

Government borrowing

A contributor asked for an update on government debt.

The UK had a difficult borrowing problem in the IMF crash of the mid 1970s when the country ran out of foreign currency to borrow and had to make emergency cuts. The IMF supervised a programme of lower public spending in return for loans.

It had a bit of a domestic borrowing problem in the 1980s as a Conservative government tackled the large inherited borrowings. Interest rates rose to high levels to persuade people to take state debt as investments. As spending came under better control so rates came down, helping economic recovery.

It had a worse borrowing problem during and after the banking crash of 2008. State debt was high going into the crash alongside very high levels of private sector borrowing. Both sectors reined in in the last months of the Labour government. The incoming Coalition, contrary to media reports, raised the levels of state borrowing over their tenure.

On each of these occasions debt interest was over 3% of GDP or 6-7% of total public spending. It was considerably higher immediately after the war when state debt was 250% of GDP reflecting the need to spend and borrow to win the war. Patient work brought the debt under better control in the 1950s.

People ask me if we can afford the sharp build up in gross debt brought on by the policies chosen to deal with the pandemic. I am pleased to report that we can afford it, because interest rates have tumbled so much and because the Bank of England is buying in substantial quantities of the debt. The latest official predictions show net debt interest as a percentage of GDP falling to a tiny 0.8% of GDP next year as debts are rolled over at low rates and as the Bank completes its buying programme. This means debt interest will be at its lowest for the post 1945 period. There is no need to count the interest paid on the debt owned by the Bank of England, as taxpayers and government get that receipt.

The UK government today can borrow money for 10 years at 0.29%. The stated debt is a large 105% of GDP, but the state itself will own £875bn of that so the true figure for the actual net debt owed by the state is around two thirds of GDP.

These are unusual times when the US, UK, leading EU countries and Japan can all borrow at around zero very large sums of money. It is still not a good idea to go on borrowing at scale for too long, and never a good idea to waste money borrowed. The immediate need for high borrowing is necessary to subsidise people and companies that are prevented from working by lock downs. The sooner we can unlock, the sooner we can get our finances under better control.

The good news is there is no need to worry yet. Markets are allowing all the

major countries to borrow plenty at ultra low rates of interest, underpinned by Central Banks buying up a lot of the debt. This only has to change were inflation to pick up, which so far it has not. Japan has been doing this now for several decades with no inflation, with gross state debt at 250% of GDP but net state debt around half that and the interest burden very low.