

On pot plants, the economic multiplier and why George O...

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I was talking to two decidedly non-economists yesterday. The subject was tweeting. They wanted to know why I was tweeting about economics. The question was "has anything happened in the world of economics in the last week that's worth tweeting about?" And, for one, the answer is a decided yes.

Last week the IMF published a new [World Economic Outlook](#). Let's cut through all the verbiage. The key point in it was that, as Wolfgang MÃ¼nchau has noted in the FT:

The claim that most forecasting models underestimate the multiplier by 0.4 to 1.2. This implies that it must be in a range between 0.9 and 1.7.

Now that may sound just a little technical. It is. It may even be wonkish to be excited about it, but I can assure you it matters.

Duncan Weldon has done a good job explaining multipliers, [here](#), but I'll offer my own stab anyway. The multiplier is a measure of the impact of government spending. So, if an additional pound of government spending increases GDP by £1 then we say the multiplier is 1. If it only increases GDP by 50p then it is 0.5 and if it increases it by £1.70 then it is 1.7.

I hope that immediately gives some perspective to why that one revaluation by the IMF is so important. They had assumed for several years - right throughout the crash in fact - that the multiplier was 0.5. So, they argued that extra government spending did not boost the economy much. More than that, they argued that cutting government spending by £1 only shrunk the economy by 50p so it was worth doing if the overall priority was to tackle the deficit. Let's again cut out the verbiage: that's exactly why Osborne claimed legitimacy for his austerity programme. His argument, as [Duncan has shown](#), was that the IMF said it was right, and it had to work because they said it did precisely because they'd estimated the multiplier to be 0.5.

But now they don't estimate it as 0.5 anymore. They've realised that what the multiplier might be when the economy is growing fast, when there is a boom in asset prices and

when economies are not far from full employment or can easily afford the unemployment they've got (which is much the same thing for these purposes) is very different from what the multiplier might be in a downside. You'd have thought that glaringly obvious.

Put it like this, a metaphor might be watering a pot plant. If the plant is in good health and growing well, the soil is damp and nutrition levels high the benefit of any additional water is going to be low. Most will drain away and be wasted, you could actually have a negative effect: you could waterlog the plant and impair growth. The multiplier effect of watering is going to be low. That's the IMF's 0.5.

Now suppose we have a plant in near dry soil, with low nutrition and weak growth. A good watering can in the vast majority of such cases then do a power of good. A little knowledge has to be applied: there are of course exceptions, but as a rule of thumb you can be pretty sure water will in such cases revive the plant, be almost entirely taken up by it and growth will follow. Little or no waste will result: indeed, the plant growth will more than compensate for the cost of the water that's been added. That's where we are now. The multiplier is well over one.

Belief in what the multiplier is has therefore been key to suggested approaches to economic debate in the last few years. When [in 2008 the Green New Deal group](#) suggested major investment as a way of tackling the then forthcoming economic crisis we did so because we agreed between us that the multiplier was likely to be very strong: we discussed 1.6 or 1.7 at the time which just so happens to be the point that the IMF is reaching now. And we agreed between us that in that case the argument that [Larry Summers and Bradford de Long](#) have now embraced, that spending could pay for itself was logical. We explicitly said so. We've never waived from it. We were right, all along.

We'd have been a lot better off the world had agreed with us then. Right now we would a result be in the midst of a major social housing building programme, a massive insulation programme, a big programme of enhancing flood defences, a major investment in low carbon energy and real spending on related new technologies. Instead we've lost four years.

Now we know this can pay. For every £1 spent at least £1.70 of income is generated That results in over £70 of tax paid: the net cost is 30p in government spending., But save benefits and that rapidly disappears and if the spending is on investment that has import substitution effects as green technology will then the benefits keep on rolling and that's even before the social and environmental factors are taken into account.

I can't resist saying "we told you so". Because we did.

Now the only problem is persuading Osborne he's wrong. That, I fear, is a bigger problem.