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Transatlantic Relations in an Age of Fiscal Austerity

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What opportunities for cooperation exist between the U.S. and EU to foster long-term economic growth and fiscal sustainability?

What policies should the EU and the U.S. consider in order to regain the confidence of financial markets?

Introduction

Prior to the economic and financial crisis that began in 2008, the fiscal challenges of both Europe and the U.S. largely were viewed as longer-term issues, associated with gradually rising public expenditures in the face of aging populations (the main issue for Europe) and soaring health care costs (the main issue for the United States). But the fiscal situation on both sides of the Atlantic has been made more acute by the Great Recession of 2007-2009, which, via sharp declines in tax revenues and massive government stimulus to prevent an even deeper economic decline, opened up another dimension of the crisis: sovereign debt sustainability. Gross government debt in the U.S. and the European Union (EU) has risen sharply, casting market doubt on the capacity of some countries to make good on their large and growing liabilities, and making the debt trajectory on both sides of the Atlantic untenable in the absence of significant policy changes. Already, there are signs that the sharp fiscal deterioration has begun to weigh on growth in the short term—naturally in the European countries that have been compelled to adopt strict austerity packages, but also in other EU member states and even in the United States. There is little question that the worsened fiscal outlook poses a risk for longer-term economic growth on both sides of the Atlantic.

As a consequence, the focus on both sides of the Atlantic has shifted toward fiscal consolidation—both in the near term as well as the longer term. The European Union out of necessity continues to be absorbed with the sovereign debt crisis that has plagued several smaller euro area countries and threatens to engulf larger ones as well. In the U.S., the political rise of deficit hawks in Congress (as seen in the debt ceiling near-crisis this summer) has put fiscal consolidation at the top of the agenda, even as the U.S. economy continues to struggle to gain momentum nearly two years after the technical end of the Great Recession.

It is generally a welcome development that Europe and the United States have started the serious work of getting their fiscal houses in order. Putting public sector budgets on a sustainable path is crucial for the longer-run health of both economies. Over time, unsustainable debt levels will weigh on economic growth via higher interest rates and higher taxes that crowd out private investment and crimp domestic demand. Leading economists Carmen Reinhart

(Peterson Institute for International Economics and the University of Maryland) and Kenneth Rogoff (Harvard University), as well as Stephen Cecchetti (Brandeis University) and co-authors, have found that an increase in the ratio of gross government debt beyond 90 percent of GDP results in a significant slowing of long-term potential GDP growth.[1] Slower potential growth in turn makes it more difficult to start reducing or even stabilizing that debt. And measures to reduce deficits and debt can slow growth if they are applied in haste or while an economy is still weak. It is difficult for a country to get out of this kind of vicious circle once it slips in, and that risk is all too real at the moment for several euro area countries.

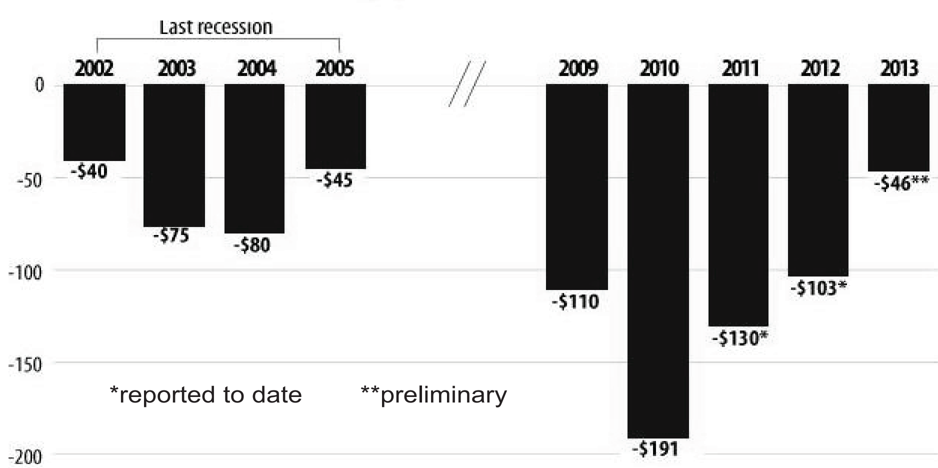
A major contributing factor is the fact that neither side has thus far done a good job of engineering a political solution to its fiscal challenges. Nor have leaders on either side of the Atlantic been able to put in place or even to articulate clearly credible plans for large but delayed fiscal consolidation that leaves room for the economic recovery to regain footing and for additional investment spending in areas that will contribute to sustained economic growth over the longer term. Europe's policy response to the sovereign debt crisis in the euro area has largely been viewed as cumbersome and insufficient, while U.S. lawmakers managed to create a near-crisis unnecessarily in their handling of the debt ceiling issue. Markets have begun to doubt not only the fiscal credibility of advanced economies (especially in Europe), but also the political credibility of U.S. and European leaders to address the formidable fiscal, economic, and financial challenges at hand. How successfully or unsuccessfully policymakers on both sides of the Atlantic confront these challenges, and what choices regarding government spending, taxation, and investment they make as a result, undoubtedly will have a large and lasting impact on transatlantic relations. While resulting tensions may arise, there is also scope for greater transatlantic cooperation in the current era of austerity.

It's the Debt, Stupid? Fiscal Policy Hurdles in the United States

The challenge of long-term fiscal sustainability is not new to U.S. fiscal experts, who for years have warned that policies must eventually be altered or the United States will face a gradual upward trend in its national debt, which would impinge on long-run economic growth. But prior to the sharp run-up in deficits and debts and the recent contentious fiscal policy debates, the U.S. was not considered at risk of default. And addressing those fiscal challenges was also associated with tough political choices (e.g., unpopular measures such as cutting Social Security or raising taxes) that voters and their elected officials generally preferred to avoid. But the Great Recession changed that rather nonchalant attitude toward the nation's fiscal situation. At the end of 2008, U.S. federal debt held by the public amounted to 40 percent of annual economic output (a little above the 40-year average of 37 percent). By the end of 2011, the Congressional Budget Office (CBO) projects federal debt will reach roughly 70 percent GDP (or a gross general government debt ratio of just under 100 percent of GDP as measured by the International Monetary Fund (IMF) and used for international comparison).[2] By either measure, that is the highest U.S. debt ratio since 1950, and higher than all euro area countries with the exception of Greece, Ireland, and Italy. The sharp rise in U.S. government debt stems partly from lower tax revenues and higher federal spending related to the recent severe recession, but it also reflects a trend of rising government spending and declining government revenues that predated the recession and marked the first decade of the twenty-first century.

Another important aspect of the U.S. fiscal situation is the problem surrounding state and local finances, which have also deteriorated sharply in recent years. Although nearly all U.S. states have a constitutional obligation to keep their budgets in balance, most are running large deficits now, as a result of steep increases in outlays associated with state unemployment benefits and medical insurance for the poor, as well as steep declines in tax revenue (particularly state and local property taxes, which plummeted with the housing market bust). In

Figure 1: State Budget Shortfall[3]
Total shortfall, fiscal year, bn

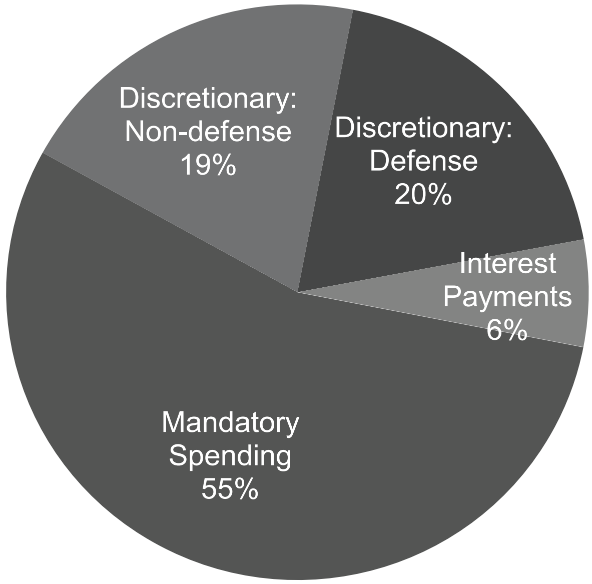


response, states and localities are in the process of cutting back drastically on spending (on schools, public safety, government jobs) to improve their finances. That's good for their fiscal outlook but is exerting a large drag on economic growth both at the state and national level. Municipalities also are having to pay higher interest rates to obtain financing, as investors demand higher interest rates on municipal bonds to finance state and local public works projects.

The rapid deterioration in the U.S. fiscal situation and the emergence of public sector finances as a main issue of national debate is complicated by the fact that the American public is split about how to solve the problem. Unlike in Europe, there is no broad consensus in the United States about the appropriate role and size of government. Opinion polls point to confusion among voters, who may strongly advocate debt reduction and a smaller government sector but at the same time oppose cuts to the social programs upon which they depend or tax increases on anyone but the wealthiest Americans. On the broad question of whether it is more important to reduce the budget deficit or to maintain current Medicare and Social Security benefits, the public decisively supports maintaining the status quo. In a recent Pew Research Center poll, 60 percent polled said it is more important to keep Social Security and Medicare benefits as they are; only 32 percent thought it more important to take steps to reduce the budget deficit.[4]

The recent highly-charged political debate over raising the debt ceiling unfortunately did not help to bridge the public opinion gap or even clarify the fiscal choices at hand. Nor did its outcome come near to achieving the goal of setting the nation on a sustainable fiscal trajectory. Moreover, the debate failed to change the minds of those who doubted the potentially disastrous consequences of letting the U.S. default on its obligations. Interest rates were not driven higher as the threat of default loomed, or even after Standard & Poor's decided to downgrade U.S. debt one level; on the contrary, long-term rates fell even further as investors seeking a "safe-haven" continued to flock to the traditionally "risk-free" asset, U.S. Treasuries, that had just received the lower grade. The Budget Control Act that emerged from the debt ceiling debate does make some progress toward stabilizing deficits over the next years, and puts in place caps on discretionary spending and "triggers" that many fiscal experts had argued must be part of an agreement. Yet, even accounting for the debt reduction measures agreed in the Act, the CBO predicts that federal debt will continue to rise under realistic policy assumptions (e.g., that tax cuts enacted under former President George W. Bush will be renewed). Under their "alternative scenario" that assumes current policy rather than current law, CBO estimates that the United States would amass an additional cumulative deficit of $8.5 trillion over the ten-year period 2012-2021—nearly four times the amount of savings set out in the Budget Control Act.[5]

Figure 3: Composition of Federal Spending[6]



Specifically, the Budget Control Act focuses almost solely on discretionary spending (which accounts for less than 40 percent of the budget), with most of the cuts so far enacted aimed at non-defense discretionary spending (e.g., education, infrastructure) that amounts to about 19 percent of total federal spending. Fiscal experts agree that achieving long-term fiscal sustainability cannot be achieved solely through cuts in discretionary spending, but rather will require a combination of spending cuts, revenue increases, and reform to mandatory spending, or social "entitlement" programs (Social Security, Medicare, Medicaid).

The Joint Select Committee on Deficit Reduction, better known as the "super-committee," presents an opportunity for a deal that delivers savings from all sections of the budgetary pie. Ideally, the Committee would go beyond the target of finding $1.2-1.5 trillion in additional savings over ten years to propose a much larger ($4-5 trillion) package that would stabilize and even begin to reduce the U.S. debt-to-GDP ratio. The tax increases and spending cuts agreed to in such a "grand bargain" should be back-loaded (i.e., cuts take effect toward the end of the ten year period) and phased in gradually, and fiscal rules put in place that would make it difficult for future Congresses to unwind the savings pledges. In order to send a growth-supportive message, the package could include additional short-term spending measures on cost-effective investments for the long-run health of the economy (e.g., education, training, infrastructure), as well as an extension of some tax cuts to support economic recovery. But achieving a compromise like this, that makes sense for both fiscal adjustment and growth, is not looking very likely in the current political environment, where Republicans remain vehemently opposed to tax increases and Democrats to cuts in entitlement benefits. If a so-called "grand bargain" is not achieved this fall, then the rancorous debate over America's fiscal challenge is likely to remain front and center for some time to come, potentially adding to the uncertainty that is weighing on the economy.

The Challenge for Europe: Containing the Crisis, Sustaining Growth

The fiscal situation in the euro area is more acute and immediate than that of the U.S., even though the sovereign debt crisis per se has been focused on just a few member countries. The risk of the crisis spreading to larger euro area member states such as Spain and Italy has increased in recent weeks, and there are signs that the crisis is weighing on consumer and business confidence throughout the euro area. Increased financial stability risk is also threatening to affect the entire region, with increased funding pressures in the European banking sector accompanying the rise in financial market stress and volatility.

Like in the United States, the Great Recession put considerable strain on public finances in all euro area member states, albeit with vast differences between countries. Pre-existing imbalances in terms of public debt have worsened. Previously overlooked vulnerabilities in several member states have driven up sovereign bond yields and credit default swaps (CDS) spreads, thus fuelling a further deterioration of public finances in the affected countries and threatening to endanger the macro-financial stability of the euro area and EU member states.

Against this backdrop, Europe has undertaken unprecedented steps to manage contagion risks in the common interest of all EU and euro area members. Despite the criticism, European leaders have actually achieved a great deal and have acted boldly—but markets have demanded bolder and faster action. Unprecedented financial assistance programs, run jointly by the European Commission, European Central Bank (ECB), and IMF, have prompted fiscal adjustments and structural reforms in Greece, Ireland, and Portugal that were unthinkable a little over a year ago. In Spain and Italy as well, whose interest rates were driven up sharply earlier in the summer as markets increasingly began to doubt their ability to service their existing debts under current economic conditions, drastic fiscal adjustment and necessary structural reforms are being adopted and implemented. Even countries in less acute fiscal trouble are also taking pains to reduce budget deficits and enact growth-enhancing reforms previously not tackled. In addition, the European Financial Stability Facility (EFSF) and (as of 2013) the European Stability Mechanism (ESM) have been created and given unique powers to provide financial support to member states. The European Central Bank, meanwhile, has expanded its own mandate to provide liquidity to the banking system in troubled countries.

At the same time, the EU has agreed on a broad strategy for a stricter and more cohesive economic governance framework for the euro area and accelerated structural reforms. The overarching goal of the governance reforms is essentially to inject more "E" into EMU—in other words, to strengthen the economic governance framework to function more like an economic union (and, gradually, even a fiscal union). The architects of the single currency expressly crafted the Economic and Monetary Union (EMU) to ensure that the single monetary policy and common currency would be backed by coordination on economic and fiscal policies. Unfortunately, the instruments for economic and fiscal coordination (chiefly, the Stability and Growth Pact) failed to exert sufficient discipline and lacked an effective means of enforcement, and policymakers at the European level did not anticipate the "reform fatigue" that would set in shortly after EMU was launched in 1999. In the age of easy credit leading up to the financial crisis, markets also failed to exert discipline and demand more prudent fiscal policies, charging essentially the same interest rate on government debt from Greece as for that of Germany.

But putting more "E" in EMU is neither a smooth nor easy process in a monetary union of 17 countries (and a European Union of 27). For many member states, it is difficult to accept greater fiscal union, particularly for economically stronger countries like Germany, which fears its taxpayers would wind up footing the lion's share of the bill to bail out its poorer and fiscally profligate neighbors. Progress toward an "ever closer union" in the economic and fiscal dimension is thus almost always slower than desired, and it is also difficult to communicate. Moreover, focusing on the architectural deficiencies of the Europe's single currency risks undermining confidence in the euro and its ability to withstand this crisis.

Since early 2010 when trouble started brewing in Greece, European leaders have tried in vain to deliver solutions but have been unable to stem the tide of negative market sentiment. It seems that every time the European Council comes to an agreement, markets almost immediately begin to question the political will behind the measures. (A case in point was the recent European Council decision of 21 July 2011 that increased assistance for Greece and expanded the size and powers of the EFSF, and which markets initially celebrated yet within a day began to doubt its effectiveness and implementation.) Partly to blame for this is the fact that it takes time for the details of these agreements to be fleshed out, and for them to be endorsed by national parliaments and implemented. Markets are not willing to wait for these developments and consider delays to be a threat to the particular mechanism or program itself. For their part, European policymakers have in many cases failed to follow through quickly and clearly communicate their intentions. Germany is a prime example of this, having created confusion and uncertainty regarding its willingness to support the country assistance programs or agree to crucial institutional changes (e.g., enabling the EFSF to purchase government bonds in the secondary market, or the idea of creating a euro bond).

Europe's to-do list is long and difficult. Its fiscally weaker member states need to achieve rapid fiscal consolidation to avoid default and regain competitiveness, and the others need to achieve fiscal adjustment without strangling economic growth in the short run. A concerted effort must be made to stem contagion risks, which in some cases may involve supporting banks and reforming banking systems. Structural reforms and targeted investment are needed to enhance potential growth throughout Europe. There is still much work to be done in these and other areas, including implementation of the measures already taken at European and national levels.

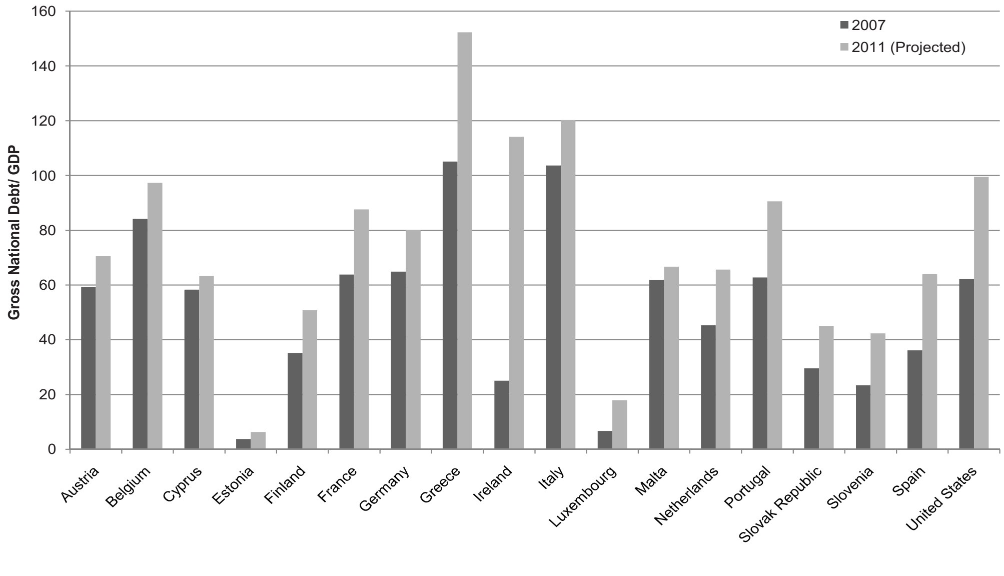
U.S. Views of Europe's Fiscal Crisis, Europe's Views of the U.S.

Fiscal policy developments over the past months in Europe have been watched closely by the United States, and vice-versa. An element of "Schadenfreude" is certainly at play, i.e., among a large euro-skeptic faction of American economists and commentators, and also among a faction of Europeans taking heart in the fact that the U.S. is also struggling with its own fiscal issues. But each partner realizes it has a real economic stake in how the other deals with its fiscal challenges.

U.S. reactions to Europe's sovereign debt crisis have been varied but almost exclusively negative. Generally, U.S. commentators, like financial markets, seem to have little understanding of, or patience for, Europe's complicated political procedures and drawn-out debates. Many in the American economic media have seized upon Europe's sovereign debt crisis as an opportunity to remind that the euro "experiment" was "doomed from the start" and built on a faulty construction. From some corners one hears the view that Europe's "bloated" welfare states and the euro itself are to blame for the crisis,[7] and one does not have to go far to find a reference to the seeming curse of "becoming like Europe." Interestingly, in the fiscal debate over the past year Europe's sovereign debt crisis has been used by Republicans and Democrats to support the opposing views of either side. Republicans have cited the crisis in Europe to support deep and rapid spending cuts to reduce deficits and debt, while Democrats pointed to the sharp slowdown in growth in the EU-IMF program countries as a warning against applying the fiscal brakes too soon to the U.S. economy.

Lately, however, the more euro-skeptic "we-told-you-so-ing," while still visible in some press reports and commentary, has given way to increased interest and concern about how Europeans are dealing with the crisis and what impact it might have on the U.S. economy. U.S. policymakers appear increasingly worried about the risk of spillover effects from the euro crisis to the United States, particularly if the crisis spreads to larger euro area countries (where U.S. banks have greater direct exposure) or to the banking sector (where transatlantic channels run deep and the knock-on effects of market disruptions unpredictable). There seems also to be a growing faction that is concerned about rising structural problems in the United States (e.g., long-term unemployment becoming entrenched) and thus sees growing similarities between the challenges the U.S. and Europe are facing. Notwithstanding an appreciation

Figure 3: Debt to GDP in the Euro Area Member States and the U.S.[8]



for Germany's relatively strong economic recovery, in the U.S. the economic prospects for the euro area as a whole are largely seen through the lens of the fiscal problems of its most troubled member states. The overriding view in the U.S. is that the euro itself may not survive the sovereign debt crisis.

While some European commentators seemed to enjoy a bit of "Schadenfreude" during the recent U.S. debt ceiling debacle (along the motto: "at least we're not the only ones"), the market reverberations resulting from the S&P downgrade of U.S. debt showed how much Europe has to fear from a fiscal crisis in the United States. Europe would be negatively affected if interest rates rise in the U.S., and also by greater financial market volatility and risk aversion, as well as potential volatility in asset and foreign exchange markets. Europe's economic growth outlook is highly dependent on the economic health of the U.S. as well. It has become quite clear this summer the extent to which the two economies are interlinked. U.S. and European consumer and business confidence indicators are tracking each other closely. Each U.S. economic data release has been reflected in European markets, just as every jitter about potential crisis contagion in Europe has been felt in U.S. markets.

Implications for Transatlantic Relations and the Transatlantic Agenda

The ascent of debt reduction as a major priority for both the U.S. and Europe could pose a risk to transatlantic relations, particularly if it causes both sides to retrench and become inward-looking. Fiscal consolidation, if done too quickly in either or both regions, could weigh on economic growth in the short run and affect the partner region through the large U.S.-EU trade and investment channels. Worse yet, the regions might react to this economic weakness by adopting measures to protect their own industries and businesses, at the expense of the economic partnership. While a protectionist reaction was avoided during the economic and financial crisis, there is still a risk that countries could resort to such a losing strategy, particularly if growth remains sluggish. Moreover, reductions in government spending reductions could necessitate a shift of resources and political attention away from issues important in transatlantic relations.

Several specific questions follow from these broader issues. For example, will the U.S. be compelled to cut defense spending and limit its involvement and spending on foreign military and development assistance activities? This could lead to conflict with the EU, which may be asked to take on more of the burden for joint peacekeeping and military operations, particularly in its nearby regions (MENA, eastern Europe). And what about the ability to pursue fiscal consolidation while preserving economic growth (i.e., investing in R&D, infrastructure, education)? What will be the impact on the financing of measures to combat climate change and promote environmental sustainability? Will previous policy priorities in these and other areas (e.g., development assistance) be compromised?

To avoid these kinds of undesired consequences, the U.S. and Europe both need to ensure that fiscal adjustment does not impinge on growth. For Europe, the challenge is how to win back market confidence in its fiscal sustainability but not strangle the economic recovery. Raising potential growth throughout the euro area, and also regaining competitiveness in particular in the program countries, will require a greater structural reform effort on the part of national governments. Yet while structural reforms benefit growth in the long run, they can weigh on economic activity in the short run. In the case of the U.S., a more ambitious plan for medium-term fiscal consolidation should be accompanied by measures to increase productive investment that will help spur growth in both the short and long run. Europe and the U.S. could both use a "Sputnik Moment" now, but it's not easy to see how it can be financed at a time when governments, businesses, and households are cutting back. In terms of long-run growth prospects, the U.S. may have an advantage over Europe, in particular due to its more favorable demographic outlook and its tradition of entrepreneurship and dynamism. But signs of emerging structural issues in the U.S. economy, such as high long-term unemployment, are casting doubt on the U.S.' ability to innovate its way out of its fiscal and growth problems.

The U.S. and Europe's common pursuit of both austerity and growth should be viewed as an opportunity to employ the transatlantic relationship to help both partners address their fundamentally similar challenges. Stepping up transatlantic economic cooperation through existing fora like the Transatlantic Economic Council (TEC) will be essential, but the efforts should be focused and goal-oriented, and greater political weight should be given to building on the strength and importance of trade and investment between the U.S. and Europe. The following ideas might be considered:

- Dust off past plans for a "transatlantic marketplace" and create a new initiative to expand transatlantic trade and investment, with particular focus on the market in services. The TEC, until now rather narrowly focused, could see its profile elevated by taking on this task. Plans to further facilitate transatlantic trade and investment could also help revive the stalled Doha Round of international trade talks. The global economy is in dire need of a positive message right now, and a strategy based on opening up economies rather than raising protectionist barriers might be exactly the kind of action and demonstration of economic leadership that is needed to change the market mood and instill confidence.

- A transatlantic dialogue involving fiscal authorities, independent budget advisor agencies, and think-tanks to explore the impact of various fiscal policy measures on deficits and growth; the long-term benefits of structural reform; and effective fiscal rules. The U.S. and Europe are both trying to determine the best strategies for fiscal consolidation, i.e., where to find savings and revenue with the least negative impact on growth, and where to find the most cost-effective areas for investment. Both sides could benefit from sharing expertise and best practices.

■ A transatlantic exchange on employment policies, involving labor department/ministry officials, unions, business, and think-tanks, which would share outcomes and cost-benefit analysis of investments in education, training, and skills development and matching. Europe's experience with short-term work programs and other active labor market policies to reduce unemployment could be explored as a potential option for the U.S. as it struggles to reduce high and long-term unemployment, while Europe could potentially take away useful policy ideas from the U.S.' higher participation rates of older workers.

■ In the area of financial sector reform, greater cooperation and dialogue is essential particularly as the reform plans on both sides of the Atlantic take shape, for example in the areas of bank capital requirements and regulation of derivatives markets. Existing channels of communication in this area should be strengthened and given top priority, and a transatlantic commitment should be made to avoiding policies that would encourage arbitrage and impede lending.

■ A transatlantic dialogue on infrastructure issues (public transportation, energy, financing) should be created, which could include lessons from Europe as the U.S. aims to set up a National Infrastructure Bank or similar initiative to leverage private capital for public works projects somewhat similar to the European Investment Bank.

These and other targeted proposals could serve to advance the debate on both sides of the Atlantic and help both sides better evaluate the broader fiscal options and inform the important policy choices to be made on these issues in the coming months and years. These kinds of positive efforts in the transatlantic policy community might even help to shift market and public attention away from the potential fiscal and economic risks in Europe and the U.S. and toward the fundamentals and the important role of the EU-U.S. economic relationship in the global economy. It might also inspire leaders on both sides of the Atlantic to look outside their own nations for potential solutions to their respective, but increasingly interlinked, fiscal and economic challenges. Given where things stand now, it seems at least worth a try.

The saying "a crisis is a terrible thing to waste" so frequently quoted during the Great Recession deserves revisiting today. To be sure, time has been lost, credibility in political leaders has declined, market sentiment has soured, and grand solutions are not forthcoming. But leaders on both sides of the Atlantic, at the national, regional, and transatlantic level, still have a chance to break out of the negative feedback loop that seems to be taking hold (more quickly in Europe than in the U.S. due to extreme market pressure on interest rates in the peripheral countries as well as Spain and Italy, but in both regions nonetheless) between fiscal sustainability and economic recovery. The key challenge for Europe's leaders is to convince themselves and their constituents that the way out of the current problems and the path to greater prosperity is more complete economic integration (i.e., more Europe, not less). And the challenge for U.S. leaders is to put the nation's economic health ahead of short-term political gain and to encourage Americans to understand and make choices about the role and size of government. Each side has a huge stake in whether the other can manage to strike a balance between austerity and growth that will help secure the long-term economic future of both regions. Intensified transatlantic cooperation could help in that effort.

1 Carmen M. Reinhart and Kenneth S. Rogoff, "Growth in a Time of Debt," *NBER Working Paper* No. 15639, January 2010; Stephen G. Cecchetti, M.S. Mohanty, and Fabrizio Zampolli, "The Real Effects of Debt." Paper presented at the "Achieving Maximum Long-Run Growth" symposium sponsored by the Federal Reserve Bank of Kansas City, Jackson Hole, Wyoming, 25-27 August 2011.

2 Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2011)."

3 Elizabeth McNichol, Phil Oliff, and Nicholas Johnson, "States Continue to Feel Recession's Impact," *Center on Budget and Policy Priorities*, 17 June 2011, <http://www.cbpp.org/cms/index.cfm?fa=view&id=711> (16 September 2011).

4 "Public Wants Changes in Entitlements, Not Changes in Benefits," *Pew Research Center Survey Report*, Pew Research Center for the People and the Press, 7 July 2011.

5 Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2011).

6 Ibid.

7 Paul Krugman, "Can Europe Be Saved?" *New York Times Magazine*, 12 January 2011; Robert J. Samuelson, "The Welfare State's Death Spiral," *The Washington Post*, 10 May 2010.

8 International Monetary Fund, *World Economic Outlook: Tensions from the Two-Speed Recovery: Unemployment, Commodities, and Capital Flows*, April 2011, <http://www.imf.org/external/pubs/ft/weo/2011/01/> (16 September 2011).

The global economy has still not managed to overcome effects of the financial and economic crises in 2008 and 2009. Despite improvements in the American and European financial markets in 2010, the fiscal crisis in Greece and the continually rising U.S. deficit have caused a decline of trust in the capital markets and have overshadowed any growth in the real economy. Fear of a new recession remains, especially as unemployment figures in the U.S. stagnate. Overcoming the recession and returning to a sustainable growth pattern, however, is of paramount importance for the wealth and security of all nations and has an impact on almost all other policy areas. This Issue Brief is a result of a conference in Frankfurt in June 2011 that examined these issues and is part of a larger project on “The End of the Years of Plenty? American and German Responses to the Economic Crisis.”

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