

Why we need more government debt

Published: January 12, 2026, 9:29 pm

It's a popular myth that government debt is a bad thing.

It's a dangerous myth that we should reduce government debt. It's especially dangerous that this myth is being used as part of the Tory election campaign.

First, some facts. It's a fact that the UK government does not need to issue debt. In the modern era of money the Bank of England can create any amount of money that the government requires without having to borrow or tax a penny of the sum in question. That is because all money is now, as a matter of fact, created out of thin air when banks lend money, including when (as will be legal again after Brexit) the Bank of England lends directly to the Treasury. This is because all money is debt: if in doubt read what it says on a UK bank note, and realise that these are just debt, a fact that is confirmed by this cash being included in the national debt in the UK's government accounts. Quantitative easing also proved this: £435 billion of UK national debt has been monetised since 2009. There is then no technically reason why all government debt could not be cancelled (as this QE debt has, in effect, been) in this way. As a result it has to be appreciated that when the UK has its own currency and its own central bank government debt is a choice and not something that has to be issued.

But this then leads me to state the other obvious fact: government debt is just another form of government created money. It's convertible into cash, as QE proves. And all it provides is a savings mechanism. But it is a very important savings mechanism. In fact it's the most secure form of saving available in the UK. That is because whatever happens the UK government will always be able to repay its debts because it can always, on demand, electronically create the cash to do so. It has that right. No one else has it in the same way. And creating that money is effectively costless: it happens simply by entering data into a computer.

Having made these obviously correct points (which appear to have passed most politicians by) let me now say why we need steady growth in government debt. There are several good reasons.

First, if we are to have some inflation (and we generally agree two to three per cent is good) then we need more money. And government debt is money. It is, in effect, the promise to pay that underpins the economy. So inflation says we need more of that debt each year. If we don't get it then the economy is starved of cash and that causes economic stress, at the very least. It might also lead to more private debt, and that is much more dangerous as it carries much higher interest costs than government debt and so constrains real growth. So inflation demands more government debt. It's the best deal for a growing economy that there is. That's why governments have to create it.

Pensioners also demand more of that debt. The annuities that underpin all private pension payouts involve a delicate juggling act that balances life expectancy against the funds available and the return that they can generate. One variable where the risk can be reduced is the rate of return and the certainty that it will be paid. The return on government debt may be very low (it's effectively negative at present after inflation is allowed for) but it is guaranteed to be paid, and that is exactly what pensioners want. No one wants their pension to expire before they do. So, government debt is what pension annuities are very largely invested in. And as we face an increase in private pensioners as the baby boom generation retires the need for government debt to underpin their pensions is growing.

Third, banks need this debt. When most people put money in the bank they assume it is safe. That is because the government guarantees the deposits most individuals make in banks so that if the bank fails the depositor will get their money back. That is the only reason most of us trust a bank. But this does not apply to businesses depositing millions of pounds in their bank accounts overnight, as happens every night in the UK. Those businesses have no such guarantee. If the bank fails on them, as Lehman did in 2008, then they might well go down with it. So they don't deposit the cash. They enter into contracts with banks. The banks sell them government bonds in the evening, which the depositor then own, and which cannot fail because the UK government (unlike banks) can't fail, and which the bank agrees to buy back in the morning at a slightly higher price, with the increase representing the interest due. If there were no government bonds to fulfil this role then the banking market would grind to a halt.

Fourth (and I like this one), at times like the present when the real rate of interest (as adjusted for inflation) is negative those who own government debt subsidise the taxpayer. The more debt there is the more the taxpayer is subsidised.

Fifth, interest paid on government debt is a good thing. As already noted, it underpins private pensions for a start. And a lot of the most stable savings funds. I'm not saying this is a perfectly equitable redistribution of wealth, because it is not. But I am also saying it is not income lost to the economy. And because it's taxable some is even recovered. But saying it's terrible is akin to an argument against usury and is again akin to an argument that a government should not have a role in seeking to provide a secure, stable and safe banking, pensions and savings sector in the country. I would

argue that is precisely one of the roles government should have.

So we need debt, and because of inflation, growth and growing numbers of pensioners we need more of it. How much more? Notional national debt is now about £1.8 trillion and after QE it is around £1.4 trillion. Assume inflation of between 2% and 3% and how much extra debt do we need a year? Anything between £30 billion and something in excess of £50 billion would seem to be the answer. It's not a precise science: there will be swings and roundabouts.

But the point is that this new dent is vital: it has to happen or the economy is harmed. And this sum excludes debt issued for specific purposes, like an infrastructure fund. Issue less than this and the economy will be in trouble. That's a simple fact and explains why the Tory obsession with a balanced budget is so dangerous.

Which brings me to the final fallacy that needs to be addressed, which is that one day the debt will have to be repaid. No it won't. That's because this debt is money. That makes it unlike all other debt which is denominated in money. They're simply not the same thing. Debt denominated in money has to be repaid. Debt that is money is only repaid if we want to destroy money. And why would we want to do that? Is anyone seriously suggesting that we can live in a moneyless society in future? I seriously doubt it. And in that case national debt does not have to be repaid, ever, which is exactly what history tells us.

Government debt is a good thing. The danger is inherent in the myth that it isn't.