

Donald Trump's Return to Office Ushers in Economic and Geopolitical Shifts:



The Expected Impact of Donald Trump's Second Term on the American economy and the EU

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Summary

- Donald Trump's return to office in 2025 brings significant changes to US economic and geopolitical strategies, marked by a focus on tax cuts, protectionism, deregulation, and reduced immigration.
- Trump's economic agenda aims to stimulate growth but raises concerns over fiscal imbalances, labour shortages, and strained global trade relationships.
- While modest GDP and employment growth are anticipated, the national debt is projected to increase by \$3 trillion, raising long-term fiscal sustainability questions.
- In foreign policy, Trump's expansionist aspirations challenge the EU's reliance on US security guarantees, pressuring Europe to strengthen its defence and strategic autonomy.
- The EU must respond to these shifts by bolstering defence capabilities, diversifying trade partnerships, and deepening economic integration to navigate the evolving global order.

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Introduction

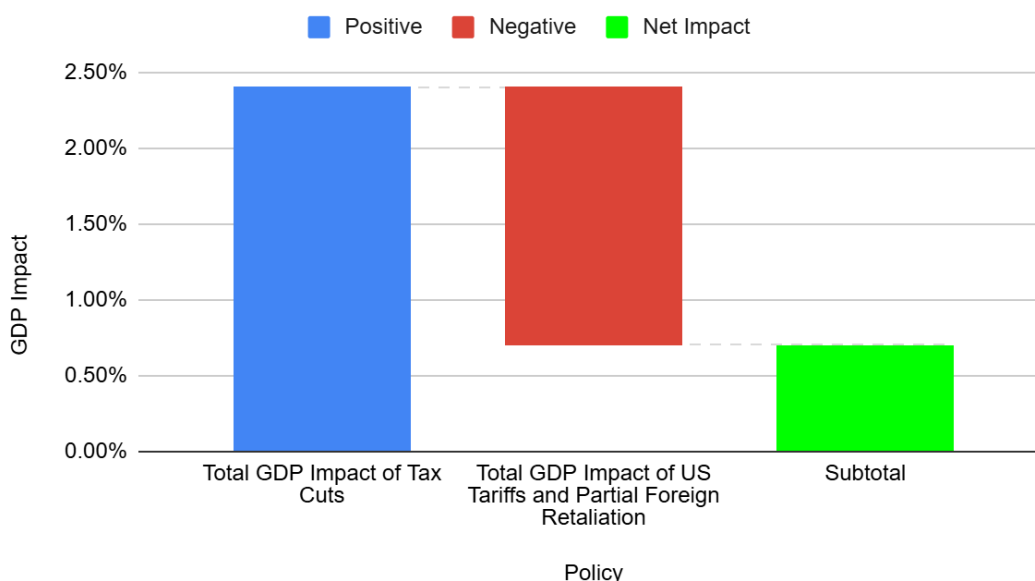
The 2024 presidential elections in the US designated Donald Trump as the 47th president, signalling a pivotal shift in the country's status as a prominent economic and geopolitical actor on the global stage. With wars raging in the Middle East and Europe, China expanding its international influence, and inflation continuing to remain high, the new president has a lot of work to do to satisfy the American people's demands.

This policy brief aims to examine the impact of the new president's plans for the American economy until the year 2034. As with any forecast, it is impossible to fully account for all impacts. New challenges are bound to arise, geopolitical shifts will occur, and politicians may not fulfill all the promises they made during the election period.

The impact of Donald Trump's planned economic policies

Trump's economic policy emphasises tax cuts, protectionist trade policies, deregulation, and reduced immigration. It aims to boost economic growth but also poses notable risks to fiscal stability and global trade relations. The tax cuts seem promising – given that they intend to increase the gross domestic product (GDP) by around 2.4 per cent – although the tariff policy and the impact of possible retaliation by target countries may undermine this effect (Figure 1).

Figure 1. Donald Trump's tax plan: expected impact



Source: York et al (2024)

Trump's tax agenda focuses on lowering personal and corporate taxes to spur investment and job creation. He aims to enhance business competitiveness by reducing corporate tax rates and repealing green energy tax credits. However, these tax cuts are projected to add \$3 trillion to the national debt over the next decade if implemented without corresponding spending reductions, exacerbating fiscal imbalances.

By rolling back regulations – especially in sectors such as energy, finance, and sustainability – Trump aims to create a more dynamic and competitive market. Lowering the regulatory burden on businesses can drive innovation, reduce operational inefficiencies, and encourage growth. Furthermore, Trump has expressed a desire to cut federal waste, emphasising the need to reduce bloated government spending. He has even suggested rolling back spending on initiatives such as the Inflation Reduction Act and environmental programmes. Although reducing government interference is a step in the right direction, America's role in supporting the green transition is vital for the West to achieve its environmental goals.

Trump's stance on immigration – particularly, his efforts to reduce illegal immigration and curb asylum seekers – could also have negative economic consequences. Although during the first two months of his presidency, illegal immigrants were deported at a slower rate than under the last year of the Biden administration, it remains to be seen if this pattern will continue¹.

Immigrants are a vital part of the workforce in sectors such as agriculture, construction, and technology. Restricting immigration could lead to labour shortages, thereby driving up costs and slowing economic growth. From a libertarian perspective, immigration is a net positive for the economy. It expands the labour pool, fosters cultural exchange, and boosts economic dynamism by bringing in new talent and diverse perspectives. Policies that limit immigration risk undermining these benefits and curbing economic potential.

In this context, it is noteworthy that, to a large extent, the president's cabinet consists of more people from the world of business than was common in previous administrations – for example, big names from the financial and technology sectors, such as Elon Musk and Scott Bessent². Musk has been designated to lead the new Department of Government Efficiency, which seeks to cut fiscal waste and streamline the government's processes³. While the entrepreneurial and operational expertise of business leaders could boost government effectiveness, these moves raise concerns that oligarchic influences on government policy could distort fair market mechanisms and possibly harm public interest. This could be by undermining product safety standards or adopting a profit-driven foreign policy based on the global business interests of the cabinet.

Trump has repeatedly talked about a 10–20 per cent universal tariff on all imports into the US and a 60–100 per cent levy on Chinese-made goods. He had partially fulfilled this promise at the time this policy brief was written⁴. Until 2034, a 10 per cent tariff can generate \$2.8 trillion in tax revenue, whereas a 20 per cent tariff would increase this figure to \$3.3 trillion (York 2024). He recently put in place a 25 per cent tariff on all goods imported from Mexico and Canada, as well as a 10 per cent tariff on China, on top of the previously announced 10 per cent levy⁵. Canada's prime minister, Justin Trudeau, directly responded with a 25 per cent tariff on American goods worth \$30 billion and

¹ 'Trump deporting people at a slower rate than Biden's last year in office', Reuters, 22 February 2025 (<https://www.reuters.com/world/us/trump-set-broaden-arrests-deportation-routes-expand-immigration-crackdown-2025-02-21/>)

² 'Trump fills his government with billionaires after running on a working-class message', AP News, 31 January 2025 (<https://apnews.com/article/donald-trumps-cabinet-wealth-billionaires-0d5147df74c7f0a851df296aeab2e164>)

³ 'Trump has tapped an unprecedented 13 billionaires for his administration. Here's who they are', ABC News, 18 December 2024 (<https://abcnews.go.com/US/trump-tapped-unprecedented-13-billionaires-top-administration-roles/story?id=116872968>)

⁴ 'Fact sheet: President Donald J. Trump imposes tariffs on imports from Canada, Mexico and China,' The White House, 1 February 2025, <https://www.whitehouse.gov/fact-sheets/2025/02/fact-sheet-president-donald-j-trump-imposes-tariffs-on-imports-from-canada-mexico-and-china/>

⁵ 'Europe could try to stop – or get around – damaging Trump tariffs', CNBC, 11 November 2024 (<https://www.cnbc.com/2024/11/11/how-europe-could-try-to-get-around-future-trump-tariffs.html>)

Mexico is expected to announce retaliatory measures. China responded with a 15 per cent tariff on American agricultural products and restriction of exports to 15 American companies.

Trump's trade policies have introduced significant tension in the global economic landscape. Tariffs on Chinese goods and the potential future tariffs on European exports can create artificial price hikes, disrupt global supply chains, and harm industries dependent on imports. From an environment of relative import and export ease, the US is moving towards neo-protectionism – trade relations are being shaped not by individuals and profit-maximising firms, but by state guidelines and political games.

This can significantly harm the entrepreneurial spirit so closely associated with the US and encourage clientelism and government favouritism.

The imposition of steep tariffs on Chinese products is likely to displace a significant portion of the \$500 billion worth of goods that China exports to the US. In response, China will seek new markets to redirect these displaced goods, with the EU being the most likely target. To achieve this, Chinese companies are expected to further lower their prices. China's protectionist policies – which are known to subsidise businesses engaged in dumping practices – could create an environment of unfair competition in the European market.

Key sectors that may face the greatest impact include the automotive industry, renewable energy, chemicals, and electronics. These industries are particularly vulnerable to price undercutting, which could threaten their competitiveness and disrupt market stability in Europe.

Table 1 presents the expected effects of Trump's policies on key macroeconomic variables.

Table 1. Effects of Trump's policies on key macroeconomic variables

Indicator	Value
GDP	0,8%
GNP	-0,1%
Capital Stock	1,7%
Wages	0,8%
Full Time Equivalent Employment	597.000
Conventional Debt to GDP ratio	223,1%
Dynamic Debt to GDP ratio	217,0%

Source: York et al (2024)

On the one hand, through Trump's economic policy from 2025 to 2034, a slight increase in employment, GDP, and wages is expected. However, the US's 10-year government revenue will decrease by \$3 trillion, further worsening its public debt. It remains to be seen how this debt will affect the US's fiscal future.

On the other, during her election campaign, Kamala Harris took a different approach from Trump. The Democrats' tax policy proposed significant tax increases for businesses and high-income earners, including raising the capital gains tax to 28 per cent, implementing a 25 per cent 'billionaire minimum tax' on unrealised gains, and increasing the stock buyback tax to 4 per cent (McBride et al. 2024). Additionally, she proposed tax credits, such as \$25,000 for first-time homebuyers, exemptions for tipped income, and increased child and earned income tax credits.

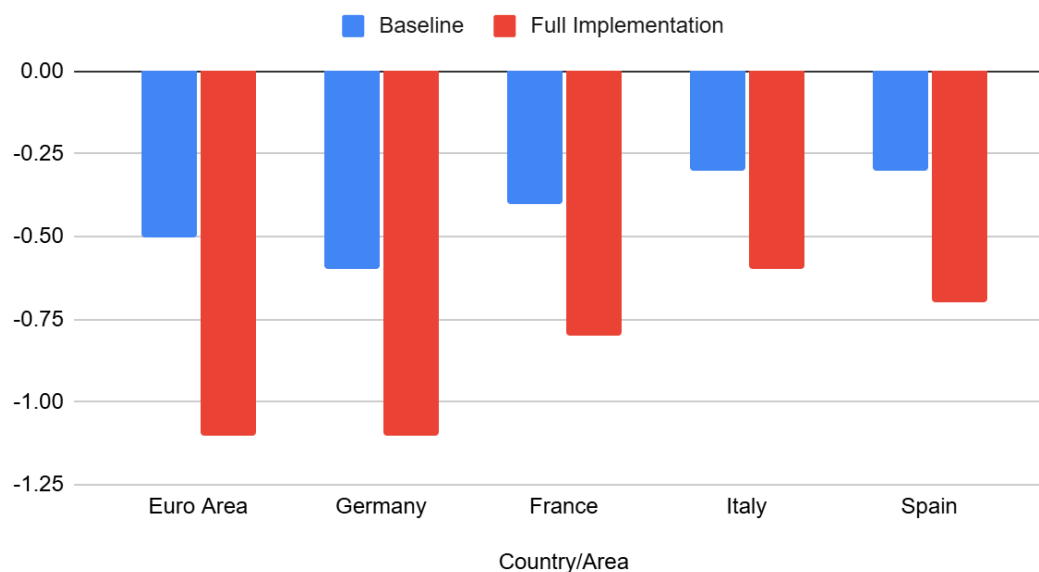
Economic projections based on Harris's economic policies using the Tax Foundation's general equilibrium model indicate a 2 per cent drop in GDP, a 3 per cent decline in capital stock, and a loss of 786,000 full-time jobs (McBride et al. 2024). These outcomes have been attributed to reduced corporate investment due to higher taxes. Even so, her policy could have raised \$1.7 trillion in revenue without significantly increasing public debt. However, these complex tax changes might hinder economic efficiency. For example, Harris's homebuyer tax credit could exacerbate housing price inflation, undermining its intended benefits. While Trump's economic programme focuses on growth at the expense of the deficit, Harris opts for the opposite. The question of which is more important – fiscal stability or economic growth – is at the epicentre of a continuous debate in the US political scene.

EU's shaky economy faces another recessionary hit

The EU is already facing structural economic challenges. Its economic model was largely based on the belief that globalisation will continue at an unchanging pace, geopolitical risks will no longer have an impact, and initially hostile and inaccessible markets – such as China – would continue liberalising, offering significant growth opportunities in international trade. In recent decades (China–EU, 1980s–now), the EU – particularly, outward-looking industrialised economies such as Germany – have reaped substantial benefits based on this belief. Until 2022, trade with China and Russia appeared to be stabilising, and it seemed that this trend would persist. While simultaneously easing fragile and uncertain relations, trade also ultimately led to a sustained collaboration between all parties. However, the explosive rise in Chinese exports to the EU – coupled with its protectionist policies – led to a rapid shift in economic balances, displacing many industries from European soil. This situation led to legitimate concerns about the future of the European economy and its trade relations with the two powers.

Further, Russia's invasion of Ukraine perpetuated the greatest shock, not only to the perception that this state of affairs would continue but also to direct trade between the EU and Russia. The distortion in the supply of energy – especially natural gas – severely impacted the competitiveness of countries that have a high energy dependence on Russia, which led to a significant increase in their input costs. The EU now faces an expensive and challenging decoupling from its previously established trade ties with unreliable partners. As a result, it faces serious supply chain disruptions and a stagnating economy. In this already difficult situation, the imposition of tariffs in the range of 10–20 per cent will deal a significant blow to the EU's fragile economy. Figure 2 presents the impact of US tariffs on the EU's main jurisdictions at the GDP level.

Figure 2. Impact of US tariffs on the EU's main jurisdictions at the GDP level



Note: The full implementation assumes a 10 per cent tariff on all US imports – including those from Europe – while the baseline assumes a more limited set of tariffs on Europe, including on auto-related imports and tariffs on China.

Source: Goldman Sachs Research⁶

Characterised by economic isolationism, Trump's foreign policy poses significant economic challenges for the EU. The EU should avoid retaliatory tariffs in response to US trade policies, since this would only escalate tensions and harm consumers on both sides. However, it must also safeguard its economic interests, perhaps by negotiating mutually beneficial agreements and increasing European imports of US goods, such as liquefied natural gas and agricultural products, such as soybeans, in exchange for tariff exemptions. This move is without precedent – Jean-Claude Juncker, the former president of the European Commission, similarly prevented a trade war on EU cars during Trump's first presidency.⁷

However, adopting a conciliatory approach poses a challenge: the EU's current leadership deficit will place it at a major disadvantage in any negotiations that may emerge from this issue. Additionally, this strategy is not sufficient on its own. The EU must also diversify its trade relationships while limiting bureaucracy and deregulating key industries to foster a more dynamic economic environment. By reducing its reliance on US trade policies, the EU can bolster economic resilience against external shocks. Strengthening internal economic integration – particularly, in the services and technology sectors – is crucial for sustaining global competitiveness. Additionally, expanding and unifying capital markets will provide greater access to financing, encouraging innovation and

⁶ 'The euro area is forecast to avoid recession despite Trump tariffs', Goldman Sachs, 25 November 2024 (<https://www.goldmansachs.com/insights/articles/the-euro-area-is-forecast-to-avoid-recession-despite-trump-tariffs>)

⁷ 'America under Trump: Domestic and European implications', VoxEU, 13 January 2025 (<https://cepr.org/voxeu/columns/america-under-trump-domestic-and-european-implications>)

growth across the bloc. These combined efforts will position the EU as a more flexible, competitive, and robust economic powerhouse.

Europe's geopolitical thesis

The evolution of globalisation and the formation of a prosperous political and economic Union presents an image of unshakeable stability. The North Atlantic Treaty Organization (NATO) became the guarantor of EU security, allowing European states to shift resources away from defence. By 2021, only 7 of 22 European NATO members met the 2 per cent defence spending target (NATO 2021). All of them were located within the EU's borders. Trump was the first US leader to challenge this complacency. In 2016, he called NATO 'obsolete,' and in 2018, he warned of US withdrawal if spending did not increase.⁸⁹ In February 2024, he declared that their failure to meet the target could lead him to encourage Russian aggression.¹⁰

Trump has also announced that he is planning to incorporate Greenland, the Panama Canal, and Canada into US territory with the potential use of military or economic coercion. As a show of power over the country's southern neighbours, he has declared that the Gulf of Mexico should be called the 'Gulf of America'.¹¹ Some have suggested that this move is also a show of force against China's rising political and economic influence across the world. By trying to capture the world's largest island and second-largest landmass, Trump is trying to show that the US's might is not declining in any way.¹² International relations analysts are still in shock; only the future will determine whether Trump will carry out his expansionist aspirations.

The twentieth century saw two divergent approaches to US foreign affairs (Kissinger 1994: 18). Isolationism argued that the US should not intervene abroad and instead only care about its internal issues and stay true to its democratic spirit. Meanwhile, the 'crusader' approach argued that the US should protect the rights and liberties of foreign civilians wherever these were 'threatened' and secure its own interests in the region. Even in the latter case, direct expansion of US territory was never part of the political dialogue. An isolationist in his first term, Trump has now started to promote expansionism. His politics has also been termed 'transactional', lacking an overarching strategy and based on short-term goals.¹³ It remains to be seen if this is a strategy to showcase American strength or an entirely new chapter in geopolitical history.

European countries should no longer hold onto false hope and see the US as their 'protector'; they must take care of their national security themselves. Weaning Europe off the US in matters of security and defence demands swift action to kickstart the European defence industry and adopt a

⁸ 'Donald Trump says NATO is "obsolete," UN is "political game"', The New York Times, 2 April 2016 (<https://archive.nytimes.com/www.nytimes.com/politics/first-draft/2016/04/02/donald-trump-tells-crowd-hed-be-fine-if-nato-broke-up/>)

⁹ 'Remarks by President Trump at press conference after 2018 NATO summit in Brussels', US Mission to NATO, 12 July 2018 (<https://nato.usmission.gov/july-12-2018-remarks-by-president-trump-at-press-conference-after-2018-nato-summit-in-brussels/>)

¹⁰ 'Trump's NATO comments draw scorn, White House calls them "unhinged"', Reuters, 12 February 2024 (<https://www.reuters.com/world/european-officials-criticize-trumps-nato-comments-2024-02-11/>)

¹¹ 'Donald Trump's empire of ego', The New Statesman, 11 January 2025 (<https://www.newstatesman.com/international-politics/2025/01/donald-trump-expansionism-greenland-canada-panama-canal>)

¹² 'Trump is opening Pandora's box', Foreign Policy, 14 January 2025 (<https://foreignpolicy.com/2025/01/14/trump-us-president-greenland-canada-panama-expansionism-history/>)

¹³ 'Donald Trump's empire of ego', The New Statesman, 11 January 2025 (<https://www.newstatesman.com/international-politics/2025/01/donald-trump-expansionism-greenland-canada-panama-canal>)

unified foreign policy. In 1991, Mark Eyskens described Europe as 'an economic giant, a geopolitical dwarf, and a military worm'.¹⁴ Unfortunately, this proves to be as true today as it was back then.

There is clearly an urgent need to establish a unified common defence doctrine, passed with the unanimous agreement of member states. However, the challenge lies precisely in this requirement for unanimity, since European countries have divergent perspectives on the possible threats to their sovereignty. Further, bilateral relations often take precedence over efforts to formulate a common foreign policy, and cooperation among member states has stalled due to successive crises and disagreements.¹⁵ In particular, the European debt crisis, which emerged in late 2009, intensified Euroscepticism and led to the division of the EU into two opposing poles (PIGS–North) for a prolonged period.

There have been numerous ineffective attempts to create a defence arm that would be partially autonomous from NATO. However, it is widely acknowledged that these initiatives would not have been able to entirely replace NATO due to their limited to moderate scope. From the creation of the EU in 1992 with Maastricht Treaty up until just before the Russian invasion of Ukraine, the most notable initiatives in this area included the Common Foreign and Security Policy (CFSP) in 1993, the Petersberg-type military tasks in 1992, the European Security Strategy (ESS) in 2003, the EU Global Strategy (EUGS) in 2016, the European Peace Facility (EPF) in 2021, and other initiatives of similar or lesser significance. However, due to the persistent lack of decisiveness and a reluctance to reach a consensus on defence-related issues, these initiatives did not progress enough to lead to the formation of an institution that could play a role similar to NATO while being under the full control of the EU.

The widespread insecurity in Europe, following the outbreak of a major war on European soil that exposed its military inadequacy, combined with the withdrawal of security guarantees by the US, have made the reconstruction of its armed forces an urgent necessity – a demand that must be met by its domestic defence industry. As a result, governments are now subject to new political pressures to formulate a common defence policy and possibly even a common foreign policy (Strategic Compass).¹⁶

The primary challenge is the large number of member states (27) and the presence of strategic dissenters, such as Hungary, which opposes any measure that could, directly or indirectly, be interpreted by Russia as a provocation.¹⁷ As a result, initiatives requiring unanimous approval can be stalled by a single member state.

To what extent European cooperation can replace NATO remains unclear; however, what is evident is the effort required to achieve 'strategic autonomy'. The inherent disadvantages of the EU, compared to its competitors, China and the US, stem largely from its fragmented decision-making system, which is trapped in a complex web of national vetoes, bureaucratic inefficiencies, and institutional inertia¹⁸.

¹⁴ 'Europe is an economic giant, a political dwarf, and a military worm', Mark Eyskens, January 1991 (https://en.wikiquote.org/wiki/Mark_Eyskens?utm)

¹⁵ 'Europe does not have the luxury to panic over Trump's election', Emissary, 7 November 2024 (<https://carnegieendowment.org/emissary/2024/11/trump-election-win-europe-nato-ukraine-strategy?lang=en>)

¹⁶ 'A strategic compass for security and defence', European Union External Action, 2024, (https://www.eeas.europa.eu/eeas/strategic-compass-security-and-defence-1_en)

¹⁷ 'Hungary blocks €50bn of EU funding for Ukraine', BBC, 15 December 2024 (<https://www.bbc.com/news/world-europe-67724357>)

¹⁸ 'Türkiye advances Eurofighter fighter jet acquisition with French Meteor missiles despite Greece's objections', Army Recognition Group, 31 January 2025 (<https://armyrecognition.com/news/army-news/2025/turkey-advances-eurofighter-fighter-jet-acquisition-with-french-meteor-missiles-despite-greeces-objections>)

The EU remains, above all, a supranational political and economic union. It lacks a unified government capable of making swift decisions like China and the US; it struggles to find a common path, because each member state has its own interests; and its economic and industrial policies remain fragmented¹⁹. This fragmentation hinders the region's capacity to tap into opportunities such as economies of scale, which could enhance productivity and the interoperability of its weapons systems.

As a supranational union of states, the EU faces additional challenges in establishing a European army, particularly given that the average citizen struggles to grasp and fully embrace a shared European identity that is worth fighting for (Chopin 2018). The lack of a common European identity constitutes a significant obstacle to achieving the EU's goal of establishing a force of 300,000 troops (Burikov and Wolff 2025).

The EU has come to the realisation that it can no longer address geopolitical challenges by relying solely on its soft power; it must also be able to defend itself and assert its military power on the global stage. Its military vulnerability renders it dependent on the goodwill and the interests of the US, while its longstanding geopolitical passivity has left it adrift, vulnerable to the actions of major global powers.

Recent developments allow for cautious optimism

Some recent initiatives by the EU indicate efforts toward addressing this problem.

1. The strengthening of existing institutions such as Permanent Structured Cooperation (PESCO), the European Defence Agency (EDA), the European Defence Industrial Strategy (EDIS), the Common Security and Defence Policy (CSDP), and CFSP represent positive steps towards reinforcing European defence and security.
2. The commitment by the newly elected German Chancellor Merz, to attempt to bypass Germany's constitutional limit on governmental borrowing, through constitutional reform, indicates the keen interest in increasing spending on defence. This commitment signals a clear policy direction favouring the removal of a significant financial constraint.
3. The EU has lifted restrictions on financing the defence industry by creating new funds – such as the European Defence Industrial Programme (EDIP), European Defence Fund (EDF), and Act in Support of Ammunition Production (ASAP) – and by authorising the European Investment Bank (EIB) to invest in defence. This effectively bypasses Article 41 (formerly Article 28 TEU) of the Lisbon Treaty, which previously limited direct EU funding of military expenditure.
4. Perhaps the most significant development, the ReArm Europe plan, introduced in 2024, aims to mobilise approximately €800 billion over the next four years toward defence spending. Of this amount,
 - €650 billion will come from the fiscal space created by applying the escape clause, which allows a 1.5 per cent GDP exemption for defence spending.

¹⁹ 'The Nord Stream 2 project', OMV, 4 September 2015 (<https://www.omv.com/en/media/press-releases/2015/gazprom-basf-e-on-engie-omv-and-shell-sign-shareholders-agreement-on-the-nord-stream-2-project>)

- €150 billion will come from loans that the EU will raise from capital markets.

The above highlight the EU's longstanding inability to institutionalise a defence framework equivalent to what it has achieved in the political and economic domains. Trump's election shocked Europe, which failed to recognise it as a possibility during the campaign, and now is rushing to establish the military power required to deter a potential attack. Achieving the necessary capacity and stockpiles will demand an enormous investment of time and money, which in turn requires cohesion, a common strategic vision, and unwavering commitment.

Conclusion

The outcome of the 2024 US presidential election has initiated a complex interplay between domestic policy, global economic trends, and geopolitical realities. For the EU, Trump's stance in the geopolitical arena serves as both a challenge and an opportunity. It highlights the need for Europe to diversify its trade relationships, deepen internal economic integration, and develop an independent defence capability. Strengthening its capital markets, reducing bureaucratic obstacles, and pursuing strategic autonomy will be essential for the EU to navigate this evolving global landscape and safeguard its economic and geopolitical future.

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