

Labour may reduce borrowing or not: that's a target not...

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Labour has [promised to reduce UK government borrowing in its manifesto](#), to be formally published tomorrow. The aim is, of course, to appear to be fiscally prudent and most people will accept that claim at face value, or not, depending on their prejudices and not on the basis of economic reasoning.

If economic reasoning is applied to the claim, however, the reality is that Labour cannot make such a promise. They can certainly state a desire. And it can state it will try to achieve it. But the fact is [that as I have explained elsewhere](#), no government has any real control over the deficit it runs because how much a government borrows is largely dictated to it, and is not within its own control. That comes from holding the position of lender of last resort.

The reason is that there are, in macroeconomic terms four sectors in the economy and they must balance. The first is consumer spending. If consumers borrow more to increase spending then someone must lend it to them, or borrow less, as a matter of fact. That person who must borrow less might be business, who might invest less as they borrow less to compensate for more consumer borrowing, or it might be net overseas trade, or it can be the government. But the point is that the net lending and borrowing of these four sectors, consumers, business, overseas and government, will always balance, as a matter of fact.

So, frustrating as this might be to a politician who wants to appear to be in control of the destiny of their government and the state, the fact is that they have remarkably little control over how much they will borrow. If consumers insist on saving, as does business, and trade is running a deficit, (which in effect means foreigners are saving in Britain) then as a matter of fact the government will run a deficit whether it likes it or not. And there is nothing, bar stimulating business investment, exports, or consumer borrowing that they can do to change this.

So Labour can promise to reduce the deficit. But its promise to do this through carefully costing its programmes does not, I am afraid, make complete sense because that is not what defines whether or not the government will run a deficit or not -

because spending is only a part of the explanation of the deficit and this calculation ignores the revenue side of the equation, which is what these other factors impact. The promise has to therefore instead be matched by a macroeconomic explanation of what Labour will do to make consumers borrow more, business invest more or exports increase. Otherwise no such promise can be delivered without a counter-productive policy of raising tax if there is a decline in economic activity in the future, which no one would make.

That then inevitably leads to the question of what is the best way to stimulate all these activities that are necessary if the government is to spend less. The answer is, perversely for most people but accurately nonetheless, that the government must spend more - because that increase in spending increases consumer spending power, which encourages them to borrow, and that in turn promotes business investment and that in turn stimulates the innovation required to deliver exports. Which means the best way to cut the deficit is, literally, to spend. It is the only way to achieve the goal, and that is precisely why austerity has not worked because the process also works in reverse.

Fiscal prudence may be electorally popular; a fact that I do not doubt. Unfortunately though it is not what we need. I just hope Ed Balls fiscal rule on investment does allow the wriggle room to allow for the spending that is really needed despite the rhetoric, because that is essential.

And [green QE](#) does, of course, break all those rules, successfully by printing money and not borrowing it. But that's another story.