

# The nightmare progression to being a failed state begin...

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The nightmare has begun. I think I realised that when on the Jeremy Vine Show on BBC Radio 2 yesterday, debating with Mark Littlewood of the Institute of Economic Affairs. I have done this countless times before on that show, but Mark was undoubtedly different. After all his years of disappointment with governments, both Tory and Labour, Mark was finally a happy man. He had an ally in Number 10.

This was apparent in the madness of what he had to say. Whilst acknowledging that Truss would have to help people with energy bills, he was also clear that he now believed he had an exponent of small government in office, and went on to say what he wanted.

Apparently, we should cut business rates, altogether. That costs at least £25 billion a year, whilst VAT should be halved, with a likely cost of £75 billion. And this was only for starters.

So I challenged Littlewood, saying what services he would also cut given that he wanted the government to 'balance its books'. Was it the NHS, schools, defence, pensions and care or something else that should take the blow? He did not, of course, say. Such details that imply joined-up thinking do not bother people like Littlewood.

My suggestion on air was that what people actually want is not cuts to any of these services - that are already massively underfunded and stretched to their limits - but more of them. I am certain that this is true.

What is more, as I explained on air, if growth is the Truss aim then more government spending is just about the only way to deliver it right now. But rather than deliver the one thing she can guarantee in this area, Truss will instead be planning to reduce government spending and so growth instead. A policy quite so contrary to that she says she wants is very hard to imagine.

This then brings me to the plan for helping households. According to the Guardian, and others, the plan put forward by the energy industry, and already adopted by Labour, is

the one that Truss backs. Bills will be capped for four months (which makes no sense when the problem is clearly going to last for a lot longer) during which period energy companies will be lent money by commercial banks to make up their revenue shortfalls. They will then be able to charge excessive emergency prices for the following ten to fifteen years to recover the cost of these loans (plus interest, of course) to repay the banks. The estimated cost is £130 billion, which is absurd when my plan for assistance for households would cost no more than £45 billion a year.

There is in this a quadruple bonanza for Truss. First, the government is little involved. That will appeal to her enormously.

Second, banks will profit, a lot, and that is always Tory policy.

Third, the energy companies will not have to change their behaviour, although how they will be contractually able to treat the receipt of loans as income that will maintain profits is an accounting issue that few seem to have thought through. Given that they will have to create a liability on their balance sheets to record the repayment of these loans that they will owe, and this is a credit balance, they cannot also create another credit balance as sales revenues at the same time unless they create a new debt to match it: which is the sum we will all owe them over the next decade or more. I do wonder if anyone suggesting these loans actually thought the double entry through and what its consequences might be

Fourth, and most especially, Truss will say that she saved the country from bankruptcy (although how this scheme will help business and schools is far from clear) but the price will be the cuts to public services that she must then impose as a result, even though the scheme she is planning should have little or no influence on the public finances, meaning that any link between it and the need for cuts would be tenuous, in the extreme.

How to appraise this? First, people rumbled Sunak's first go at dealing with this crisis by forcing loans on people and rated it very badly. I see no reason at all why anyone should celebrate high energy prices in perpetuity with any more enthusiasm. I am sure that they will not.

Second, unfortunately Labour will have to vote for this, having already proposed it. Yet again they will be enabling Truss.

Third, the political cover will evaporate when the process has to be repeated time and again in 2023 without any sign that the scheme will be doing anything for the country at all, bar supporting bank and energy company profits.

And fourth, the plan is going to have curious impacts on measures of inflation and its persistence. How the ONS will react when measuring inflation to energy companies finding ways to record income that does not apparently get reflected in prices to

consumers is going to be interesting to see.

Fifth, and more certainly, the Bank of England is going to interpret the scheme as guaranteeing long-term higher prices and so will keep increasing interest rates to try to eliminate the impact of government policy. The conflicts created by non-joined-up economic thinking will be considerable. More relevantly, the impact on households will be considerable. As I mentioned recently, a Bank of England rate increase from the current 1.75% to 4% will increase average mortgage costs by maybe £600 a month - or more than £7,000 a year. Energy price increases are going to look modest as a result. Truss will have capped energy costs to bring the economy down as a result of interest rate rises instead.

So where does this lead us? If she delivers her energy plan Truss might get through Christmas without as much difficulty as I expected. But by early 2023 the Bank of England will have set her government, and the rest of us, on the path to economic ruin as a consequence. The chance that 2023 will be the first year in history when a major economic power becomes a failed state remains very high. It's not a pretty prospect.