

Clegg destroys Ricardian equivalence - but sticks by it...

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[The FT notes:](#)

Nick Clegg admits that the threat of deep public spending cuts has had a “chilling psychological effect” on Britain but will insist in Davos on Thursday that the coalition will not abandon its tough fiscal position.

He misses the point of those cuts entirely in that case. Anatole Kaletsky described that purpose very well yesterday in The Times, but it has been conveniently reduced on [Left Foot Forward](#) so we can get round the paywall:

[The Government] hopes that people will be impressed by its determination to cut borrowing and therefore to reduce potential pressures on the public purse – so impressed that consumers will spend more, businesses will create more jobs and entrepreneurs will start new businesses, all based on the confidence that their future taxes will be lower than today.

“Why has the Government decided to bet the economy on this untested theory? Apart from the pure party politics of branding Labour’s policies as recklessly irresponsible, there is an interesting intellectual background to Mr Osborne’s faith that the confidence engendered by cuts will offset the depressing effects on demand predicted by Keynesian economics.

“This faith is based on a theory traced back to the works of David Ricardo, perhaps the most respected economic thinker of all time. In a paper written in 1820, Ricardo examined whether a government that went to war would be better off collecting £20 million in taxes or borrowing the same amount at an interest rate of 5 per cent or £1 million a year. “In point of economy, there is no real difference,” he concluded. “For £20 million in one payment and £1 million per annum for ever are precisely of the same value.”

“This was seized on by conservative anti-Keynesian economists as Ricardo’s endorsement of their view that government borrowing was indistinguishable from taxation – and therefore that cuts in borrowing would automatically boost

private spending.

"This came to be known as Ricardian equivalence, but conservative economists failed to mention that Ricardo himself poured scorn on this simplistic idea, pointing out that it was based on unrealistic assumptions about human nature. Just after the passage about the theoretical equivalence of public borrowing and taxation, he added: "But the people who paid the taxes never so estimate them, and therefore do not manage their private affairs accordingly" It would be difficult to convince a man possessed of £20,000, or any other sum, that a perpetual payment of £50 per annum was equally burdensome with a single tax of £1,000." In other words, Ricardo himself doubted the Ricardian equivalence on which the coalition's entire economic policy depends. After yesterday's figures Mr Osborne had better take note."

In other words, Osborne thinks people are so excited by cuts because they think they are the equivalent of a decrease in tax, which means that they are the foundation of a future of greater personal prosperity (because, of course, personal prosperity is reduced by the actions of the state, always, in his book), that they will all be so happy (despite having no work, reduced income, and no benefits for those they know) that they will all go out and spend and drive the economy upwards. They'll max out the credit card to day in anticipation of that future prosperity in other words. Even though the banks won't lend to them, which is a minor side issue.

And Clegg on the other hand thinks the cuts have a chilling psychological impact that, I presume, means he thinks they are perceived as immensely burdensome.

Now one of them is right, and the other not.

Anyone with an ounce of common sense knows which it is - and for once it is Clegg.

But if he's right he has to see that Osborne's policy is wrong. Except his wit does not seem to stretch that far. In which case he's as culpable, and as incompetent, as Osborne.

And as ITN's economics editor said last night - "the world is watching this experiment with interest, glad they're not those subjected to it".

Well, I am a subject of that experiment. And I'll tell you - the hypothesis was wrong and the outcome will be disastrous. Stop it now. Because the psychological impact on millions will be untold, and harmful. And for knowing that and doing nothing you're doubly culpable Nick Clegg.