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KRUGMAN: 2 warped perspectives on Europe

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LISBON, Portugal — Things are terrible here, as unemploy-ment soars past 13 percent. Things are even worse in Greece, Ireland, and arguably in Spain, and Europe as a whole appears to be sliding back into recession.

Why has Europe become the sick man of the world economy? Everyone knows the answer. Unfortunately, most of what people know isn't true — and false stories about European woes are warping our discourse.

Read an opinion piece about Europe — or, all too often, a supposedly factual news report — and you'll probably encounter one of two stories. Neither story fits the facts.

The Republican story — a central theme of Mitt Romney's campaign — is that Europe is in trouble because it has done too much to help the poor and unlucky, that we're watching the death throes of the welfare state. This story is a perennial right-wing favorite: Back in 1991, when Sweden was suffering from a banking crisis brought on by deregulation, the Cato Institute published a triumphant report on how this proved the failure of the whole welfare state model.

Did I mention that Sweden, which still has a very generous welfare state, is currently a star performer, with economic growth faster than that of any other wealthy nation?

But let's do this systematically. Look at the 15 European nations using the euro, and rank them by the percentage of GDP they spent on social programs before the crisis. Do the troubled GIPSI nations (Greece, Ireland, Portugal, Spain, Italy) stand out for having unusually large welfare states? No, they don't; only Italy was in the top five. So excessively large welfare states didn't cause the troubles.

Next up, the German story, which is that it's all about fiscal irresponsibility. This story seems to fit Greece, but nobody else. Italy ran deficits in the years before the crisis, but they were only slightly larger than Germany's (Italy's large debt is a legacy from irresponsible policies many years ago). Portugal's deficits were significantly smaller, while Spain and Ireland ran surpluses.

Oh, and countries that aren't on the euro seem able to run large deficits and carry large debts without facing any crises. Britain and the United States can borrow long-term at interest rates of around 2 percent; Japan, which is far more deeply in debt than any country in Europe, pays only 1 percent.

So what does ail Europe? The truth is that the story is mostly monetary. By introducing a single currency without the institutions needed to make that currency work, Europe effectively reinvented the defects of the gold standard — defects that played a major role in causing and perpetuating the Great Depression.

More specifically, the creation of the euro fostered a false sense of security among private investors, unleashing huge, unsustainable flows of capital into nations all around Europe's periphery. As a consequence of these inflows, costs and prices rose, manufacturing became uncompetitive, and nations that had roughly balanced trade in 1999 began running large trade deficits. Then the music stopped.

If the peripheral nations still had their own currencies, they could and would use devaluation to quickly restore competitiveness. But they don't, which means they are in for a long period of massunemployment and slow, grinding deflation.

The afflicted nations, in particular, have nothing but bad choices: Either they suffer the pains of deflation or they take the drastic step of leaving the euro, which won't be politically feasible until or unless all else fails. Germany could help by reversing its own austerity policies and accepting higher inflation, but it won't.

For the rest of us, however, getting Europe right makes a huge difference, because false stories about Europe are being used to push policies that would be cruel, destructive, or both.