

## Fallacy of composition

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*Having written a glossary entry on the [paradox of thrift this morning](#), I realised one was also required on the fallacy of composition. This it:*

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### **Fallacy of composition**

The fallacy of composition is the mistake of assuming that what is true for an individual or a part of a system must also be true for the whole.

In economics, this logical error underlies many policies that appear sensible when viewed from the standpoint of a single person, household, or business, but create harmful outcomes when adopted by everyone simultaneously.

The classic example is the paradox of thrift. One household saving more might be prudent. But if every household cuts expenditure at once, demand collapses, jobs are lost, incomes fall and society becomes poorer overall. The very goal that each individual sought, of greater financial security, becomes harder to achieve.

Other economic instances are widespread.

For example, if a business cuts wages, it might gain a competitive advantage in the short term. But if all businesses cut wages, consumers have less to spend, profits fall, and the entire economy shrinks.

In addition, if one country tries to run a budget surplus by reducing government spending, it might succeed at others' expense. But if all countries pursue surpluses through austerity, global demand collapses, and recession follows.

The fallacy of composition reveals why good economic management cannot be reduced to the household metaphor or household analogy so beloved by politicians. A currency-issuing government is not a family and cannot sensibly behave like one. Public

deficits are a private surplus: cutting them inappropriately removes the income that households and businesses depend upon.

In short, the fallacy of composition warns that systems behave differently from their parts. Policies must be judged by their collective outcomes, not their superficial resemblance to individual prudence. Economic common sense for one is often economic nonsense for all.

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