

Is the Eurozone headed for economic deflation?

In much the same manner as US military and geopolitical power appears unrivalled, it has become conventional amongst economists to point to the favourable performance of the US economy relative to the core Eurozone states (Germany, France, Italy) as proof of the superiority of the market driven Anglo-Saxon model. According to the conventional wisdom, Eurozone growth is constrained by various supply-side ills: inflexible labour markets, a burdensome bureaucracy impeding job creation and unsustainable welfare costs. Support for this view spans a broad spectrum, including most of today's EU social-democratic parties. Anti-globalisation protests may command large numbers of young people, but the movement is short on coherent economic doctrine. However, as the Eurozone's prolonged stagnation threatens to turn into deflation, economic orthodoxy is coming under growing critical scrutiny.¹

According to a recent IMF report² Germany, the locomotive of the EU economy, may soon join Japan in the deflation league.³ When consumer demand stagnates and unemployment remains high, the economy has excess capacity exercising downward pressure on prices. As stagnation becomes prolonged, prices may start to fall pushing the economy into reverse. The last time this happened in Europe was in the 1930s. Households postpone their consumption in the expectation that prices will fall further. Net debtors, typically households with mortgages, experience a rise in the real value of debt. Firms find that their costs rise since money wages cannot readily be cut; hence they lay off workers, increasing unemployment and weakening aggregate demand still further. But the EU's political class remains mesmerised by the monetarist and supply-side economic ideology of the 1980s, and the price of adhering to orthodoxy may be the unravelling of the social-market economy.

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¹ See, for example: John Grieve Smith (2001) *There is a Better Way: a new economic agenda*, London, Anthem Press; Andrea Boltho, 'What's wrong with Europe' NLR 22, July-August 2003; amongst the more critical economic journalists, the reader will find Will Hutton, Larry Elliot, William Keegan and Charlotte Denny.

² See <http://www.imf.org/external/pubs/ft/def/2003/eng/043003.htm>; IMF 'Deflation: determinants, risks and policy option', IMF, Washington DC, 30 June 2003.

³ See Paul Krugman 'Is the world stumbling into an economic quagmire?' New York Times, May 27, 2003; also The Economist 'Of debt, deflation and denial' Oct. 10, 2002.

As Keynes pointed out nearly 70 years ago, to counter deflation the Central Bank should ease monetary policy by lowering interest rates and pumping more cash into the economy. Nevertheless, he added, monetary policy alone cannot cure the problem since households may simply hold the extra cash in the form of increased savings: the ‘liquidity trap’ in economists’ parlance. Neither the market on its own nor the Central Bank can cure the problem. A robust and sustained fiscal stimulus is needed to get the economy moving again. Some economists are worried that deflation may occur in the United States, but Germany is currently the more likely candidate. Even the Bank for International Settlements (BIS) has recently called for less emphasis on fashionable ‘structural reform’ and more on expansionary demand management.⁴

Japan: zero interest rates and no growth

We need not go back to the 1930s to find an example of incipient deflation. Since the Japanese property bubble burst in 1989, that country’s GDP has remained stagnant and is currently falling. After a decade of stagnation, Japan has slipped into a deflationary spiral. Prices have been falling for nearly three years. The Japanese Government lowered interest rates to nearly zero nearly a decade ago, but this failed to induce a sustained rise in economic growth. Instead, Japan’s once enviably low rate of unemployment has slowly risen. Today it stands at 6 percent, a historic post-war high by Japanese standards.⁵ Moreover, attempts to jump-start the economy using traditional fiscal stimuli have failed.

Until 1998, successive Japanese governments were politically unable and unwilling to run large fiscal deficits.⁶ Since the Asian crisis, the deflationary danger has been recognised and the public deficit, used mainly to finance public works, has been larger than in any OECD country. It currently stands at just above 8 percent of GDP, but this has failed to produce sustained growth. Moreover, because the deficit has been financed by borrowing, public debt is high (100% of GDP) and its finance is a heavy burden. That the economy remains flat is perhaps not surprising since---

⁴ See William Keegan ‘Sinking US dollar “could drag the world economy under”’, Guardian Weekly, July 10-16 2003.

⁵ Because of the way Japan’s unemployment is measured, 6% is probably a serious underestimate.

⁶ In the early years until 1997, the deficit gradually grew to 4%, but the Japanese Treasury stepped in and insisted on a hefty tax increase, promptly killing what little growth there was in the economy.

unlike the USA and UK---the public deficit is partly offset by strong household savings and an overvalued yen.

Most important, though, is that a decade of stagnation produces ‘deflationary momentum’. One should not forget that after the Great Crash of 1929, the US economy dragged its way through much of the 1930s with falling prices and high unemployment, defying the efforts of Roosevelt’s New Deal to prime the fiscal pump and renew growth. In Europe during the 1930s, countries put up tariff barriers and engaged in competitive devaluations, effectively exporting their unemployment. This was a game in which there were no winners. Ultimately---and paradoxically--it took the ruins of war and the imperative of reconstruction to re-launch growth. Today, after nearly a decade of stagnation in the Eurozone’s main economies, the parallel is painfully obvious.

Weaker fiscal systems

One reason why advanced economies have avoided deflation since the inter-war depression is because they enjoyed a robust fiscal system. Throughout the post-war boom-years until 1973, Keynesian policies were the norm and came with in-built fiscal stabilisers. During an upswing with incomes rising, a progressive tax structure resulted in money being siphoned off to Government; in the downswing, money was pumped back into the economy as fiscal revenues fell and unemployment benefit kicked in to boost private consumption.

Since the early 1970s, the Keynesian consensus has been eroded if not destroyed. Today’s Socialists and Social Democratic parties have joined Christian Democrats and other right-wing parties in their adhesion to monetarist orthodoxy.⁷ At Ministries of Finance throughout the EU, it has become part of the received IMF wisdom to assert that a government ‘cannot spend its way out of a depression’. Jim Callaghan first used the phrase in 1976 when Britain was in IMF receivership. Gordon Brown repeated the same anti-Keynesian dictum in his speech to the Labour Party Conference in 1997. The IMF decrees canonically that all external payments crises stem from excessive Government spending; hence, the all-purpose remedy is to cut

⁷ For an excellent discussion of the corrosive effect of monetarism on New Labour in Britain, see John Grieve Smith *op cit*

spending. These policies were applied to Latin America in the 1980s and to East Asia and Latin America in the 1990s; most recently they have resulted in near economic collapse in economies as diverse as Indonesia and Argentina.

Two further factors have undermined fiscal stabilisers. First, economic deregulation and tax cuts of the Reagan-Thatcher era have increased the size of the informal labour market and made tax incidence less progressive. This process is perhaps most advanced in Britain. In the name of labour market ‘flexibility’, a growing percentage of the labour force finds itself in non-unionised low-wage employment, often of a casual nature and such workers can readily be sacked during the downswing of a business cycle. A recent study of total tax incidence in Britain shows it to be regressive; the total effective rate of tax paid by the richest quintile of households is 34% while that of the poorest is 42%.⁸

Second, the huge growth of international capital markets and financial deregulation has made it far more difficult for governments to pursue counter-cyclical Keynesian policies. Where the international financial market perceives a government deficit as ‘unsustainable’ the result is usually a large capital outflow; ie, a speculative attack on the currency. In the EU, the best-known example is that of France in the early 1980s following the 1979 recession. Then, the newly elected Mitterand Government attempted to pursue expansionary fiscal policies; in consequence, capital fled the country effectively causing the Government to reverse course.⁹

The Maastricht Treaty’s deflationary bias

When the Eurozone countries locked into the euro on 1 January 1999, they greatly reduced the EU’s vulnerability to the sort of capital market shock that occurred in France and in the UK; ‘Black Wednesday’ in 1992. Reducing vulnerability is indeed one of the main arguments in favour of the single currency. Ironically, though,

⁸ See C. Lakin (2003) ‘The effects of taxes and benefits on household income, 2001-02’ London: Office of National Statistics.

⁹ See M. Lombard ‘A re-examination of the reasons for the failure of Keynesian expansionary policies in France 1981-83’ *Cambridge Journal of Economics*.

Maastricht (1992) and the subsequent Stability and Growth Pact (1997) have become an economic straightjacket.¹⁰

Amongst those economists raised on the market orthodoxies taught at US graduate schools from the 1970s onwards (some of whom later worked for the IMF), deflation is a dirty word since a market economy is proclaimed to be self-regulating.¹¹ Governments merely need to pursue sensible, rules-based monetary policy and all will be well. The drafters of the Maastricht Treaty of 1992 were not all conservative economists; indeed, many were respected public servants imbued with the noblest motives.¹² But for these men, memories were fresh of the inflationary decade that followed 1973, as for some was the folk memory of the German hyperinflation of 1923. The Maastricht Treaty was informed by good intentions, but economically it was deeply flawed.

The European Central Bank's brief to target 2 percent inflation or less contrasts unfavourably with that of the US Fed, which by statute must consider both inflation *and* employment. Most important, member states signing Maastricht who wished to accede to the single currency were obliged to lower their budget deficit to 3 percent of GDP and their total public sector borrowing to 60 percent of GDP. Penalties for not doing so were introduced in the SGP of 1997. Some years ago such a policy was arguably defensible on the ground that in the run-up to the 1999 euro-launch, deflationary rules were necessary to minimise the danger of speculative attack on eurozone currencies by the international capital market. Today these monetary and fiscal rules are not merely archaic but are positively counter-productive. High unemployment and zero growth *are* a recipe for social instability and rising nationalism. For the euro to succeed and for the EU social-market economy to prosper, the SGP will need to be scrapped, or at last substantially amended.

One should quickly add that the British Treasury's mantra that 'we do things better' is fallacious. Gordon Brown's 'golden rule' differs in only one respect from Eurozone

¹⁰ The ECB and SGP have been criticised by a large number of centre-left economists. A centrist critique is J-P Fitoussi and Jerome Creel (2002) 'How to reform the European Central Bank' London: The Centre for European Reform.

¹¹ An excellent non-technical book on deflation and market fundamentalism is Paul Krugman (2000) *The Return of Depression Economics*, London: Penguin Books.

¹² Ironically, one of the chief architects of the Treaty was the French Socialist, Jacques Delors.

rules: the Bank of England pursues a symmetrical inflation target¹³ which is slightly higher than that of the ECB.¹⁴ Indeed, much was made of the fact that the 2003 budget met the Maastricht criteria. Secondly, while it true that Britain's GDP growth rate has been higher than Germany's, average Eurozone GDP growth for 1999-2002 *excluding* Germany is about the same as the UK average. Given Britain's record on labour productivity per hour worked (20% lower than Germany and France) and income distribution (inequality is worse only in Portugal and Greece), the Treasury has little to boast about.

Most alarming, Britain's growth---like that in the US---- is currently propped up by a widening gap between household spending and income growth in a manner reminiscent of the run-up to the unforgettable crash of the early 1990s. This argument has been carefully researched, amongst others, by Wynne Godley and Alex Izurieta at the Cambridge Endowment for Research in Finance (CERF). Their work shows that even if the ECB were to follow Mr Brown by adopting a symmetrical inflation target, this alone will not reverse the drift towards deflation.

Eurozone stagnation

For the Eurozone countries (including Germany), average GDP growth in 2001 was 1.5% and only 0.7% in 2002. German growth in the first two quarters of 2003 was negative---the third successive year for which German growth has been less than 1%-- -while French and Italian annualised growth rates were barely positive. Eurozone growth for 2003 is forecast to be less than 1%. Even in Britain, current growth forecasts are being revised sharply downward. At present Eurozone inflation is below 2% and Germany's is 1.4%. In both Germany and France, unemployment is nearly 11% and rising.

¹³ A 'symmetrical' inflation target means that in inflation falls *below* the target, expansionary monetary policy is used to raise it to target level. The problem with this reasoning is that because of the liquidity trap, lowering interest rates will not necessarily raise employment, growth and inflation. Luckily, the effectiveness of 'symetry' has yet to be tested.

¹⁴ Brown has announced that the UK will adopt the EU measure of inflation, the Harmonised Index of Consumer Prices (HICP); this will result in a measured UK inflation rate lower than the current BoE target.

The growth of unemployment is not merely conjunctural. As Boltho¹⁵ amongst others have pointed out, Eurozone unemployment has been higher at each successive peak of the business cycle, rising from 2.5% in 1972-73 to 9% in 1999-2000. The EU's relatively strong labour productivity performance is due in part to a smaller proportion of the active workforce working shorter hours. Thus, the Eurozone's high wages, high levels of social provision and low inequality are apparently bought at the expense of growing unemployment. This contrasts to the situation in the Anglo-Saxon economies where unemployment has been lower, but social provision has deteriorated and income inequality has markedly worsened. In the words of Richard B. Freeman, one of the leading labour market economists in the US:

Since the early 1970s, while the income of the top 1 percent of households has doubled, family and household incomes have stagnated or declined for 80 percent of the [US] population.¹⁶

In short, what the Eurozone needs is more people in at work. Improved training and equal opportunity of access to jobs are palliatives; such measures can only be effective if there are jobs to be had. Removing restrictions on shop opening hours and easing the creation of small businesses, as the Dutch experience shows, can help reduce unemployment. But what is needed above all is a climate of buoyant demand to promote expectations of higher growth.

While EU inflation can be expected to blip because of the recent fall of the dollar against the euro, the effect of a stronger euro is deflationary; ie, it slows growth. To offset merely this deflationary effect, it is agreed that the ECB would need to cut rates by at least one percent. In early June it cut its main rate by half a percentage point to 2%, a cut which doesn't fully counteract the impact of the strong euro, still less get the Eurozone economy moving. In July it left the rate on hold. But here is the rub, if the ECB lowers cuts the nominal rate much more the real rate of interest will turn negative. Very low interest rates could seriously disrupt money markets in the UK. If, additionally, long-term interest rates fall, commercial bank profits will be squeezed. Squeezing bank profits is risky when the economy is faces a downturn and firms may soon be struggling to repay bank loans.

¹⁵ A. Boltho (2003) *op cit*

¹⁶ See Richard B Freeman (1999), *The New Inequality; creating solutions for poor America*, Boston: Beacon press, p 7.

Structural Reform, while necessary, is not the answer

In January of this year, the European Commission issued a report critical of the slow pace of structural reform. It reminded EU members that at the Lisbon summit of 2000, leaders---urged by Tony Blair---had committed themselves to making the EU the world's 'most competitive' economy by 2010. The list of reforms called for is well known: labour markets must become more flexible, public finances must be put in order and product markets must become more competitive. All are 'supply-side' measures, which the current orthodoxy considers a pre-requisite for restoring dynamism to the Eurozone economy.¹⁷

Competition in product markets means that member-states must remove remaining barriers to intra-regional trade; these are typically non-tariff barriers embedded in obscure protectionist legislation. So far, so good! Labour market flexibility and public finance reform are more problematic goals. The former means lowering wage and non-wage costs (eg, pension and health insurance contributions) for employers. The latter means cutting state expenditure on public services, typically through forms of privatisation allegedly increasing economic efficiency.

One does not have to be a neo-liberal economist to recognise that specific inefficiencies and abuses exist in EU labour markets.¹⁸ In Germany today, occupational disability payments account for 4% of GDP, a greying population threatens to raise the old age dependency ratio within a generation to 35% and state pension transfers are equivalent to 10% of GDP; such trends are cause for serious concern.¹⁹ Nevertheless, this cannot be used as an excuse for the wholesale dismantling the EU's social market model, the sort of comprehensive attack on public services and labour guarantees which took place in Thatcher's Britain in the 1980s.

¹⁷ For a highly critical view of the benefits of 'labour market flexibility', see Dean Baker, Andrew Glyn, David Howell and John Schmitt, 'Labour Market Institutions and Unemployment: A Critical Assessment of the Cross-Country Evidence', in D. Howell, ed (2004), *Unemployment and the Welfare State*, Oxford: OUP.

¹⁸ For a far more detailed examination of labour-market constraints on growth than provided here, see Andrea Boltho (2003) *op cit*.

¹⁹ See March, R J (2003) 'Germany and the Challenge of Global Aging' Washington, DC: Centre for Strategic and International Studies.

First, cutting back on social provision weakens aggregate demand, precisely what is not needed under conditions of potential deflation.²⁰ Secondly, institutional reform must be negotiated between all parties and seen to be fair; in consequence such reforms take time and cannot be allowed to weaken social cohesion or increase social exclusion. Thirdly, encouraging flexible labour markets usually means abandoning centralised wage bargaining. If and when growth returns, the main supply-side institution for promoting employment while restraining potential inflation (used to great effect in the Netherlands and Nordic countries) will have disappeared. Finally, rethinking government receipts is just as important as rethinking expenditure.

When deflation threatens, balancing the government budget is not a sensible aim. Neither is it considered sensible in the EU to legislate tax breaks for the very rich, who have the lowest propensity to spend. Governments should be running a well-targeted deficit, in the extreme case financed by printing money (an avenue now blocked by the ECB). Deflationary expectations, once they set in, can only be overcome by a policy of deliberately promoting inflation. Once the danger of deflation recedes and economic growth picks up, not only will revenue rise as employment grows but also new means can be explored of strengthening the revenue side of public finances.

Admittedly, under conditions of high unemployment and a growing dependency ratio, it is difficult for many EU countries, already highly taxed, to find extra finance. One possibility is introducing a form of ‘Tobin tax’, the main aim of which is to reduce capital market volatility. In a world where the average daily volume of foreign exchange transaction is USD 1.5 trillion---about 250 times the annual value of world trade---an EU-wide Tobin tax of 0.1% would both strengthen public finances and, most important, greatly increase resources available for combating poverty and disease in the Third World.²¹

²⁰ A good critique is provided by William Keegan ‘A policy vacuum’ *The Guardian*, July 9, 2003.

²¹ The tax is named after the American economist who first suggested it in 1989 and is advocated, amongst others, by George Soros. A form of Tobin tax in the form of a reserve requirement has been used successfully in Chile since 1991. It taxes short-term speculative flows (money market and portfolio transactions) rather than foreign direct investment. There is a large literature on the Tobin tax; for a useful short survey, see ‘Time for a Tobin tax?’ *Federal Reserve Bank of San Francisco Economic Letter*, April 9, 1999.

The need for a co-ordinated EU macroeconomic policy

At the beginning of July 2003 Herr Schroeder announced a modest package of tax cuts aimed at boosting industrial profits and consumer spending. But because German households, unlike their British and American counterparts, cannot be coaxed into becoming net debtors in order to boost consumption, the danger is that a modest tax cut may simply raise household savings further. More generally, once taxes are slashed it is difficult to raise them again, thus weakening the fiscal system. True, the German economy needs structural reform, but such reform takes time as noted above.

What is needed *now* is a massive and sustained fiscal stimulus, a Government-led boost to demand in Germany, France and Italy of the order of 1-2 percent of GDP. That such a injection would breach the SGP goes without saying; SGP rules need to be amended accordingly, a step which will need the support of the eurozone's economic and finance ministers. For such a policy to be successful, moreover, public spending will need to rise not merely in Germany but in all those Eurozone countries whose economies are stagnating. This is why the co-ordination of macroeconomic policy between member-states is so important.

Equally, deflation is the reason the EU needs broad tax harmonisation. The argument that because US states have different tax regimes, the EU can do the same is fundamentally flawed. US macro economic policy is steered by a Federal Government whose share of GDP is above 25%; by contrast, 'federal' spending in the EU represents just 1.2% of members states' combined GDP. Moreover, the Brussels budget contains no built-in tax stabilisers. Tax competition amongst member states weakens EU public finance as capital flows from high- to low-tax regions. Broad agreement on levels of and corporate tax and personal tax for the super-rich is a desirable policy goal. But this principle is resisted fiercely the Treasury in the interests of the UK's financial service sector.

Bush is a closet Keynesian (although he may not know it)

The irony of the EU's situation is that in the USA, the home of conservative economics and free market orthodoxy, Government has provided a tremendous monetary and fiscal stimulus to the economy. Bush Jr is pursuing the sort of defence-

linked Keynesian policies combined with non-Keynesian protectionism used by Ronald Reagan, inventor of the hugely expensive Star Wars programme, which hastened the economic collapse of the USSR.

In late June the Fed lowered the prime rate to 1%, the lowest in 45 years, and is currently debating whether to push down long-term interest rates. The Fed knows that lowering long-rates could hurt the banking sector; indeed, any further cut in short-term rates could damage US money markets, which account for nearly 25 percent of the total money supply. This is the main reason its Chairman, Alan Greenspan, backs the Bush tax cut and extra spending which raise the deficit to nearly 4%.

It may be of great concern that the 2003 Bush tax cut chiefly benefits the rich and selected industries and that extra public spending goes largely to defence. But consider the policies in detail. In June 2002, Bush passed a farm bill raising agricultural subsidies by 80%, or nearly USD 200 billion over 10 years. He has asked Congress for a USD 1.4 trillion tax cut over the same period. In his State of the Union message in January 2002, he asked Congress to raise defence spending by USD 50 billion, the largest rise in two decades. However poorly targeted,²² the sheer magnitude of these fiscal stimuli suggests the US still knows how to prime the economic pump. As Keynes famously remarked, under conditions of incipient deflation, Government should create employment even if it means hiring workers to dig holes and fill them up again.

The EU response

EU Economic and Finance Ministers at an Ecofin meeting in Brussels in mid-July 2003 appeared to accept the need to boost the EU economy--- although the previous day, Eurozone ministers unwisely rejected a plea by Jacques Chirac, made in his televised Bastille Day speech, for a relaxation in the Maastricht fiscal rules. Instead, ministers discussed a proposal by the Italian Finance Minister, Giulio Tremonti, to spend more on EU infrastructure (unsurprisingly dubbed the 'Tremonti Plan'). This is a warmed-over version of the 1993 Delors Plan for improving trans-European

²² For a stinging critique of the Bush tax cut, see Paul Krugman (2001) 'Fuzzy Math: An Essential Guide to the Bush Tax Plan' New York: W W Norton. As Alex Izurieta at CERF Cambridge has pointed out, the defence spending has a multiplier of only unity as opposed to a multiplier of four for social spending.

transport infrastructure. While the new plan has yet to be costed, it would involve public and private money, EUR 50 bn of which would be lent by the European Investment Bank. Such a plan could usefully be included in a co-ordinated package of measures for EU reflation; it cannot serve as the principle instrument of reflation.

What was instructive about the meeting was its display of ignorance and economic orthodoxy in proposing solutions to the problem of economic stagnation. Pedro Solbes, the European Commissioner for Economic and Monetary Affairs, saw the solution as ‘structural reform’, shorthand for labour market flexibility. In this, Sr. Solbes merely echoed Wim Duisenberg’s neo-liberal views of 10 July following the ECBs failure to lower interest rates. Denmark supported the Tremonti plan while arguing that any new spending should not breach the Maastricht fiscal rules. Gerrit Zalm, the Dutch Finance Minister accused the French of having stormed the Bastille and now storming the SGP. Germany’s Finance Minister, Hans Eichel stood firmly against changing the SGP.

Of course, there’s nothing inherently wrong about boosting EU-wide infrastructure spending. However, there are two objections to using such spending as the main instrument of reflation. First, capital spending takes a long time to plan and execute and, secondly, it needs appropriate targeting. A few billion euros might usefully be spent (say) on improving trans-EU road and rail links, but this will not necessarily boost household spending in the EU’s major economies where it is most needed. An anti-deflation package needs to be targeted at the pockets of French and German consumers. The Japanese experience of the past decade shows that poorly-targeted fiscal stimuli cannot kick-start a large economy—indeed, once deflation actually sets in, not even large fiscal stimuli can do so.

Under conditions of potential deflation, it is patently absurd to aim at a balanced budget for each member state. Nobody---least of all the financial markets---believes that loosening the German and French fiscal purse strings will lead to hyperinflation under current conditions. Neither the IMF nor the BIS are particularly progressive bodies, but they do know that action is needed. Sadly, their warnings have been ignored. Pedro Solbes, Hans Eichel and their colleagues continue to defend a policy based on the economics of Herbert Hoover.

The EU is thus at a crucial juncture. Although still nominally committed to the post-war political settlement that institutionalised the welfare state and guaranteed near full-employment and strong social safety nets, the settlement is in danger of unravelling. Politically, the EU has concentrated on widening the union rather than on deepening its federal structures. Giscard's compromise constitution does little more than codify the *status quo*; its initially modest federalist proposals have been almost wholly abandoned in favour of what Perry Anderson has aptly termed 'a hierarchy of nation states ... without a summit'.²³ Economically, the EU's adherence to neo-liberal orthodoxy, reinforced by the Anglo-Saxon posturing and free-market fervour amongst the accession states, has blocked the adoption of economic policies that might reverse the drift towards deflation.

In the past decade, IMF-style fundamentalism has had a poor track record: Japanese stagnation, the 'tequila crisis' in Mexico, the East Asian crisis and recession, the speculative attack on Brazil and the Russian bail-out. In the new millennium, there has been meltdown in Argentina and a stock market crash in the US. Recovery in the US has been problematic, while the core Eurozone economy remains comatose.

The founding fathers of a united Europe hoped for more than merely a free trade area; their vision of a 'social' Europe formed the bedrock of the post-war settlement. They knew full well that high unemployment and low growth leads to social instability and xenophobia. That was the fundamental lesson of the 1930s, a lesson ignored at Maastricht and which, if unheeded in today's economic climate, could prove fatal for the European project.

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²³ See Perry Anderson 'Force and Consent' NLR 17, Sept-Oct 2002.