

## Osborne is categorically promising to make us worse off

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The [Guardian has reported](#):

*George Osborne has warned he may have to impose bigger than expected cuts to public spending towards the end of the current parliament as the “storm clouds” in the global economy hit economic growth.*

This is utterly bizarre. GDP is, it is pretty universally agreed, made up of four elements:

$$\text{GDP} = C + I + G + (X - M)$$

where:

C = consumption

I = investment

G = government

X = exports

M = imports.

i think this is pretty fair as summaries go. So, let's consider what George Osborne is saying in this context.

First, let's be clear; what George Osborne is saying is that GDP is at risk of falling.

And let's be clear, what we also know is that we are already operating in an economic environment where we are using less than the UK's economic capacity.

In other words, GDP could be bigger than it is, but is being constrained because there is a shortage of demand (so C is under performing); business is under investing because business is sitting on massive piles of cash (so I is under performing); G is under-performing because of austerity and we know imports are apparently growing

faster than exports. No wonder George says it is not a pretty picture.

And despite knowing all this Osborne is saying that if C, or I or  $(X - M)$  fall then he has an obligation to reduce G. In other words, if these three elements of GDP is falling George Osborne is saying that he has a duty to exacerbate the trend by cutting government as well.

This is utterly illogical, for three reasons. First, any argument of the type put forward by George Osborne that we cannot afford to provide public services because of the shrinking private sector is very obviously wrong. The very reverse is true. Because the private sector is not using resources the opportunity for the state sector to make use of otherwise unutilised resources (including, let's be clear, large numbers of people who are unemployed, underemployed or underpaid for what they actually do) exists at this moment. Precisely because these people will either do nothing or do far too little as the alternative to the state putting them to work it makes absolutely no sense at all to say we cannot make use of their potential services and that to do so is to live beyond our means. As a matter of fact the vast majority (but maybe not all) of these people are going to live through any austerity George Osborne imposes. To not use the skills and resourcefulness they have to offer to alleviate currency economic stress is not just absurd, it is criminally irresponsible.

Second, the argument George Osborne puts forward suggests that we tax and then spend. As a matter of fact this is wrong. Just as we now know that banks do not lend out deposits, but do instead make money out of thin air which is then, when spent, used to create deposits, so is it true that all government spending takes place, as a matter of fact, out of money created for the purpose and not out of taxation. The role of taxation is to then cancel the money created in this way. The role of gilt lending is to commoditise the process. QE cancels any excess commodification, again out of money created out of thin air. But the key point is a simple one: we never do tax and spend. A government spends because it can, and because it has to in order to create much of the money an economy needs (which is a fundamental reason why it must usually run deficits, and cumulatively must always do so). So to be blunt, the constraint that George Osborne says exist, which is that there is no money available unless the private sector provides it is not just blatantly wrong, it reveals a fundamental lack of understanding of the fact that unless George Osborne spends money into the economy the private sector cannot repay in the form of tax. Every part of his logic is the wrong way round. And before you jump up and down and say I am wrong, remember that for 320 years the Bank of England and almost all economists got banking the wrong way round but I was one of those who did not. They have now admitted their error. I was right on that issue and I am right on this spend and tax issue too.

And third? Here I go back to the issue of sectoral balances, which I have addressed many times before, perhaps most clearly here. Let me remind you of the logic. There are four segments to the economy: consumers, business, government and the rest of the world. The similarity to the GDP formula should be obvious. And what is true is that

in a single currency the loans between these sectors must balance. That's just basic accounting: it has to happen. So if business is saving (and against all historical precedent, it is because it is refusing to invest), and if consumers are net about neutral, as is the case right now, whilst the overseas sector is net massively saving in the UK (either through net financial flows or because we are not simply settling the sums owing to those selling to us) then overall these three sectors are either net saving or at least not borrowing in the UK. This means that by default the government has to borrow, and as it has the role of borrower of last resort in its simultaneous capacity as currency creator it has absolutely no choice, at least in the short term, about this, at all. If everyone else refuses to borrow the government has no choice but do so. The books have to balance.

The mention of the short term was deliberate. The situation can be changed, but only if the government sends out the right signals to change the behaviour of consumers, investors or the overseas sector. What might do that? Well, if the government signals that it will spend more to boost the economy then it will encourage business to borrow and invest. And if it invests in business sectors (directly, or indirectly) that might export the it might change trade balances. And if it signals that it will provide consumers with greater security, whether by creating more jobs, or increasing real wages, or by improving the social security safety net so that people need to save less, then they might borrow more, spend more and so boost the real economy, whilst at the same time, automatically, and by default, reducing the government's deficit. I stress, these are the only actions the government can take that make a difference. The problem is that, without exception, George Osborne is planning to do the exact opposite of what is required. By announcing cuts he gives business no reason to invest and does not create export opportunities. And by reducing spending, most especially on social security, he encourages individual saving which then denies him any chance of reducing the government deficit.

In summary, it is not that he has to reduce G in the GDP formula as he says: it is, instead, precisely because he plans to reduce G (and has announced that fact) that C, I and even (X-M) will get worse. His austerity does then compound the economic crisis and significantly increase the chance of either slow or no growth and a budget deficit.

It's very hard to make up a failure of economic policy on this epic scale. George Osborne is managing it.