

Debt Interest

We read that the Chancellor is being told there is no scope for tax cuts in the budget because debt interest continues to leap upwards.

I do agree the government needs to reduce the deficit and control state debt in future. The best ways to do that are to control public spending better, and to grow the economy faster to increase tax revenues. Tax cuts are essential to a growth strategy. The decision to cut HS 2 is an important first step in controlling public spending. This blog has identified plenty more.

The debt interest figures being used to terrify the Chancellor are a muddle of three very different things.

There are the payments actually being made in cash on all the past government borrowings. These are going up a bit as a result both of the increase in debt, and the increase in interest rates meaning that when some of the debt matures the replacement borrowings are at higher rate. These are still affordable.

There is the payment being made to the commercial banks for holding reserves at the Bank of England. This is a new torture for taxpayers introduced as part of the Bank's ill advised Quantitative Tightening policy familiar to readers of this blog. Money deposited at the Bank by commercial banks as reserves used not to attract interest, then attracted a reduced amount of interest based on a weighted calculation. The European Central Bank has recently announced they are going back to no payments on required reserves. Why doesn't the Bank of England resume its old policy to save the taxpayer some money? Interest paid to commercial banks has soared as the Bank has hiked interest rates and passed it all on to them, a direct gift from taxpayers.

Then there is the real killer in the figures, the inflation cost on the indexed part of the debt. Around one quarter of the state debt has been borrowed offering the lenders reimbursement for inflation on the income and capital they are owed. The main capital enhancement is not paid as a cash sum each year as inflation mounts. At the maturity of the debt which may be 10 or 20 years away then the inflation is added to the sum to be repaid. In practice the state just borrows the extra sum as it rolls over the debt. It is wrong to treat this as an annual cost affecting the running deficit as the current accounts do. This gives alarming figures for debt interest when inflation is high. In June debt interest was said to be £13.6bn but £9.3bn of this was inflation provisions where no cash was paid out.