

# The EU's economics of the madhouse

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*I first posted the following on Saturday, in haste. It's now been edited a little and typos have, I hope, been eliminated and as requested by some, reposted with a new title:*

As the [Guardian reported](#) on Saturday:

*Merkel is pushing for a new enforceable regime under which countries using the euro would ultimately need to sacrifice budgetary and fiscal powers to a European authority that would monitor and then either endorse or veto budgets. It would penalise those whose debt levels are deemed to be destabilising the currency.*

Let's leave aside for the moment all the issues about loss of sovereignty to the EU (and I would have major reservations about this). Let's instead deal with utter economic stupidity (I can't be blunter than that) of this plan.

What Merkel, and so many right wing economists and politicians, assume is that government is in complete control of its budgets. That is completely untrue.

A government can and should would work out what it wishes to do with regard to spending to fulfil its mandate. So it should set budgets for health, education, social security, defence and so on. And it has a duty to explain why it has budgeted those costs.

And of course a state has a duty to do two further things. The first is to cover current spending as far as is possible with current income and to also cover the current cost of servicing loans used to pay for capital spending out of that same current income. If it does that then its book balance in a true accounting and economic sense.

That's the theory. That's the world Merkel thinks can be delivered. And she's completely wrong to presume this can be done.

Whilst government spending is, bar the so called 'automatic multipliers' such as unemployment benefits that are largely beyond government control since the level of unemployment is also at least in part also beyond its control, largely predictable. That's

the easy side of the budgeting equation. What government gets in income is to quite some considerable degree — especially in times like the present — hard to estimate.

As I have pointed out, often, Labour did not suffer an overspending crisis in 2008. Far from it: spending stayed on track. What went wrong was that government income crashed. And that was not its fault. Banks crashed and economic activity with it. The deficit was not a matter of choice, it was imposed on Labour.

Of course there is an argument about whether there is a structural deficit or not: I contend there isn't. But that's not the issue here. The reality is that whatever deficit there is was almost entirely beyond the control of Labour in 2008 and to some extent is of course now for George Osborne — assuming at least that the government decides it has no role in stimulating the economy, as Osborne has done.

And so for Merkel to say that states in the Eurozone have to control their budgets is just an indication of economic stupidity on her part. If they could then I am quite sure most would, all too willingly. They aren't because they can't. And the reason they can't is because of fundamental accounting equations. For example, if the economy as a whole decides to save (I stress save, which means cash stockpiling, and is an act quite different from investing which involves expending cash) as it is now, with corporations in particular stockpiling cash in quite spectacular fashion, then government is going to run a deficit: it is an accounting truism. It is beyond government's control but do so. And if it does seek to cut its spending in that circumstance — as Osborne is doing — then the inevitable consequence is that income — the only other variable in the equation — must be cut. So, for example, as Martin Wolf has pointed out recently, if you cut government spending right now and it is corporate saving that is funding it the inevitable consequence is that you must cut corporate profitability to achieve that result. It follows like night does day.

But this is what Merkel is saying. In a perverse throw back to the economics of the 1920s she is saying that come what may the governments of Europe must balance their books. The result is inevitable: the automatic balancing role that government deficits have played in the economy, picking up the slack in times of depression and recession, will instead be passed on to the private sector and individuals. That has to be the case. Business and individuals must run deficits if governments won't. That's not desirable, that's just what has to be.

But if banks won't fund those deficits and there aren't enough savings to pay for them (and the institutional structure of much saving such as pension funds does not facilitate this) then we'll simply see income crash instead. That has to follow because what we also know is that as we demand that banks rebuild their balance sheets they will not lend to cover it.

So Merkel's plan is a plan for deep, deep recession. That's what fiscal conservatism brings. It's not chance. It is, as I say, just what will have to happen if this plan proceeds.

This is the mad house of the commitment to the Gold Standard seen in the 1920s and which was so damaging with large all over European economic policy.

This is a policy guaranteed in the interests of the 1% whose savings will be protected from inflation (the alternative cure to this crisis) to wreak havoc on the well being of the 99%.

This is a policy designed to destroy government.

It is a policy designed to destroy the welfare state.

It is a policy designed to destroy democracy.

And it will do all those things.

It is a policy designed to create social instability and turmoil.

And it will do that too.

This is the economics of the madhouse. And it is not just being proposed in the Eurozone. The same logic underpins [\*'In the black Labour'\*](#), a new Labour pamphlet published this week. I am sure its authors are well intentioned. But they're still prescribing economic disaster and Labour must have nothing to do with it.

*The choice is a stark and simple one: is government to manage the economy as a [Courageous State](#) should or run from its responsibility and let people sink as Merkel and the fiscal conservatives want?*

*Labour has a duty to put the Courageous alternative to people. Or candidly we've surrendered already.*