

Kwarteng is basing his policy on fantasy economics

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I [posted this thread on Twitter](#) this morning:

In a week when politics is not meant to be happening the government has let it be known that it might hold a mini-budget next week and that growth is its sole economic goal. That aim makes no sense in the context of their own behaviour. A thread.....

The growth Kwasi Kwarteng says he wants is in the gross domestic product, or GDP, of our country. GDP is said by economists to be our national income. Growth is the increase in that income.

There is a formula that explains how this is made up. It is:

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

C is basically household consumption. G is government spending excluding payments like pensions and benefits, which deliver consumption instead. I is investment in real new items for long-term benefit. X is exports and M is imports. So X-M is the net balance of trade.

The government's policy of delivering 2.5% growth does require that overall these aspects of UK economic behaviour trend upwards. But how likely is that?

Let me deal with the easy ones. Whilst Brexit stress remains, and with a trade war with Europe likely over the Northern Ireland protocol, the chance that exports are going to grow whilst imports will fall is remote. Politely, to suggest that might happen is absurd.

Investment growth is also easy to dismiss. First, there is no academic evidence that tax cuts stimulate investment. And in a period of economic crisis, which is what we have, there is massive evidence that investment falls because no one knows whether doing it will pay.

In that case, the idea that investment is going to increase over the next couple of years is another thing that only economic fantasists might believe in.

Then there is government spending. The government says it believes in the small state and wants to cut this. In that case, let's assume that it will stick to its word. That means government spending will fall.

So, three out of the four elements that can deliver growth over the next year or two have greater likelihood of falling than increasing. I suspect few economists would disagree.

That means Kwasi Kwarteng must be pinning all his hopes for growth on a massive increase in consumer spending right now. Nothing else can, simply because of the mathematics of this, deliver the growth he wants.

So is that growth in consumption likely? We know that a great many households will be stretched to their limits and beyond (meaning they will plunder whatever savings they have) over the next year or two by the cost of living crisis.

I estimate 60% of households will be hit very hard by the energy crisis and other inflation over the next couple of years. They will spend all they get. They might even borrow to spend a bit more. So it looks like they will consume a lot.

But let me also add that they already do this. That is why those same households have remarkably few savings. They already spend all they get. All that will happen over the next year or two is that they will get no choice on what they spend their money on. It will just be basics.

GDP data does not care about this. That people will change what they spend their income on doesn't matter to the GDP calculation. However, there is still a reason why these 60% or so of lower-income households will contribute less to growth.

This reason is obvious and is that because they won't get the pay or benefit rises that they need to keep up with inflation, because the government is adamant that they should not, then in real terms their consumption will fall.

These households will spend all they have, but they will in real terms have less to spend because of real cuts in their income after inflation are taken into account. No amount of borrowing is going to make good for that. So, in real terms these people will cut their consumption.

That means all Kwarteng's hopes for growth will now hang on the top 30% to 40% of households, who will need to go on the most spectacular spending bonanza to give him the growth he wants.

And they are not going to do that. In economic downturns, which is what we have,

people who have a choice don't spend, even when the falling value of money makes it rational to do so in the eyes of an economist.

Instead, these people save, because their mindset moves into a defensive mode. They are less likely to change job. And they put off spending on big-ticket items because they want to be sure that they will still have some money left when the crisis is over.

And saving, whilst rational for those doing it, does not create growth. Instead it withdraws money from use in the economy. And since investment is almost never funded by funds provided by savers in the UK, it does not increase investment either. It's just dead money.

Of course, there will be exceptions to all these comments. But generalities matter here. We are after all talking about the behaviour of populations and not individuals when looking at this issue.

When looking at these generalisations it is very hard to see where Kwarteng is going to find the growth he wants.

And that matters. His whole economic policy is based on growth. He assumes he can pay for tax cuts and new spending from growth. There is nothing else in his plan that could do so. And there's not a hope that the growth he wants will happen.

So what happens then? First, the government looks stupid. I can live with that.

Second, he runs a massive deficit. But that will then be used as an excuse for austerity, and because what austerity represents is a cut in government spending we'll just keep spiralling downwards into deeper recession.

In that case Kwarteng is not just mistaken in his assumptions about growth: he is also deeply dangerous because he is basing policy on those obviously false assumptions.

We are heading for deep trouble because economic ideologues are in charge of the country. Brace yourself for the impact. It's not going to be an easy ride.