.politico.eu/article/kubilius-next-budget-should-have-e100-billion-for-defense/>
- <sup>8</sup> Münchau, Wolfgang. Eurointelligence. 9 January 2025.
- <sup>9</sup> <https://www.vozpopuli.com/espana/espana-en-la-otan-de-trump-la-nueva-exigencia-presupuestaria-empuja-a-sanchez-a-un-desafio-imposible.html>
- <sup>10</sup> <https://www.consilium.europa.eu/en/press/press-releases/2024/07/26/stability-and-growth-pact-council-launches-excessive-deficit-procedures-against-seven-member-states/>
- <sup>11</sup> <https://www.ft.com/content/169816b5-39e9-4f05-ae84-43ef8e277c76>
- <sup>12</sup> <https://www.cer.eu/insights/european-defence-missing-its-moment?.com>
- <sup>13</sup> <https://www.politico.eu/article/eu-warned-to-prepare-for-early-donald-trump-tariff-action-us/>
- <sup>14</sup> <https://www.caixabankresearch.com/en/economics-markets/activity-growth/exposure-european-economy-us-tariff-hike>
- <sup>15</sup> <https://www.bruegel.org/policy-brief/how-european-union-should-respond-trumps-tariffs>
- <sup>16</sup> [https://www.nato.int/nato\\_static\\_fl2014/assets/pdf/2024/6/pdf/240617-def-exp-2024-en.pdf](https://www.nato.int/nato_static_fl2014/assets/pdf/2024/6/pdf/240617-def-exp-2024-en.pdf)
- <sup>17</sup> <https://www.bruegel.org/policy-brief/how-european-union-should-respond-trumps-tariffs>