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Once More, the US Leads Europe

Policy Department for Economic, Scientific and Quality of Life Policies
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Abstract

The US and European economic approaches to the COVID-19 pandemic have differed in many ways. It is most likely that the US recovery will come sooner and will be stronger than in Europe, pretty much as has been the case with the global financial crisis a decade ago. In order to achieve a solid and lasting recovery, Europe needs to learn from the previous crisis and to prepare for the effects of the coming rapid US expansion.

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LIST OF ABBREVIATIONS

APP	Asset purchase programme
AIT	Average inflation targeting
ARPA	American Rescue Plan Act
ECB	European Central Bank
EP	European Parliament
EU	European Union
GDP	Gross domestic product
PEPP	Pandemic emergency purchase programme
QE	Quantitative easing
US	United States

EXECUTIVE SUMMARY

- **During the last two crises, financial and health, initially the US has taken a worse blow but recovery has come faster and is likely to be dynamic.** This can be seen from the evolution of income and employment.
- **Europe is lagging because of its economic policies.** The broad reason is that it uses its instruments sparingly when the crisis hits and tends to reverse too early.
- **Two main types of fiscal policy measures have been adopted.** The first type involves new spending, the second type consists in various loans and/or borrowing guarantees to bank loans to households and firms. The balance of these two types of measures differs drastically across the Atlantic.
- **Monetary policy has differed between the US and the euro area.** The Fed had some room to cut its interest rate while the rate was still close to zero in the euro area, depriving the European Central Bank (ECB) from its main and most efficient instrument. Both central banks have restarted quantitative easing (QE), which has made it possible to avoid a financial crisis but has limited macroeconomic effects.
- **The era of stubbornly low inflation may be coming to its end.** The huge fiscal policy boost in the US is bound to raise inflation and the Fed may deliberately delay its reaction to escape the effective lower bound of the interest rate.
- **Given its economic and financial size, the US powerfully affects the rest of the world, especially Europe given the intensity of existing links.** The rapid growth US recovery will feed Europe's weaker autonomous recovery through trade and asset price strengthening.
- **The exchange rate is another channel of transmission.** The dollar should appreciate as the result of expansionary fiscal policy and tightening monetary policy. A weaker euro will help with exports and possibly widen the inflationary impact of global recovery.
- **The ECB must decide how it will deal with inflationary pressure.** It should avoid a repeat of the mid-2010s when it failed to escape the zero lower bound. Its ongoing strategy review is an opportunity to get ready. The Fed's average inflation targeting (AIT) strategy is far from perfect but it is well adapted to current and upcoming conditions.
- **As the recovery takes hold, both fiscal and monetary policies will have to shift from expansionary to neutral and eventually restrictive, but in which order?** Faced with much increased public debts, governments will want to go first. An alternative is for central banks to raise interest rates to escape the effective lower bound, as the US did on the mid-2010s, in contrast with what happened in the euro area.
- **In the longer-run, Europe may face the downside of it very effective policies designed to protect people and firms through the pandemic crisis.** These measures have resulted in less employment losses and a reduced number of bankruptcies, which greatly helped during a catastrophic period. These scarring effects will not just weaken the recovery but also slow down longer-term growth.

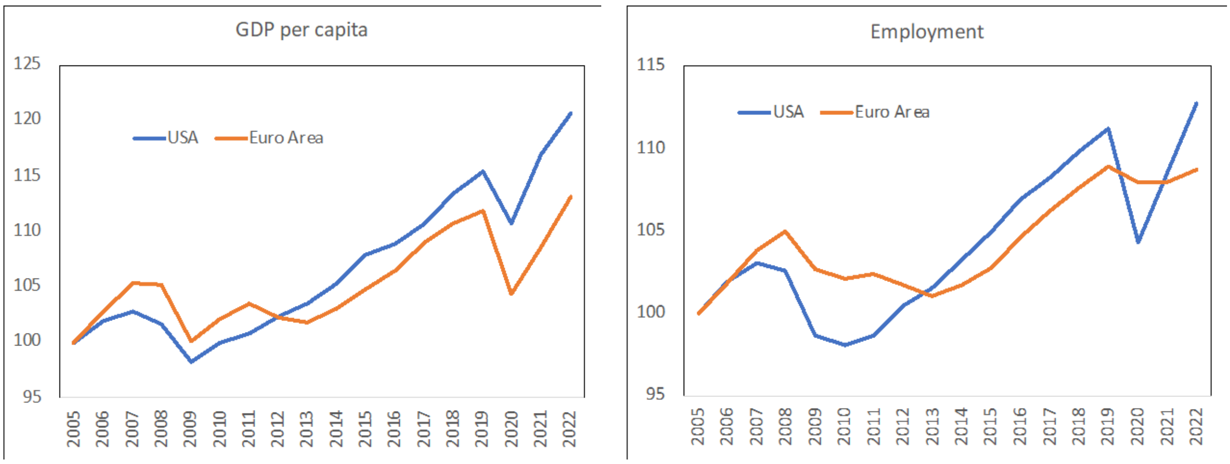
1. INTRODUCTION: A TALE OF TWO CRISES

The COVID-19 crisis is the second massive crisis that we face in a bit more than a decade. These two crises are fundamentally different. Financial crises are the results of excesses that could have been spotted ahead of time and they are known to exert durable effects. Pandemics are bad luck, their economic effects are driven by the need to significantly reduce economic activity and little is known about longer-run impact once the crisis is over. Comparisons can therefore be easily misleading. Yet, in both cases, policy responses are essential and make a difference on the outcome. Strikingly, during both crises, Europe and the US have reacted with different measures and the outcomes, both in the short and in the long run, are likely to differ. Sadly, once again with the pandemic, Europe will probably be found as the less good performer, for broadly similar reasons.

The two charts in Figure 1 compare two measures of economic activity since 2005, before the global financial crisis of 2008. Both GDP per capita and employment are set to be equal to 100 in 2005 in order to facilitate comparisons across crises and countries. The numbers for 2021-22 are forecasts, which do not take full account of the latest fiscal policy measures adopted by the Biden administration. These measures will undoubtedly deepen the difference between the US and Europe.

The two charts show that, in both crises, in impact the recession was deeper in the US than in the euro area. However, in the 2010s the US recovery came faster and was generally stronger. The forecasts suggest that this pattern is about to be repeated this time around. It looks like if, when faced with a powerful adverse shock, the US is inclined to "bite the bullet" in order to recover faster and more forcefully. One interpretation is that the US authorities choose effectiveness over protection while the Europeans opt for the opposite strategy. This is not new, of course, and it reflects deep societal preferences. But there could be more to it than deliberate and carefully thought-through choices. In particular, we need to ask whether policy mistakes may play an additional role.

Figure 1: GDP per capita and employment (2005 =100)

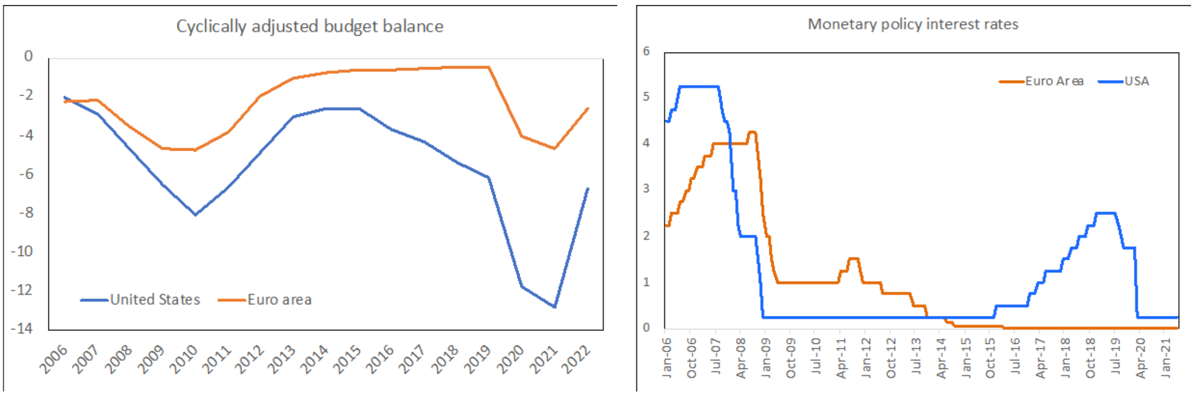


Sources: GDP per capita: *AMECO on-line*, European Commission. Employment: *World Economic Outlook*, IMF, April 2021.

The deeper US recession in the wake of the financial crisis reflects the fact that this is where the crisis originated. It started in the mortgage markets (the infamous subprimes) and had a deep impact on the housing markets, first and foremost affecting modest homeowners. It also affected banks, which were a transmission channel to Europe. The faster US recovery is largely explained by policy actions. It is now generally admitted that Europe lagged in cleaning out its banks, over many years. Beyond this aspect specific to the financial crisis, macroeconomic policies also played an important role, broadly repeating the same pattern during the pandemic. As can be seen from the left-hand side chart in Figure 2, in both crises the cyclically adjusted budget deficit was massively deepened in the US with more modest measures in the euro area. During the years that followed the financial crisis, fiscal policy remained more supportive of growth and employment in the US while, in the euro area as a whole, budget balance was nearly restored by 2013. It is not known yet whether the pattern will be similar following the COVID-19 crisis. The forecasts for the US are misleading since they do not yet take into account the very substantial fiscal measures already decided by the Biden administration and those under discussion. In Europe too, additional measures are envisaged in many countries but they will likely be considerably smaller than in the US. History repeats itself.

A similar observation can be made regarding monetary policy. The right-hand side chart in Figure 2 shows that the US policy interest rate was promptly reduced after the financial crisis and kept near zero for six years. In contrast, the ECB moved more slowly. In fact, it twice reversed its course of action, including during the subsequent debt crisis, before finally bringing its rates to zero (and beyond). Then, in contrast with the Federal Reserve, the ECB failed to "normalise" its interest rate away from near-zero. When the pandemic hit, the Fed had some room to reduce its interest rate while the ECB had lost the interest rate instrument.

Figure 2: Monetary and fiscal policies in the euro area and the US



Notes: Budget balance in % of GDP. President Biden's American Rescue Plan Act (ARPA) is not yet accounted for.

Source: Budgets: *World Economic Outlook*, IMF, April 2021. Interest rates: ECB and Federal Reserve.

This contrast extends to the health crisis. As is well known, the health management of the pandemic has been of poor quality in the US, although a number of states and cities adopted policies that reduced the health impact, still not quite to the same extent as in Europe. Accordingly, the health crisis has been much more severe in the US than in Europe. However, as early as May 2020, the US government worked on securing vaccines. Operation Warp Speed included large cash support to a number of pharmaceutical research laboratories, a few of which succeed in developing new vaccines. Europe did little of that and, it seems negotiated hard on prices once the vaccines were ready for production. Much as was the case with macroeconomic policies, the health shock has hit harder but recovery is coming faster. The similarity across all policy levers is striking.

In Europe, fiscal policies aimed at protecting jobs and preventing widespread bankruptcies. Households and firms were offered large subsidies and guaranteed loans to make up for reduced activity, sometimes no activity at all. In the US, the protection aimed primarily at people who received cash payments and more generous unemployment benefits instead of keeping people on the job. This explains that, while the US has spent more money than Europe, unemployment declined much more there. On the other hand, once the recovery has started in the US, employment promptly bounced back. Once it finally brought its interest rate down to zero and then negative territory, the ECB has kept it there so there was no room to significantly reduce it once the pandemic hit. In contrast, the Federal Reserve could exploit the room for manoeuvre that it had created in 2016-19.

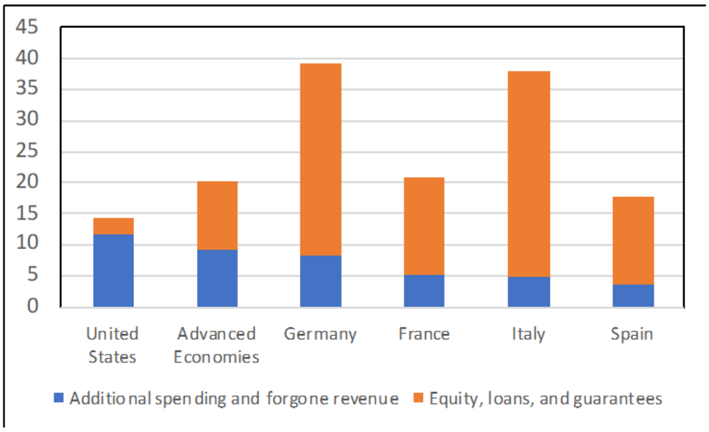
2. MORE DETAILS ON POLICY ACTIONS

2.1. Fiscal policies

Two main types of fiscal policy measures have been adopted promptly in 2020 and the speed must be noted. The first type involves new spending, including cash transfers and support programs, or tax reductions. These measures directly increase the budget deficit. The second type consists in various loans and/or borrowing guarantees to bank loans to households and firms. They do not affect the recorded budget because they are matched by assets (the loans). However, inasmuch as some recipients fail to reimburse their borrowings, the governments will have to pay out the guarantees, which will then be recorded in budget figure. Similarly, NextGenerationEU does not count as national debts but, sooner or later, member governments will have to pay for the associated debt.

The balance of these two types of measures differ drastically across the Atlantic. Figure 3 shows what happened in the US and the four largest European economies, alongside the average of advanced economies, in 2020 (therefore excluding the 2021 American Rescue Plan Act, APRA, and NextGenerationEU). Regarding direct spending, the US leads with some 12% of GDP while all four European countries raised their direct fiscal efforts by less than the average of all advanced countries. In contrast, the European countries made a very substantial use of the second type of measures, raising their total commitments to multiples of those in the US. As noted before, the priority in Europe was to limit the immediate damage of the pandemic, which made public loans and guaranteed very attractive.

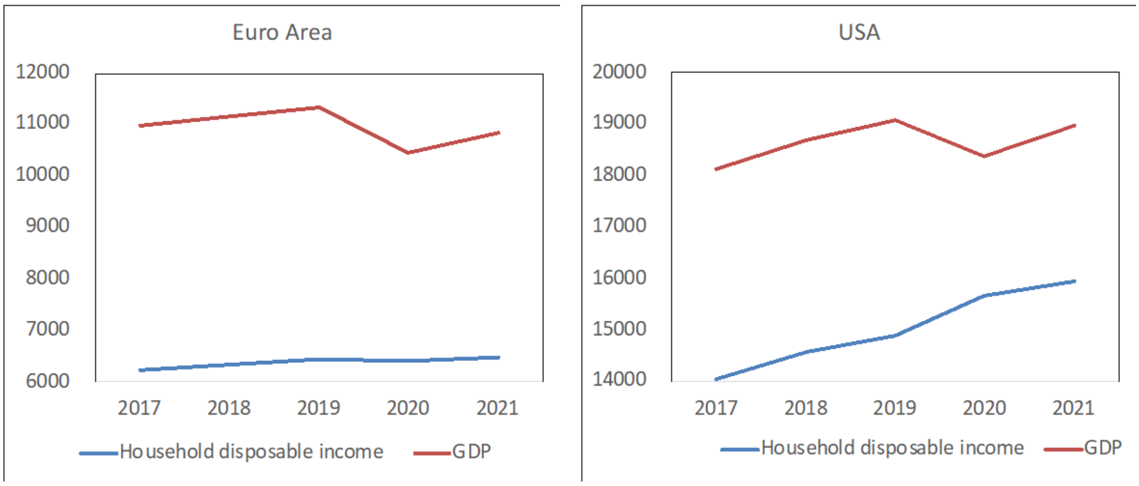
Figure 3: Types of fiscal policy measures in the euro area and the US (% of GDP)



Source: Fiscal Monitor Update, IMF, January 2021.

These measures, alongside strict distancing measures and lockdowns, made it possible to shield personal incomes from the deep decline in economic activity. In the US, the focus was on limiting the fall in overall economic activity, in Europe it was on limiting the impact on peoples and firms. As Figure 4 shows, the impacts on household incomes significantly differed. The euro area succeeded in keeping household incomes unchanged from 2019 even though GDP declined sharply. In the US, household incomes actually rose in 2020, in part because each one received a check from the government (which happened again in early 2021 but is not measured in the figure that predates this distribution), in part because unemployment benefits were raised at the state level.

Figure 4: Household disposable income vs. GDP (billions of local currency)

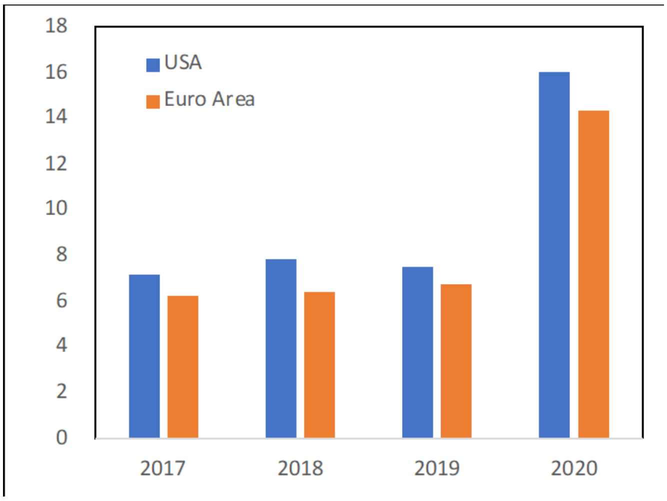


Notes: Both measures are in volumes and national currencies. Data for 2020 and 2021 are forecasts.

Source: Economic Outlook database, OECD, December 2020.

As household incomes were maintained, lockdowns restricted spending. Unsurprisingly, households increased their savings, and more so in the US than in Europe, as Figure 5 shows. This will matter as life returns to some form of normality when it is widely expected that pent-up spending, financed by accumulated excess savings will surge. If these expectations are verified, the boost to economic growth should be more powerful in the US. Along faster vaccinations, which allows an earlier return to normality, the US recovery should therefore lead the European recovery and be stronger *ceteris paribus*.

Figure 5: Household net savings (% of disposable income)



Source: Economic Outlook database, OECD, December 2020.

The different sizes and nature of fiscal policy measures taken in 2020 and those predicted for 2021 suggesting the following:

Larger deficits explain a less deep recession in the US, in spite of inefficient health policies.[1]

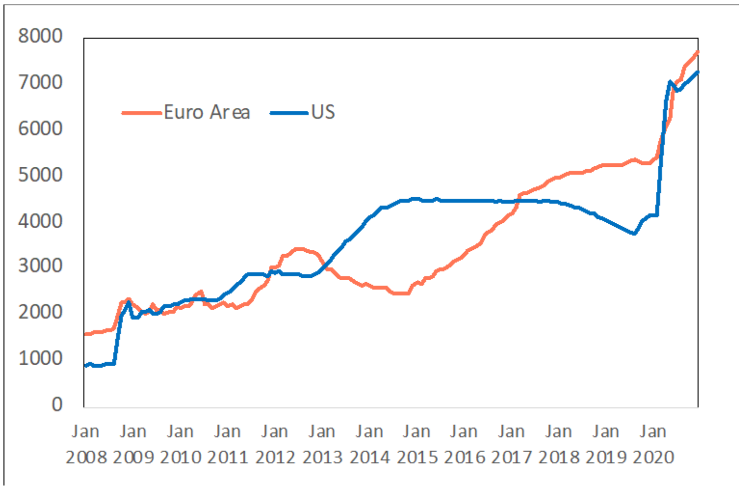
Strong continuing fiscal support predicts a vigorous recovery in the US while more modest steps in Europe raise the spectre of a moderate recovery in Europe once the early dissaving comes to an end.

The emphasis on protecting people rather jobs and firms in the US stands in contrast with the focus on protecting jobs and firms in Europe. In the short term, this has led to large differences in (un)employment and bankruptcies. In the medium run, it could be an advantage for the US as it could be easier for growing firms to hire employees and for new firms to fill the void created by firms that ceased to operate.

2.2. Monetary policies

As Figure 2 shows, the ECB had no room left to cut its interest rates when the pandemic hit while the Federal Reserve promptly cut its own rates. With interest rates close to zero, both central banks had to rely on quantitative easing (QE) to deliver more impetus. More importantly, by swamping the financial markets with abundant liquidity, QE also aimed – and still does – at preventing a simultaneous financial crisis. Here again, the Fed's action was more forceful than that of the ECB: the size of its balance sheet expanded by 75% against 43%, see Figure 6.

Figure 6: Central bank balance sheet size (billions of local currency)



Source: International Financial Statistics, IMF.

2.2.1. Monetary financing of budget deficits and inflation

Since both central banks expanded their balance sheets by amounts comparable to public borrowing, the public debts held by private investors did not increase. Indirectly, therefore, central banks have financed the budget deficits in 2020, which they had to do if they wanted to keep interest rates as low as possible.

Monetary financing of budget deficits is often considered as a cardinal sin because, historically, it has been the cause of all inflationary episodes. This is why the ECB is strictly forbidden from *directly* financing member governments but it can do so *indirectly* by purchasing public debts on the financial

[1] Delayed and limited lockdowns are known to be economically inefficient for two main reasons: 1) Many people self-isolate anyway; 2) weak distancing measures allow the pandemic to spread. See, e.g., Hargreaves Heap et al. (2020).

markets, which is a common procedure. Already, in the aftermath of the debt crisis, the ECB conducted large-scale QE – through its various asset purchase programs – which generated some concern about inflation, even leading to formal complaints to the German Constitutional Court and to the European Court of Justice. A decade later, in the run up to the pandemic, the ECB was battling against too low inflation. In fact, inflation has remained below target throughout the advanced economies. As is generally well understood, there is a good reason for this failure of a time-honoured principle.

Inflation occurs when the newly created money ends up circulating in the economy through loans to households and firms, fuelling spending. This has not happened to any significant degree, in part because credit to households and firms has not risen much, for both lack of demand from households and firms and supply by banks that were still recovering from the financial crisis. The intended result has been a massive expansion of liquidity, which has partly been directed to financial investments that lifted asset prices. Of course, a delayed boom in credit can happen eventually, which central banks closely monitor. No doubt, when and if it happens, central banks will proceed to absorb the liquidity, as the Fed started to do after 2014 (Figure 6).

Another reason for the lack of inflation response to QE has been the fact that fiscal policy in the euro area has been restrictive, in contrast with the situation in the US (Figure 2), where inflation actually started to rise before the pandemic. The abrupt change in fiscal policies in 2020 feeds the current debate about a possible resurgence of inflation.

2.2.2. Inflation in the US and the new monetary policy framework

The debate focuses on the situation in the US because the exceptional vigour of the fiscal expansion makes it likely that this is where, among the advanced economies, inflation stands to rise fast, and it has done so recently (Figure 7). Two issues dominate the debate.[2]

First is the extent to which the early price increases are temporary. These increases reflect the restart of the economy as rapid large-scale vaccinations in the advanced economies signal the end of social distancing measures. In recent weeks, prices of primary commodities and global transport costs have risen quite dramatically from previously depressed levels. Similarly, retail prices have increased as stores reopen. The question is whether these are one-off phenomena or whether they will trigger increases in labour costs, which will then lead to generalised increases in retail prices. Part of the answer depends on the labour markets. If they tighten fast, wage increases could trigger the familiar wage-price spiral, which would imply a lasting increase in inflation. Uncertainty is high because of the unusual effects of the pandemic and of the support measures on the labour markets.

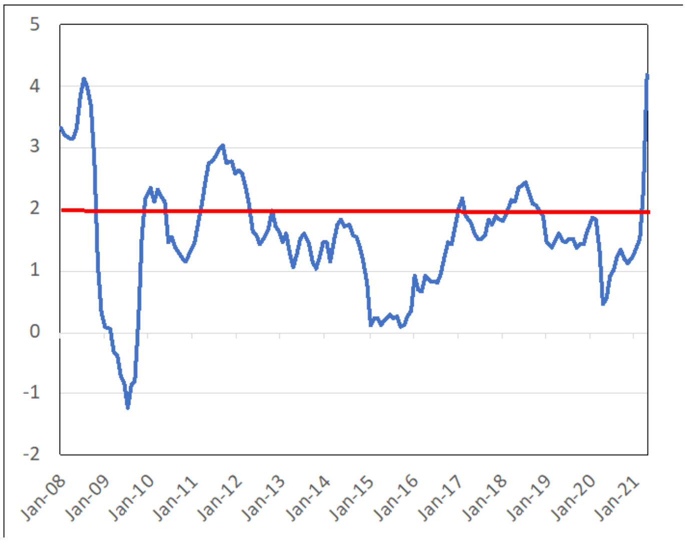
Second is the reaction of the Federal Reserve. At the time of writing, the Fed insists that the inflation uptick is temporary. Given the depressed employment rate, it does not expect wages to take off. However, the forecasts shown in Figure 1 suggest that the situation could rapidly change, which could provide the basis for a rapid resurgence of inflationary pressure.

The Fed's reaction is uncertain given its new monetary policy strategy. It has adopted the principle of average inflation targeting (AIT) according to which it aims at achieving an inflation rate of 2% over time. AIT implies that periods of inflation below target must be followed by periods of inflation above target, and conversely. As Figure 7 shows, this strategy now calls for inflation to be above 2% for a significant period of time. The AIT strategy is not precise, however. It does not say over which horizon averaging is done nor how high inflation will be allowed to go. Another aspect of the new strategy is that the Fed has committed to not just look at "maximum employment", as mandated by Congress, but

[2] A good recent survey is Ball et al. (2021).

also to take into consideration the situation of traditionally under-privileged minorities. This too is imprecise.

Figure 7: Inflation in the US (% over same month in previous year)



Source: FRED, Federal Reserve Bank of Saint Louis.

Note: Personal Consumption Expenditures (PCE).

As a result, the Fed announcements are ambiguous and therefore controversial. At the moment, the Fed is obviously mindful to support the recovery. Following the taper tantrum of 2013,[3] it is carefully refraining from any suggestion that it is concerned with inflation. A number of observers reckon that the Fed will not fight inflation promptly when it materialises. Seeing this possibility as a case of fiscal dominance, whereby the central bank feels obliged to finance budget deficits, they conclude that AIT and employment considerations will provide ample room not to act. An alternative interpretation is that the Fed is attached to keeping inflation hinged and will raise its interest rates when and if signals emerge that inflation is rising significantly above target. However, at this stage, it wants to support the recovery and does not want the financial markets to ride ahead of it and make medium- and long-term interest rates creep upward. The creeping has already started, however, suggesting that the financial markets see through the veil set up by the Fed. As explained below, the creeping is likely to affect the euro area.

[3] In 2013, Ben Bernanke, then-President of the Federal Reserve Board, observed that QE would not last forever. This casual observation was mistakenly interpreted as signaling that the Fed was preparing to taper its asset purchases and it created a financial tremor that undermined growth.

3. CHANNELS OF TRANSMISSION FROM THE US TO EUROPE

3.1. Transmission of growth and inflation

Economic fluctuations in the US economy affect the whole world. Even though the size of the US economy relative to the global economy has declined over the last decades, its GDP still amounts to 25% of the world total (down from 35% in 1985), well above China and the euro area, both at about 18%.

The first channel of transmission is trade. The US imports goods and services worth about 15% of its GDP or about 3.75% of world GDP. More spending in the US leads to more imports from other countries, which in turn spend and import more, etc. This is a multiplier effect.

The second channel runs through the financial markets, where the US dominates by far in most dimensions (capitalisation, turnover, etc.). *Ceteris paribus*, a strong US recovery is likely to lift asset prices and returns. Such movements are typically transmitted to other financial centres around the world. Higher asset prices, in turn, encourage investment spending and therefore growth.

The third channel is the exchange rate, although the effect can be ambiguous. The direct effect of attractive financial conditions in the US is an appreciation of the dollar. As the other currencies depreciate vis à vis the dollar, their exports become more competitive, which reinforces the first channel. In addition, the deepening budget deficit implies more borrowing, which further reinforces the dollar appreciation. However, this means that the US current balance worsens even more, which could lead to a weaker appreciation, possible even a depreciation of the dollar.

Summarising so far, trade flows are unambiguously transmitting faster growth while the financial channels may have ambiguous effects. The standard presumption is that all channels work in the same direction.

3.2. Transmission of monetary policy tightening

Much depends also on monetary policy. If the Fed continues to largely finance the budget deficit, the need for borrowing lessens and capital flows to the US are reduced, with less appreciation of the dollar. If, instead, the Fed is led to raise its interest rates (Section 2.2.2), financial returns in the US rise, which reinforces capital flows to the US and the dollar appreciation.

However, as long as the interest rates remain close to zero, monetary policy is conducted through QE. A monetary policy tightening in the US would therefore include the end, and possibly the reversal of QE. The experience with QE, as surveyed by Dedola at al. (2020), suggests that if the Fed stops and then reverses QE before the ECB, the dollar will appreciate. This should improve European exports and growth and therefore provide an invitation for the ECB to follow the lead of the Fed.

4. SHORT TERM IMPACT AND INFLATION

All in all, the combination of a more powerful fiscal expansion and an earlier tightening in the US should provide a boost to growth in Europe, both directly through trade and indirectly through the financial markets and a depreciating exchange rate of the euro relative to the dollar.

While this would be a positive development, there is a downside and an important policy issue. The likely depreciation of the euro will make imported foreign goods and services more expensive. This stands to make Europe import from the US not just growth but also inflation.

If this is how things will develop, the question of how policymakers respond will arise. It will be possible to start withdrawing supporting fiscal and monetary policies, but in which order? The large public debt increases will encourage governments to start reducing their deficits, relying on monetary policy to keep the economy going. The risk is that the recovery remains weak and that the ECB keeps its interest rates at the lower bound for quite a while. This is what happened after the debt crisis when fiscal austerity was combined with monetary loosening, see Figure 2, and this is why the ECB was unable to react adequately to the pandemic, while the Fed could.

In order to avoid a repeat of this mistake, we need to ponder in which order fiscal and monetary policies should normalise away from the current expansionary stance. Obviously, after sharp increases in public indebtedness, the governments will be eager to close or reduce their budget deficits. Depending on what emerges from discussions about the future of the Stability and Growth Pact, they could actually be required to do so once the escape clause comes to an end. This would be a repeat of the mid-2010s, leaving the ECB alone to deal with macroeconomic stabilisation.

The other option is to first normalise monetary policy, raising the interest rate as needed and then reversing QE, while fiscal policy remains supportive. To that effect, the ECB could use its ongoing strategy review to move to AIT, like the Fed. An important advantage of this approach is that fiscal policy will be available to deal with possible scarring effects of the pandemic as well as other major objectives, like the struggle against climate change. These objectives require detailed interventions that are out of the purview of monetary policy and of the mandate of the ECB. Another advantage is that raising interest rates more or less in tandem with the Fed will prevent a depreciation of the euro and lessen the transmission of inflation from the US. Of course, it would also reduce the boost to exports and demand provided by a depreciation, which is a good reason to use fiscal policy to support activity.

5. LONG TERM IMPACT OF THE US POLICIES ON EUROPE

5.1. Growth

As noted in Section 2.1, in the US, fiscal policy has aimed at protecting people rather than jobs and firms while Europe has generally made the opposite choice. In normal recessions, it is usually thought that the US strategy is better because it allows what is sometime called the cleansing effects of recessions. But the COVID-19 recession was special. It was largely the consequence of mandatory lockdowns and other social distancing measures needed to prevent a clogging of hospitals. As governments lifted basic freedoms, it was entirely logical to compensate people and firms. However, the decline in the number of bankruptcies is a tell-tale signal that the normal evolution process – creative destruction – has been suspended.

The downside of the European strategy will surface over time. Protected people and firms will argue for a slow withdrawal of support. Mindful of the fact that much of that support has taken the form of guaranteed loans that could turn into large expenditures in case of widespread defaults, governments might calculate that extending support is less costly. In contrast, the US will be in a better position to reallocate its human and financial resources toward sectors with high growth potential. When this happens, the tendency will be for governments to step in and support the sectors that they deem high potential. This would signal of a return of industrial policies, already shaping the NextGenerationEU programme. Unfortunately, the record of industrial policy is not encouraging. Long-term growth could be stunted in Europe.

5.2. Public indebtedness

Both the US and many euro area member countries will emerge from the pandemic crisis with large public debts. The US is not at risk of facing a debt crisis for one simple reason: the financial markets know full well that the Federal Reserve will not hesitate to act as lender of resort if any pressure arises. The situation in the euro area is much more ambiguous and leaves it open to debt crises. The ECB intervention in 2012, known as "whatever it takes", represents a step in the direction of lending in last resort. However, it has come two years too late, after several countries had been hit, and it has been highly controversial, divisive even. The pandemic emergency purchase programme (PEPP) has taken a further step in providing selected support to the more exposed countries, however it was put in place in an exceptional period.

As it reviews its strategy, the ECB needs to consider its options should pressure emerge again in the aftermath of the pandemic crisis. We know from the "whatever it takes" episode that a strong statement by the ECB is enough to quiet financial markets down. Of course, a mere statement that is unlikely to be followed by action will not impress the financial markets. What is needed, therefore is that all member countries commit to support the ECB as it makes its statement, which is what happened in 2012, and the ECB never needed to commit any resource.

Some countries may have reservations about moral hazard. Would not such a commitment discourage fiscal policy discipline in countries with a poor track record? It could, but consider the following. First, the 2012 episode showed that all member countries concluded that the risk of a breakup of the euro was far too damaging to be seriously contemplated. They are quite likely to reach the same conclusion again if a debt crisis threatens to occur. Second, the responsibility for achieving fiscal discipline lies with the Stability and Growth Pact, which has been notoriously ineffective. It is incumbent on member governments to agree on a more effective arrangement, which should limit cases of potential debt crises to truly exceptional events and therefore eliminate moral hazard.

6. CONCLUSION

The comparison between the US and Europe before, during and after the pandemic is disquieting. The US seriously mismanaged the health crisis but its macroeconomic record is in many ways superior. Helped by a rapid deployment of vaccines, it is recovering earlier, and the recovery is helped by a massive fiscal expansion. Its approach to support people, not jobs, and to let firms deal with the recession has imposed considerable suffering and an increase in inequalities, but it will help to make recovery faster and more durable.

These differences mostly reflect traditional preferences over classic trade-offs. The more protective approach in Europe meets its long-held preferences but some of them are not growth-friendly. The challenge will be to ensure a sustained recovery and to avoid long-lasting scars. It should be clear that fiscal support should not end with the final reopening but shifts from individual support to broad and rapidly implemented measures. At the moment, the ECB is rightly pursuing an expansionary stance but it should not let years pass by without normalising its policy. It should be prepared to deal with normalising by the Fed, which will come before it is needed in Europe. We need a compact between the ECB and member countries to carefully combine their instruments as recently suggested by Bartsch et al. (2021).

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The US and European economic approaches to the COVID-19 pandemic have differed in many ways. It is most likely that the US recovery will come sooner and will be stronger than in Europe, pretty much as has been the case with the global financial crisis a decade ago. In order to achieve a solid and lasting recovery, Europe needs to learn from the previous crisis and to prepare for the effects of the coming rapid US expansion.

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