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I have published this video this morning. In it, I argue that many on the political right-wing obsess about interest paid on government debt as if it disappears into some black hole. It doesn’t. It’s just interest paid on savings deposited with the government and there’s been nothing excessive about its overall cost of late.

https://www.youtube.com/watch?v=-6n0hsOm4J8?si=J0bXFIjhaLcnZXd7

The audio version of this video is here:

https://www.podbean.com/player-v2/?i=jqvv6-16acd4e-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=8bbb4e&font-color=&logo_link=episode_page&btn-skin=ff6d00

The transcript is:

Interest paid on government debt increases private wealth.

From all the comments that you hear on the media, from politicians and from everybody else, you would think that that statement of the glaringly obvious is not known to almost anyone. What I hear all the time about interest paid on the national debt is that this is a burden, and an unaffordable cost that is creating the crisis in government spending. Well, that's not true and I'll explain why in a minute, but let's just deal with this problem that people seem to have with interest being paid on what they like to call the national debt and which I call national savings.

Let's be clear what people do when they deposit money with the government in the form of savings, which is exactly what they do when they put money in National Savings and Investments, or they buy Premium Bonds, or they buy government bonds or gilts as they're called in the UK. Those are all savings mechanisms. And people put money into those various forms of savings mechanism because they want two things.

One is a safe place to deposit their money, and no one is safer than the government when it comes to depositing your money because the government is the one and only organisation in the UK that can always guarantee to repay you because it can create the cash to make the repayment.

Secondly, people deposit money with the government because they want a return for doing so, and that return is interest. There's nothing desperately novel about that idea, let's be clear. If you put money in the bank, you expect a guarantee from the government to ensure you get a repayment, much the same as you get directly from the government in the case of depositing it with them, and you expect to get paid interest.

The relationship is remarkably similar. So similar that it's obvious that the government is, in fact, running a savings scheme and not borrowing as such.

So, why do people get so upset about interest being paid by the government when it runs a savings scheme, when a bank which runs a savings scheme does not attract their opprobrium? I simply don't know why. There is no obvious answer to that.

So, let's move on from the fact that they can't explain why they're so upset about the government paying interest on the deposits that it takes and instead look at the total sums that it is paying. Because these attract as much attention and as much bile from these commentators as does the fact that interest is paid at all.

The claim is that the government is paying more than a hundred billion pounds a year in interest. It isn't. That's not true. The fact is that the government has been accruing an interest liability of around £100 billion a year for the last couple of years with regard to interest. But it has not been paying that sum. Why is that?

Well, that's because a significant part of that total cost, something like £40 billion of it a year, has actually been due on what are called index-linked bonds or ‘linkers’ as the market calls them. Index-linked bonds are quite complicated instruments, which tend to be bought only by specialist funds, like pensions, and the purpose of them is to guarantee that a person gets a very low rate of interest on the bond that they save with the government, very often in real terms negative, i.e. they get less money back in terms of interest, compared to inflation, than they could by putting their money elsewhere. But, when they get to the end of the bond period, they get the sum that they deposited at the beginning of the period inflated by the rate of inflation over that period of time. In other words, the money that they save is inflation-proofed.

What the government has done over the last couple of years, when we've had significant inflation, is add into the potential interest liability that it has recorded in its accounts the cost of that increase in the price of redemption of those bonds even though many of those bonds may not be repaid for many years to come. In fact, on average, index-linked bonds have a life in excess of 15 years, meaning that much of this money that has been recorded over the last couple of years as being payable won't be due for up to 15 years, by which time we won't even notice the cost.

So, the true cost of interest is nothing like the amount that everyone talks about. The actual cost cash outflow cost of paying interest over the last couple of years has been maybe only 60 percent of the total sum recorded. So those making complaint are anyway talking a lot of nonsense about the burden that it creates and that it is putting a cash flow strain on the government which is preventing it spending on other things when that is not the case, and the government has up to 15 years to save up the £40 odd billion - make it £80 billion for two years - that it's got to pay because of the recent bout of inflation.

And that suddenly makes that excess burden seem really rather trifling in the overall scheme of things as far as the government is concerned.

So, when we're talking about interest costs, they haven't risen anything like as much as those who are complaining about them would like to pretend. They are, in fact, frankly, very low. Hardly out of control, because the government's cost of interest over the last couple of years has overall been lower than the rate of inflation, and therefore, in fact, the cost of its debt has been going down, even though the amount of payment to private wealth holders, who have received interest, will eventually be going up.

So, is that a problem for the government? No, not at all. If you are actually borrowing money, and overall net, are not paying for it because inflation exceeds the interest rate that you're having to pay to those who've deposited with you, your financial position is improving by borrowing instead of getting worse, which is what all these commentators are suggesting.

It kind of makes everything look rather confusing, doesn't it?

Everything is as usual when it comes to economic truths, just about the opposite of what people claim it to be.

The government hasn't had a disaster with regard to interest costs. The one thing that was a bit out of control, and I accept that it was, was this cost on index-linked bonds, which I don't believe in, by the way, but which won't be paid for another 15 years.

And with regard to ordinary interest costs, everything was pretty much okay, or in fact, improving the government's financial position.

Now that could change. The reason why it could change is that the Bank of England is now working very hard to ensure that we have positive real interest rates in the UK. In other words, interest rates that exceed the ongoing rate of inflation. And that is what is happening in financial markets at present. And that is, of course, having a consequence for government borrowing.

Overall, it looks likely that it will settle on a situation where the government will pay a positive one per cent real interest rate when markets return to what we might call normal.

What does a positive one per cent real interest rate mean? The rate of interest will be one per cent above the inflation rate. So, if the inflation rate is two per cent expect, eventually, interest rates to settle on government bonds at around three per cent or so. So, is a one per cent interest cost excessive, not least when you control the money supply? There's no great burden in that.

And when you look at the proportion of the real cost of interest to overall government spending, and you looked at it in the context of its balance sheet, which would be improving over the last few years, because inflation has curiously reduced the value of government debt more than interest costs have risen, then you would have to say, there is no problem at all with what has arisen with regard to interest payments.

So, please, let's have a calm debate on this issue. Interest rates should not be preventing our government doing anything. What interest rates are doing is allowing the government, as usual, to provide depositors who want a safe place to put their money with somewhere to put it, so that our banking system can operate properly, those in the pension funds and the life assurance sectors who need long-term deposits can have them, and overseas governments can save in UK sterling, which is of enormous benefit to our economy because it facilitates trade and our balance of payments.

So, let's stop making a fuss about something that isn't real. Interest rates in the UK are not an impediment to our government doing anything with regard to what should be its core objectives, like relieving poverty, investing for the future, dealing with climate change, improving the quality of housing, and so much else. There is no interest rate problem that our government has to deal with.