Krugman: Euro crisis is not due to failure of welfare state

By PAUL KRUGMAN, NEW YORK TIMES
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This is the way the euro ends - not with a bang but with bunga bunga. Not long ago, European leaders were insisting that Greece could and should stay on the euro while paying its debts in full. Now, with Italy falling off a cliff, it's hard to see how the euro can survive at all.

But what's the meaning of the euro debacle? As always happens when disaster strikes, there's a rush by ideologues to claim that the disaster vindicates their views. So it's time to start debunking.

First things first: The attempt to create a common European currency was one of those ideas that cut across the usual ideological lines. It was cheered on by American right-wingers, who saw it as the next best thing to a revived gold standard, and by Britain's left, which saw it as a big step toward a social-democratic Europe. But it was opposed by British conservatives, who also saw it as a step toward a social-democratic Europe. And it was questioned by American liberals, who worried - rightly, I'd say - about what would happen if countries couldn't use monetary and fiscal policy to fight recessions.

So now that the euro project is on the rocks, what lessons should we draw?

I've been hearing two claims, both false: that Europe's woes reflect the failure of welfare states in general, and that Europe's crisis makes the case for immediate fiscal austerity in the United States.

The assertion that Europe's crisis proves that the welfare state doesn't work comes from many Republicans. For example, Mitt Romney has accused President Obama of taking his inspiration from European "socialist democrats" and asserted that "Europe isn't working in Europe." The idea, presumably, is that the crisis countries are in trouble because they're groaning under the burden of high government spending. But the facts say otherwise.

It's true that all European countries have more generous social benefits - including universal health care - and higher government spending than America does. But the nations now in crisis don't have bigger welfare states than the nations doing well - if anything, the correlation runs the other way. Sweden, with its famously high benefits, is a star performer, one of the few countries whose GDP is now higher than it was before the crisis. Meanwhile, before the crisis, "social expenditure" - spending on welfare-state programs - was lower, as a percentage of national income, in all of the nations now in trouble than in Germany, let alone Sweden.

Oh, and Canada, which has universal health care and much more generous aid to the poor than the United States, has weathered the crisis better than we have.

The euro crisis, then, says nothing about the sustainability of the welfare state. But does it make the case for belt-tightening in a depressed economy?

You hear that claim all the time. America, we're told, had better slash spending right away or we'll end up like Greece or Italy. Again, however, the facts tell a different story.

First, if you look around the world you see that the big determining factor for interest rates isn't the level of government debt but whether a government borrows in its own currency. Japan is much more deeply in debt than Italy, but the interest rate on long-term Japanese bonds is only about 1 percent to Italy's 7 percent. Britain's fiscal prospects look worse than Spain's, but Britain can borrow at just a bit over 2 percent, while Spain is paying almost 6 percent.

What has happened, it turns out, is that by going on the euro, Spain and Italy in effect reduced themselves to the status of Third World countries that have to borrow in someone else's currency, with all the loss of flexibility that implies. In particular, since euro-area countries can't print money even in an emergency, they're subject to funding disruptions in a way that nations with their own currencies aren't - and the result is what you see right now. America, which borrows in dollars, doesn't have that problem.

The other thing you need to know is that in the face of the current crisis, austerity has been a failure everywhere it has been tried: No country with significant debts has managed to slash its way back into the good graces of the financial markets. For example, Ireland is the good boy of Europe, having responded to its debt problems with austerity that has driven its unemployment rate to 14 percent. Yet the interest rate on Irish bonds is still above 8 percent - worse than Italy.

The moral of the story is to beware of ideologues who are trying to hijack the European crisis on behalf of their agendas. If we listen to those ideologues, all we'll end up doing is making our own problems - which are different from Europe's, but arguably just as severe - even worse.

Krugman is a columnist for The New York Times.

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