STATEMENT FROM ECONOMISTS IN RESPONSE TO JOHN MCDONNELL’S CRITICS

28 November 2017

The Shadow Chancellor and the government’s debt interest payments.

Andrew Neil of the BBC Politics programme recently challenged the Shadow Chancellor, John McDonnell on the likely cost in interest payments of additional public borrowing. Mr Neil suggested that current debt interest payments are estimated at £49 billion, and rising. His use of £49 billion was misleading, as it included £9bn owed by the Treasury to the Bank of England (BoE). Because the Bank is part of the public sector, £9bn is in effect owed by government to itself, as the Office of Budget Responsibility (OBR) explains.¹ The government’s debt interest payments are therefore just £40bn.

But the £40 billion is not meaningful in isolation. It is best understood as a share of the UK’s national income or GDP. This amounts to just 2% of GDP – a historically low share of the national ‘cake’. This is remarkably low, given the costs (debt) incurred by the government to bail out the private financial system after the 2007-9 global financial crisis, and given Britain’s falling wages which reduce government tax revenues. Above all, given the slowest economic recovery on record.

In 1987/88 when Conservative Chancellor Nigel Lawson was stoking an unsustainable boom, debt interest (see the OBR’s databank on public finances here) was at virtually the same level as the OBR estimates it is today - circa £40 billion (in 2016/17 constant prices). When the Tories left office in 1996/7 debt interest payments were again at the same level as estimated today – £40 billion (also in 2016/17 constant prices).

But there is a stark difference between the period of Lawson’s boom, the Conservative government of 1996/ 1997 and Britain in 2017. Today the nation is struggling to recover from the devastating effects of a global financial crisis, and for ten years has suffered falling wages and incomes, the dismantling and defunding of vital public services and with it, the loss of the’ social wage’. And thanks to austerity, this has been the slowest economic recovery from a slump in history.

Chancellor Nigel Lawson and Prime Minister Margaret Thatcher were relaxed about spending close to £40bn on debt interest payments at a time of prosperity. Today we face ongoing economic weakness, the rise of populism and the possibility of a major economic shock posed by Brexit in 2019. In these circumstances, neither Labour (nor indeed the current government) should be deterred from borrowing for productive investment. especially at a time when interest rates are historically very low.²

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¹ See the Office for Budget Responsibility on Debt interest: “The Bank holds lots of gilts and is part of the public sector, so the interest paid by central government on those gilts does not actually leave the public sector.”

² For example, on the 16 November 2017, sales of the 1.25% 10 year-gilt was over-subscribed 2.3 times. See DMO notice of that date.
Increased public investment in productive activity will expand our nation’s income and with it, government tax revenues. By so doing public investment will enlarge the economic ‘cake’ and help bring down future debt interest payments as a share of GDP.

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