

Do UK debt servicing costs require that the government ...

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If UK government ministers were to be believed the cost of servicing UK government debt creates such a burden on its finances that austerity is required, including with regard to public servants' pay.

As a result [comments like this](#) arise on the blog:

Hi Richard,

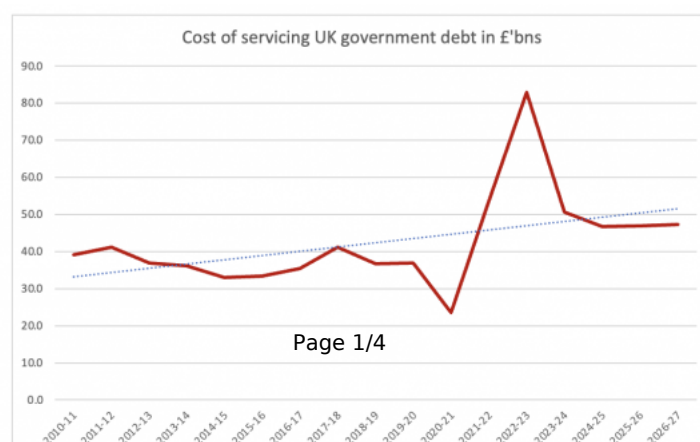
Long-time reader, first time commenter. In a pub debate, a friend of mine insisted that growth in this country was being held back by the cost of servicing government debts, and that only austerity in government spending could undo it.

Whilst I understand that a lot of government “debts” (i.e. money) are held by useful things like pension funds and foreign governments and the government debt has never, and will never, be paid off, it still appeared to be logical that servicing those debts could drag on the capacity for the government to grow the economy.

What is the MMT response to servicing government debts, and the role of the current UK's debt obligations in limiting/facilitating spending? Thanks.

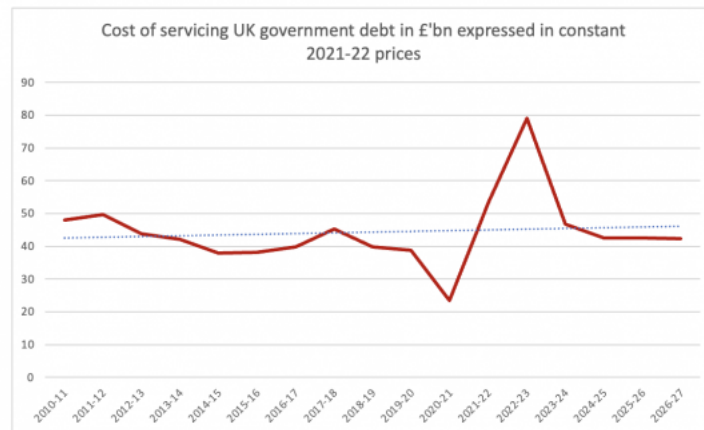
So, I used the [OBR's latest forecast of debt servicing costs](#) (which will be out of date by Wednesday lunchtime, but will do for now) plus standard [GDP deflator data](#) from the ONS monthly statistics pack to look at this issue.

This is the actual cost of debt servicing data in original prices, plus the Office for Budget Responsibility forecast to 2027:



I added the trend line. It is upward.

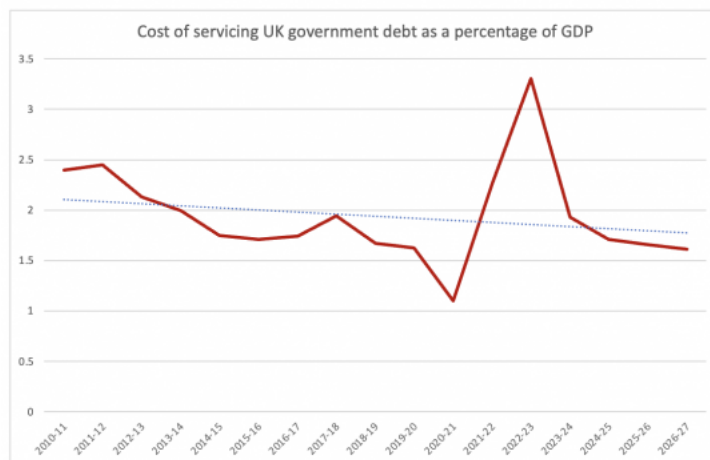
Then I restated in 2021-22 prices:



The pattern is broadly similar, but now the trend line is rising only very slightly.

What is actually quite surprising is how stable this is, 2020 - 2023 excluded.

After that I stated the data as a percentage of GDP to indicate the capacity to pay:



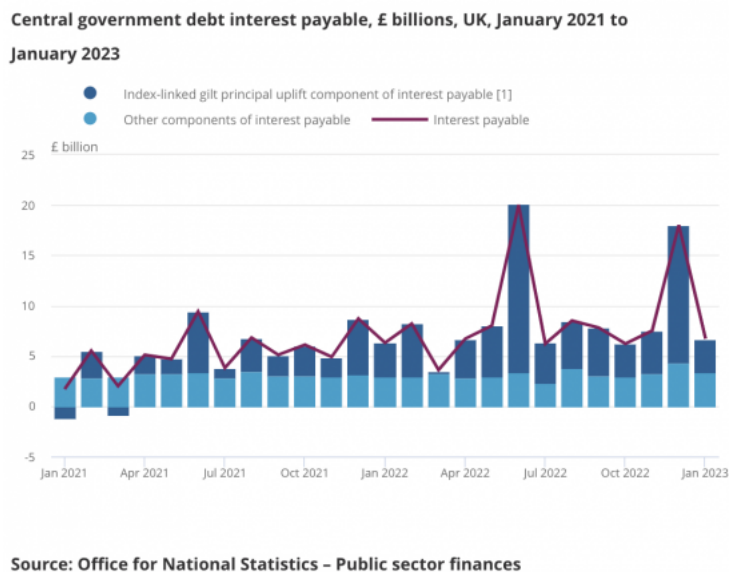
The trendline is now downward. 2020 - 23 are still aberrational.

First, some observations before drawing conclusions:

- * Debt servicing costs in 2020-21 were very low because inflation virtually disappeared in that year and that meant the cost of servicing index-linked bonds almost disappeared as well.
- * Debt servicing costs are high in 2022-23. That is because as 2021 closed inflation rose and it will not drop significantly until later this year. As a result, the claimed cost of

servicing index-linked bonds rose dramatically.

* I stress the claimed cost is high. That this is due to index-linked bonds is made clear in this chart from the [Office for National Statistics January public finances](#) release:



* Pale blue represents recurring standard gilt interest costs and dark blue the exceptional costs of index-linked bonds, showing the shift from negative costs in January 2021 to exceptional costs in January 2023.

* However, it is important to note that these costs are estimates: the actual cash due on these bonds will not, on average, be paid for 18 years: we have that long to save up for the payment. If the payments were spread over that 18-year period, as would be reasonable, there would be no exceptional cost in 2022-23.

* Note that forecast costs fall heavily from 2023-24 onwards and as a declining trend to GDP. That is because inflation is expected to fall to close to zero from 2024 onwards, largely eliminating the cost of index-linked bonds again. There is no reason to think this forecast of low inflation is wrong.

So, is there any reason to think that debt servicing costs require austerity now? The simple answer is there is none at all. The cost of servicing government debt is a small part of total spending: the exceptional cost in 2022-23 is due to exceptionally poor accounting which the government will not explain in public, and that cost will not recur. There is then no reason to take it into account when planning future public spending.

As for the modern monetary theory approach to this: MMT suggests that the government need not borrow from external sources. It also suggests that interest rates be kept as low as possible to prevent upward shifts of wealth within society and to encourage investment.

MMT also acknowledges that interest rates on government debt are set by government choice, even though they deny it.

MMT does, therefore suggest that this chosen debt servicing cost is no constraint on spending. And if the decision is made to pay it, MMT suggests that it is wholly affordable and is no constraint on other actions.

So, in summary, if the Chancellor talks about this during the budget today and says it requires austerity he is talking total nonsense. I could be less polite, but that will do.