Understanding UK Public Debt

Tim Jones, Jubilee Debt Campaign

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Introduction

Due to the impact of the Covid crisis on perceived debt levels, the size of UK government debt is seen by many as a key challenge to be tackled. These concerns are misplaced. The UK government's debt arising from the Covid crisis is not currently a problem because the UK government's extra spending during the Covid crisis has been paid for by borrowing from itself, through the Bank of England. Furthermore, the government can borrow at the lowest rates in history and has the lowest interest payments ever.

The UK government's debt payment burden is at record lows and its ability to borrow at record low interest rates is an opportunity. The government can use that ability to borrow to help recover from the Covid crisis and invest in ways that will improve livelihoods and save public money in the future. Areas where investments can be made now which will tackle key problems while also saving public money in the future include:

- The climate emergency and just transition
- The cost, availability, and quality of housing
- The major weaknesses in our social safety net

Investing now will help the economy recover from the crisis and so leave the public finances in better shape in the future.

However, the UK government has the third lowest rate of tax collection of G7 countries and is well behind other European countries. Taxing richer people and companies more now would help tackle inequality and enable further progressive increases in public spending. In the medium term the government needs increased tax revenue from richer people and companies to improve public services such as healthcare and to rebuild the UK's social safety net.

Lower income countries are not able to create money and borrow at low interest rates in the way the UK government can. The UK therefore needs to help create a comprehensive debt cancellation process for lower income countries, so they can also tackle the crisis, rebuild and have the resources to confront the climate emergency.

Throughout this briefing 'the UK' means all of the UK – both the public sector (i.e. central and local government) and the private sector (individuals and companies resident in the UK). 'UK government' is used when just the government is being referred to. 'UK private sector' when just the private sector (both individuals and companies). All the facts come from official sources, primarily the UK's Office for National Statistics, HM Treasury and Bank of England, and the International Monetary Fund and World Bank.

The most important facts everyone should know before discussing debt issues in the UK are:

1. Two-fifths of UK government debt is owed to the UK government itself

According to the IMF, UK government debt was £2,224 billion at the end of 2020, which is 108% of GDP.[1] Of the UK government's debt, just under two-fifths (39%) is owed to the UK government itself, via the Bank of England. The debt owed to the Bank of England, which is a "corporation wholly owned by the UK government"[2] comes from the quantitative easing policy. At the start of 2009, the Bank of England began creating money with which it bought UK government bonds. This was intended as a means to stimulate the economy to aid recovery from the 2008 financial crisis. In the years following 2009, £365 billion was created to buy UK government bonds,[3] followed by £60 billion in 2016 following the vote to leave the European Union. Since the beginning of the Covid crisis, a further £450 billion has been created to buy UK government bonds. This means that £875 billion of the UK government's debt is now owed to itself – 39% of the total.[4]

[1] IMF World Economic Outlook database. Accessed on 4 January 2021.
[2] http://www.bankofengland.co.uk/about/Pages/default.aspx
[3] A 'bond' is a kind of way that governments and companies borrow. To take the example of a government, it borrows money in return for issuing a contract saying it will repay the money in full in a certain number of years (e.g., 10) and interest every year until then (e.g., 3%). This contract is known as a 'bond'. The bond is then tradable. Whoever initial lent the money usually sells the bond on. Such bonds are being bought and sold in their millions every day on financial markets. The current owner of a bond is called a 'bondholder'.
[4] https://www.bankofengland.co.uk/monetary-policy/quantitative-easing

Almost no interest is paid by the government on the debts owed to the Bank of England. All interest payments above the Bank of England's base rate on these debts are returned by the Bank of England to the government, and the base rate is currently 0.1%.

Furthermore, the amount of debt owed to the Bank of England does not fall when the debts are repaid. When these debts are repaid[5], the UK government pays the Bank of England. The Bank of England then uses this money to buy other government bonds on secondary debt markets, keeping the total amount of debt owed by the UK government to the Bank of England the same.[6]

2. The UK government's extra spending during the Covid crisis has been paid for by borrowing from itself, through the Bank of England

As explained above, the Bank of England has created £450 billion since the Covid crisis began, which it has used to buy UK government bonds. Between April and November 2020, according to the Office for Budgetary Responsibility, the UK government's deficit has been £241 billion.[7] Therefore, this gap between income and spending has effectively been met by the Bank of England, with the UK government not having to borrow additional amounts from anyone else.

The UK government has on average had a deficit of £30 billion a month since the Covid crisis began.[8] With £210 billion still remaining from the Bank of England's QE during the Covid crisis, it will be another seven months - from November 2020 to July 2021 - before the government will need to borrow additional amounts beyond what the Bank of England has already funded. Furthermore, as and when the economy begins to recover from the crisis, the government's deficit will naturally fall as income from taxes such as VAT and income tax will increase, and spending through schemes such as the furlough scheme will fall.

3. Over four-fifths of UK government debt is owed to people and institutions in the UK

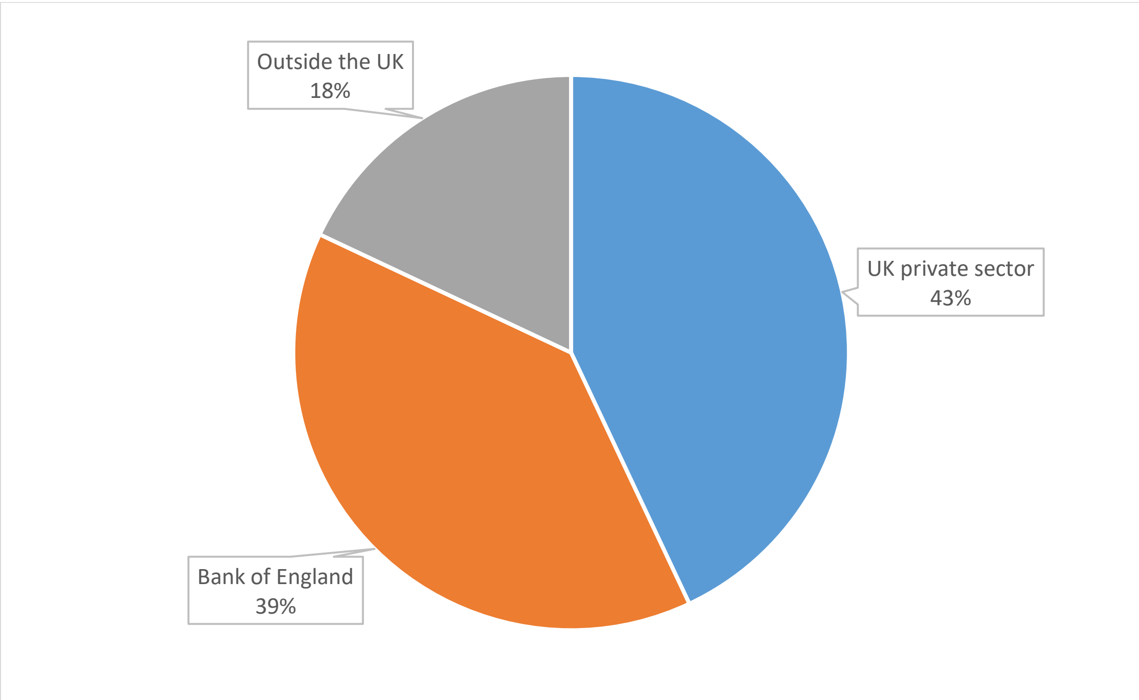
In all the debt crises we have worked on, whether in developing countries or richer countries such as Greece, the main risk posed by public debt has been debt owed outside the country. These debts are particularly dangerous because they lead to money flowing out of the country in interest and principal payments. Also, external borrowing is more volatile and prone to unexpected disturbances. Loans from abroad which have been helping to prop-up an economy can suddenly stop, either because of a change domestically, or more likely, a change in financial markets elsewhere in the world.

Here in the UK, government debt is sometimes referred to as "national debt". This is extremely misleading. A large majority of UK government debt is owed to people and institutions in the UK, not by the UK government to other nations.

[5] i.e., when the bond matures
[6] For example, see http://www.bankofengland.co.uk/markets/Documents/marketnotice151105.pdf
[7] https://obr.uk/download/commentary-on-the-public-sector-finances-november-2020/
[8] https://obr.uk/download/commentary-on-the-public-sector-finances-november-2020/

According to our calculations, based on UK Treasury figures, 18% of the UK government's debt is owed to people and institutions outside the UK. Accounting for the 39% owed to the Bank of England, the remainder – 43% – is owed to the UK private sector. Of this, 20% is owed to pension funds and insurance funds; 15% to banks, building societies and other financial companies; and 8% directly to UK households.[9]

Graph 1. Who UK government debt is owed to by sector, as of end-2020[10]



[9] The UK government says as of September 2019 29% of GILTs were owed to overseas investors https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/871876/03032020_DMR_off-sen_v2_FINAL_with_jpegs_v2.pdf This was £466 billion (29% of £1606 billion of GILTs owed in total). The rest of UK government debt – NsandI and T-Bills – is owed to entities in the UK. If £466 billion is still owed to overseas investors that would be 21% of total UK government debt. Since September 2019 there has been an increase in government debt, but an even bigger increase in Bank of England ownership of that debt. If the proportion of debt has fallen across bondholders other than the Bank of England at the same rate, £396 billion will now be owed to overseas investors – 18% of total debt.

The same report says as of September 2019 32% of GILTs are owed to insurance companies and pension funds. This is £514 billion but using the same reasoning above we estimate will have fallen to £436 billion, 20% of the current debt.

The same report says as of September 2019 17% of GILTs are owed to banks, building societies and other financial companies. This is £273 billion but using the same reasoning above we estimate will have fallen to £232 billion, 10% of the current debt. We also estimate all Treasury bills are owed to this group of creditors, a further £108 billion, making 15% of the debt in total owed to this group.

Finally, the same report says as of end-2019 £176 billion is owed to retail investors through National Savings and Investments. If this amount is still owed it is 8% of the total government debt.

[10] Calculated by Jubilee Debt Campaign as outlined above.

Virtually all[11] UK government debt is owed in pounds, the creation of which are controlled by the UK government. Unlike many other countries, which borrow in foreign currencies, because UK government debt is owed in the currency it controls, debt payments cannot suddenly increase if the pound devalues against other currencies.

Furthermore, all UK government debt is owed under English law. This means in the highly unlikely event that the government needed to restructure the debt, it could manage the process through UK legislation. This also means it would not be at risk of vulture funds preventing any debt reduction, as has been the case for other countries facing debt crises, for example Greece, Argentina, Liberia, Zambia and the Democratic Republic of Congo.

Why debt as a percentage of GDP is a very poor guide to the debt situation

Below we show a comparisons of five countries' debt profiles in 2019 to show how debt-to-GDP is a poor guide to a country's debt situation, and why other measures are much more important indicators of debt-related risks. Of the five countries, Japan has by far the highest government debt as a percentage of GDP, and the UK has the third highest. Yet Pakistan, Ghana and Zambia all have lower government revenue as a percentage of GDP and pay much higher interest rates on their debt. Therefore, they spend far more of their revenue on interest payments than Japan and the UK.

Furthermore, most of Japan and the UK's debt is owed to people in their own countries, while significant amounts of Pakistan, Ghana and Zambia's government debt is owed externally. Therefore, those three have far higher external debt service as a percentage of revenue than Japan and the UK.

Debt figures for five selected countries in 2019

Country	Total government debt as a percentage of GDP[12]	Government revenue as a percentage of GDP[13]	Government interest payments as a percentage of revenue[14]	External government debt service as a percentage of revenue[15]	Interest rate government can borrow at for 10 years on private financial markets[16]
Japan	238%	34%	4%	1%	0%
UK	86%	37%	5%	3%	0.8%
Pakistan	77%	13%	55%	28%	6.7%

[11] The government has issued a small amount of debt owed in the Chinese renminbi, but this was part of its efforts to make London into a global centre for trading renminbi assets, rather than because it needed Chinese currency.

[12] IMF. World Economic Outlook database. October 2019.

[13] IMF. World Economic Outlook database. October 2019.

[14] Calculated from most recent IMF Article IV consultation or programme document for the country.

[15] Calculated by Jubilee Debt Campaign.

[16] Figures are for borrowing in an internationally tradable currency – Yen and Sterling for Japan and the UK, dollars for Pakistan, Ghana and Zambia. Figures are from the prices bonds were being traded at in January 2020.

Ghana	64%	16%	36%	39%	8%
Zambia	92%	19%	26%	33%	15.6%

4. The UK government can currently borrow at the cheapest interest rates in its history

The interest rates the UK government can borrow at have been falling since 2007 and are at their lowest level ever. Before the 2008 financial crisis the UK government could borrow at an interest rate, fixed for ten years, of between 4% and 5%. From 2009 to 2011 this fell to between 3% and 4%. In the second half of 2011 the rate fell further, and then varied between 1.5% and 2.5% (see Graph 3. below). Following the June 2016 vote to leave the EU rate fell again, and they have fallen again with the Covid crisis.

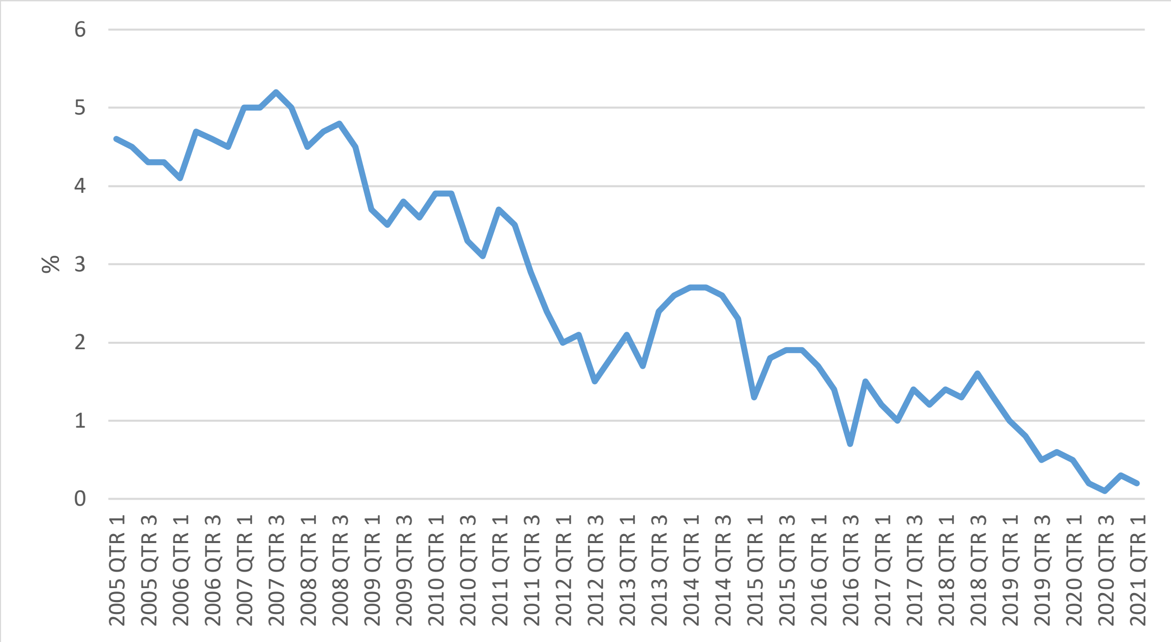
As of January 2021, the UK government can borrow for 10 years at a fixed interest rate of 0.2%, or for 30 years at 0.7% fixed. It can even borrow for five years or less at a negative interest rate – where the government pays back less than it borrows.[17] According to the Financial Times, recent years have seen the lowest government borrowing costs in the UK's history.[18]

UK government debt is bought and held by a range of actors, including pensions funds, savers and speculators, and their desire to lend to the UK government is influenced by various factors. Lenders to the UK government are willing to accept a relatively low interest rate because UK government debt is one of the safest assets they can put their money into. Unlike most developing countries, the UK government controls the creation of the currency in which its debt is owed – Pounds sterling (£). This means it is extremely unlikely the UK government would default on £ denominated debt. The main risk of holding UK government debt is if inflation erodes its value.

Furthermore, because the Bank of England now owns so much UK government debt, there is less debt available for other investors, which has driven the interest rate down further.

[17] https://www.bloomberg.com/markets/rates-bonds/government-bonds/uk
[18] https://www.ft.com/content/ef568030-a7a8-11e4-be63-00144feab7de

Graph 3. Interest rate paid on new UK government borrowing, fixed for 10 years[19]



The fact that the UK government controls the creation of pounds sterling, and also that it has guaranteed tax revenue, mean that UK government debt is a very safe asset (alongside or just behind government debt of other countries who can also borrow in the currency they control, such as the US, Switzerland and Japan). At times of fragility and crisis, speculators are more likely to put their money into safe government debt.

The fact that most UK government debt is owed within the UK, all of it as pounds sterling, also means that we face little risks because of sudden increases in interest rates based on international financial flows. It is more likely that economic shocks in the rest of the world will reduce UK government interest rates by increasing the role of UK government debt as a safe haven for investors. When risks increase in other assets – from company shares to housing and real estate – savers and speculators take money out of those assets and put them in safe assets such as UK government debt.

Increasing UK government debt does have a distributional impact by transferring money from future taxpayers to the owners of the debt, which tends to be the rich. For example, 72% of pension fund wealth is owned by the wealthiest 20% of the population.[20] However, with UK government interest rates at low levels, this is not currently a major issue. With interest rates currently below inflation, government debt acts to transfer money in real terms from savers to the government.

[19] Figures from www.uk.investing,com

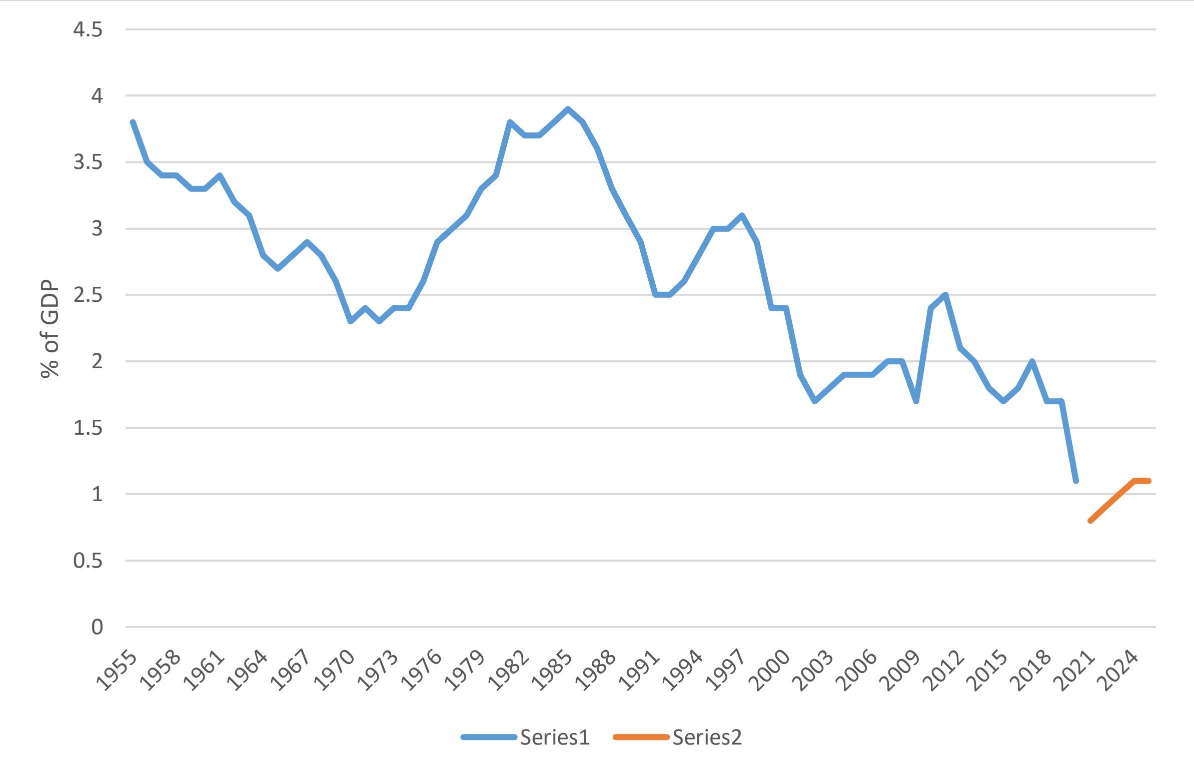
[20] https://www.nestpensions.org.uk/schemeweb/NestWeb/includes/public/docs/Cox-Private-pension-wealth,PDF.pdf

5. The UK government is paying the lowest *amount* of interest on its debt in recorded history, as a percentage of GDP

The UK government is currently paying 1.1% of GDP in interest every year. This is by far the lowest amount being paid in interest on government debt since records begin in 1955. Furthermore, the Office for Budget Responsibility projects the amount being paid in interest will fall even further, to 0.8% of GDP in 2021.[21] This lower level of interest payments, despite the higher debt as a percentage of GDP, is because:

- The interest rate paid on new government borrowing has fallen (see fact 4 above)
- Two-fifths of UK government debt is now owed to the Bank of England (see fact 1 above), on which the government only pays interest at the Bank of England base rate (now 0.1%) which is significantly lower than the interest owed under most of the debt contracts bought by the Bank of England.

Graph 4. Interest paid by the UK government as a percentage of GDP, 1955-2020, and projections 2021-2025[22]



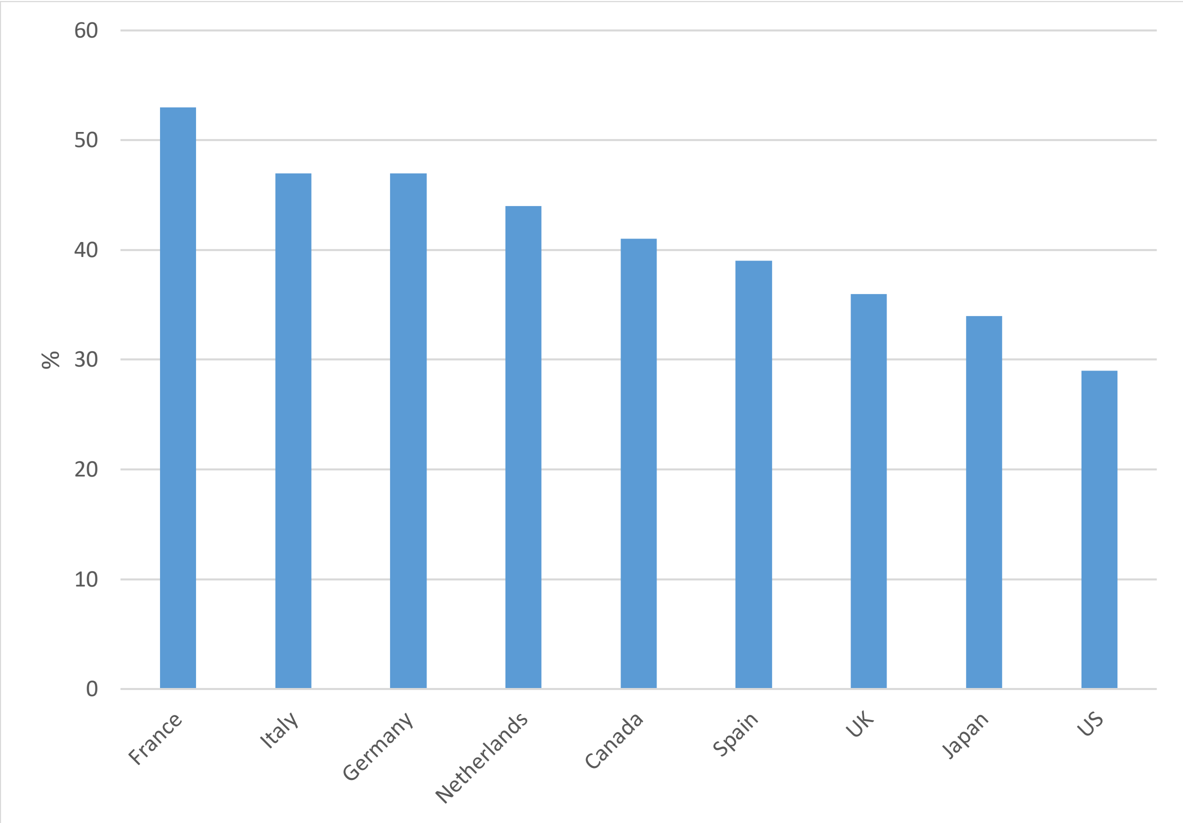
6. UK government tax revenue is the third lowest of G7 countries and well behind other European countries

[21] https://researchbriefings.files.parliament.uk/documents/SN05745/SN05745.pdf

[22] http://researchbriefings.files.parliament.uk/documents/SN05745/SN05745.pdf The figures used are those net of the Asset Purchase Facility, i.e., accounting for the fact that most of the interest payments on debt owed to the Bank of England are returned to the UK government. For the projections the data comes from https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/785550/debt_management_report_2019-20_final_web.pdf

The UK government continues to have one of the lowest tax revenue collection rates of major rich economies, as a percentage of GDP (see Graph 5. Below). On current government plans, tax revenue is projected to stay stagnant around 37% of GDP, at a time of the need for increased investment in pensions and healthcare because of an aging population. The percentage of the population who are over 60 is projected by the Office for National Statistics to increase from 23.2% in 2015 to 26.3% by 2025.[23] Maintaining government revenue at the same level alongside an aging population will mean there is relatively less money available for public spending, including on pensions and healthcare.

Graph 5. Government tax revenue in 2019 as a percentage of GDP[24]



7. The debt of the UK's private sector is 2-3 times bigger than that of the government

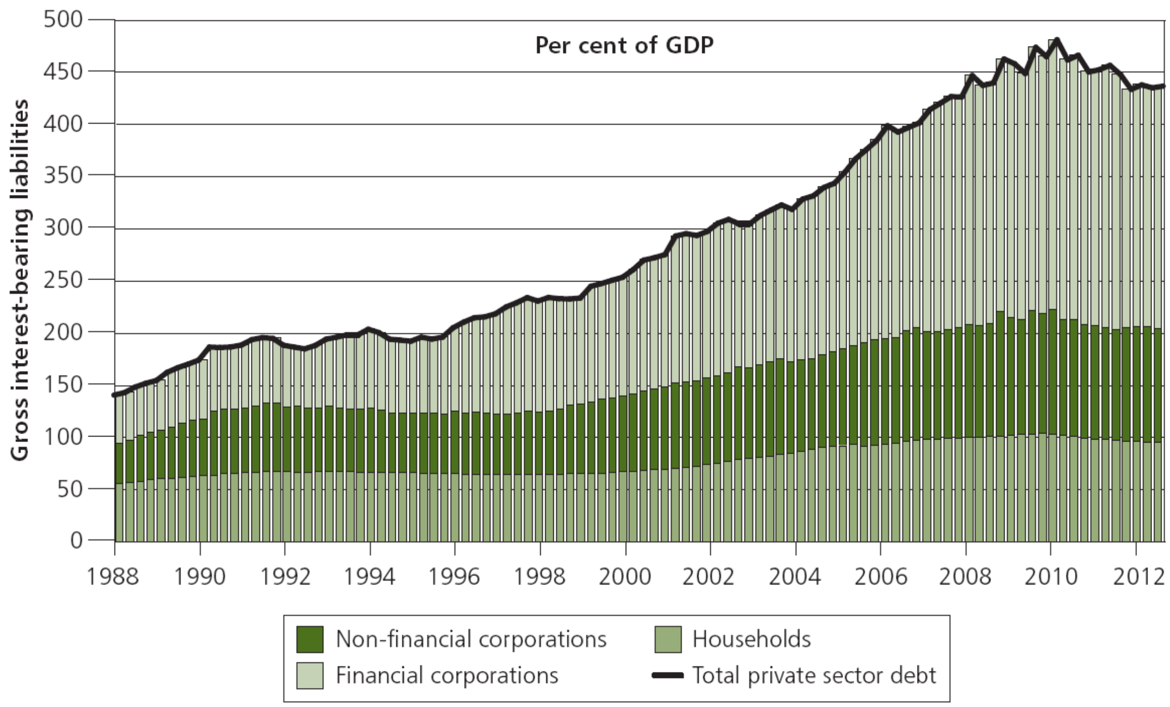
The total debt of the UK's private sector debt, i.e., companies and households, is estimated to be over 400% of GDP, around four times the size of UK government debt. At the end of the 1980s private sector debt was 150% of GDP, but it then grew to over 450% of GDP by the financial crisis of 2008 (see Graph 9. below).

23 https://www.ons.gov.uk/peoplepopulationandcommunity/populationandmigration/populationprojections/bulletins/nationalpopulationprojections/2018based

24 IMF World Economic Outlook Database. Accessed on 29/10/19

These figures all come from the budget documents produced by the UK Treasury. However, these figures have not been included in the Budget since 2013. While there are up-to-date official figures on the debt of UK households and non-financial corporations, we cannot find such figures for financial corporations. According to the OECD, the debt of UK households and non-financial corporations was 189% of GDP in 2019. This debt has fallen in recent years, but is still significantly higher than government debt. If debts owed by banks were included, the debt owed by the private sector is likely to be 2-3 times more than that of the government (even including the debt the government owes to itself). High private sector debt risks causing an economic crisis if companies go bankrupt because of being highly-indebted, or loans which have been keeping the economy going suddenly stop.

Graph 9. UK private sector debt 1988-2013, percentage of GDP[25]



8. The UK economy has the second largest deficit with the rest of the world of any rich country

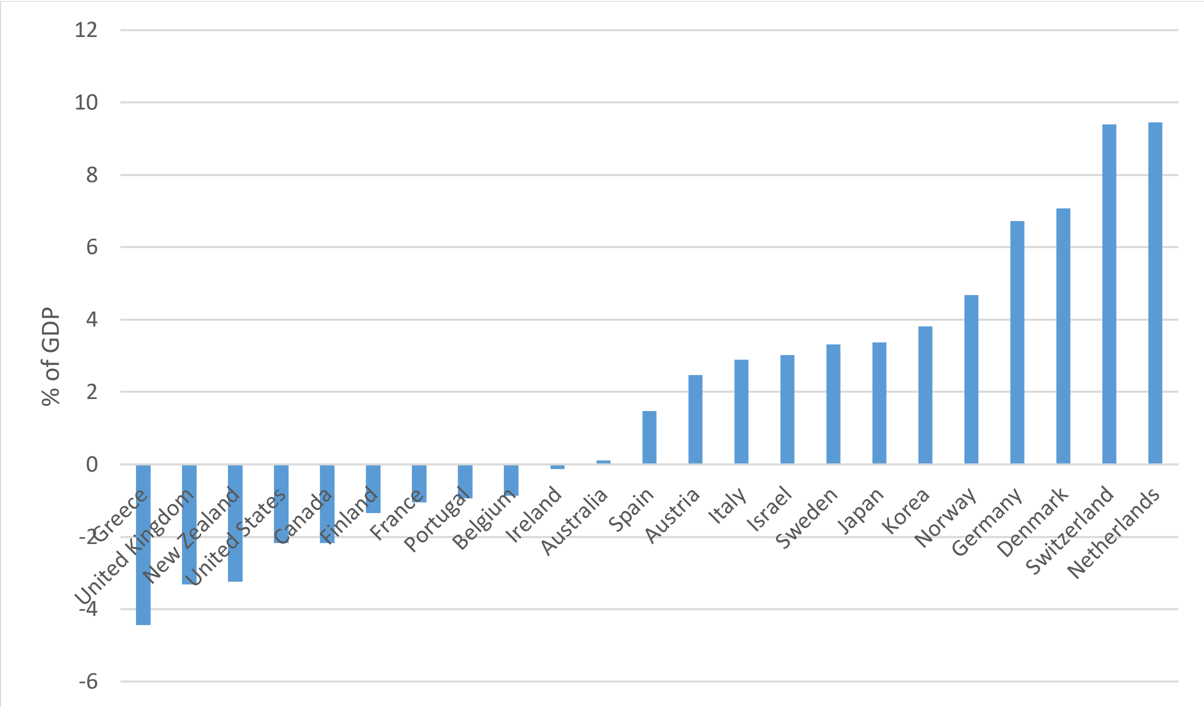
The 'current account balance' measures how much the UK (the public and private sector) is sending to the rest of the world each year through buying imports and making debt and profit payments, and how much it is earning through exports and receiving debt and profit payments.

If there is a current account deficit this means that the UK as a whole (private and public sectors) is borrowing more from the rest of the world or selling more things to people outside the UK than we are lending and buying in return.[26].

[25] HM Treasury. (2013). Budget 2013 https://www.gov.uk/government/publications/budget-2013-documents
[26] Most likely both of these things.

Between 2018 and 2020 the UK's current account deficit averaged 3.3% of GDP. According to the IMF, this is the second highest of any rich country (see Graph 11. below). Of other G7 countries, Canada had a deficit of 2.2% over the same time period, the US 2.2% and France 1%. Italy had a surplus of 2.9%, Japan 3.4% and Germany 6.7%.[27]

Graph 11. Current account deficits / surpluses of rich countries, average for 2018-2020, percentage of GDP[28]



The impact of the whole UK economy spending more than it earns from the rest of the world is to increase the amount of debt the country owes outside the UK, or the overall transfer of ownership of UK assets to speculators from outside the UK. This then leads to more money being sent out of the country in the future in the form of interest and profits.

Whilst a current account deficit allows the UK to consume more now, it is at the cost of reducing income in the future. Furthermore, if speculators suddenly reduce their willingness to lend to the UK economy, or to buy UK assets, a current account deficit can lead to a sudden drop in income in the UK, and so to recession.

Former Governor of the Bank of England Mark Carney has said that the UK's large current account deficit means the country is dependent on "the kindness of strangers".[29] However, this is not quite

[27] IMF World Economic Outlook database. Accessed 06/01/2021

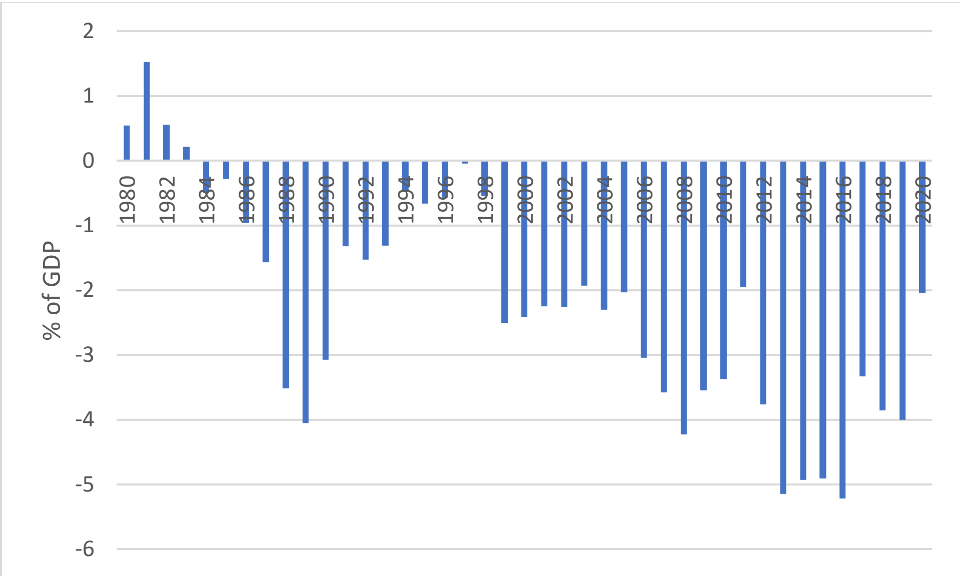
[28] IMF World Economic Outlook database. Accessed 06/01/2021

[29] https://www.theguardian.com/business/2016/jan/26/mark-carney-fails-to-rule-out-eight-year-term-at-bank-of-england

right. Those outside the UK lending to the UK, or buying UK assets, are not doing so out of kindness, but in anticipation of receiving more back in return in the future.

The UK's current account deficit peaked at 5.2% of GDP in 2016, the highest on record. Before 2013, the deficit had only gone over 4% once before, in 1989, during the boom just before the 1990s recession.[30] What is striking about the current record high deficits is that they have not even funded an economic boom. In 2020 the deficit fell to 2% of GDP due to a fall in imports because of the Covid crisis.

Graph 12. UK current account balance, 1980 - 2020[31]



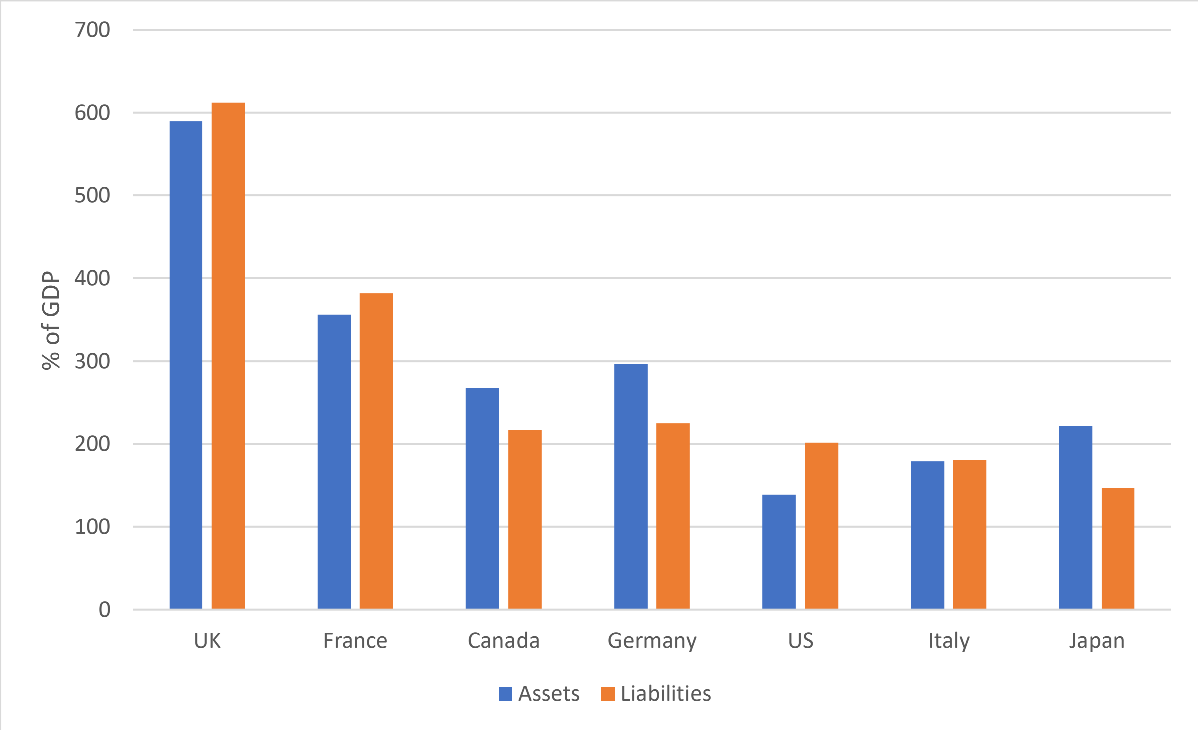
9. The UK's finance sector is the most exposed to a crisis of any G7 economy

The UK economy is the most exposed to global financial volatility of any major economy. In total, the UK economy (public and private sector) have the equivalent of 612% of GDP of financial liabilities to the rest of the world, and 589% of GDP as assets (most of these come from the finance sector). This is significantly higher than the assets and liabilities of France, the next most exposed major economy, and more than double those of Germany (see Graph 13. below).

Financial shocks, such as a fall in the value of those assets, could rapidly and negatively affect the UK economy if they led to a fall in income for UK companies, even resulting in bankruptcy of major companies. In 2007-2008 it was the fall in value of such foreign held assets which led to the effective bankruptcy of UK banks.

[30] ONS. Balance of payments time series dataset https://www.ons.gov.uk/economy/nationalaccounts/balanceofpayments/datasets/balanceofpayments
[31] IMF World Economic Outlook database. Accessed 06/01/2021

Graph 13. External assets and liabilities of G7 economies, mid-2020, percentage of GDP[32]



In 2017 the ONS revised its estimate of assets and liabilities, which led to a change from a surplus of £470 billion (24% of GDP) to a deficit of £22 billion (1% of GDP).[33] This re-estimate led to headlines of "Britain's missing £490 billion." However, the real problem is the huge scale of the UK's external assets and liabilities, such that re-estimates can lead to changes of the magnitude of £490 billion.

For example, if we imagine there was a 20% fall in the value of external assets held by all the G7 economies, this would leave the UK with net liabilities of 141% of GDP. France's would be 97%, the US's 90%, Italy 37% and Canada 3%. Germany and Japan would still have net assets of 12% and 30% respectively. This makes the UK uniquely vulnerable to financial changes elsewhere in the world.

[32] Assets and liabilities data from IMF database http://data.imf.org/regular.aspx?key=60947518 GDP data from IMF World Economic Outlook database.
[33] https://blog.ons.gov.uk/2017/10/23/has-500-billion-really-gone-missing/