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This & That
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Getting Real About Economics

Backdrop

A Treasury briefing years ago to a new government, part of a BBC series on Departments of State, has long been expunged. This opening statement set the scene. 'Britain has been in relative financial decline since 1870.' Research backs up the claim.

This was intended perhaps to take the wind out of the sails of an incoming chancellor who thought this could be reversed over the life of a government in office, or a little longer.

So, how do we make sense of a blizzard of statistics and reassuring rhetoric that the UK's parlous financial state might not be that bad? It much depends on who is talking and with what authority, what we are comparing, with whom, and over what period of time.

A common denominator is to express economic data in real terms, which means adjusted for inflation. Like for like comparison, especially over many years, then makes more sense, though not complete sense. We need to dissect what's going on. A key indicator helps.

We may then compare the UK with other countries, especially the G7 comprising Canada, France, Germany, Italy, Japan, UK and United States. A further option is comparison with a country that has a similar stat to get us started. All methods will be used.

A Key Statistic – National Debt

The stat selected is national debt and what is owed and to whom. Over the past 25 years, in both nominal and inflation-adjusted terms, this has grown enormously. Debt has been driven mostly by global economic shocks and, controversially, self-inflicted wounds.

At the turn of the millennium, the UK public sector net debt stood at £320 bn, equating to 28% of GDP – Gross Domestic Product (the market value of all final goods and services produced within an economy over a given period – LSE definition).

By August 2026 this had surged to £2,985 bn, or 93.8% of GDP. Over these years, two massive shocks were the financial crash of 2008 and Covid, with reverberations going beyond the end of the pandemic. That still left a significant debt to be financed.

Unpicking this, several facts stand out. First is the cost of servicing debt. Interest alone is £109 bn, roughly 3.6% of GDP, or 8% of government spending. Put another way, it is more than the budgets for UK Defence, Transport and Public Order combined.

The per person share is an eye-watering £40,500. A historical long-view sets it in context. In 1946, UK national debt peaked at 251.7% of GDP. It took nearly 40 years to whittle this down to below 40% by the late 1980s.

In 2001, the UK experienced a rare budget surplus when the national debt stood at 27.3% below the G7 average. By 2024 this had surpassed the G7 average. We will explore why.

Making Sense of National Debt

For 2024/25, debt as a percentage of GDP, shows Japan way in front at 254% and Italy and USA at 139.2% and 123.3 % respectively. France, UK and Canada follow, ranging between 100% - 112% of GDP. These figures in isolation do not reveal what's going on beneath the surface. What seems acceptable for one country may mask serous issues for another.

Stats can be misleading. At issue are the rates of borrowing and the tax/spend mismatch. Because a significant portion of the UK's national debt is tied directly to inflation (index-linked gilts), the UK pays a higher percentage of tax revenues in debt interest than almost all advanced economies. Exposure to fiscal risk is one of several major factors.

Digging Deeper for the Significance

A helpful comparison of debt percentage is Canada as the national debt for both is around 104%. The similarity ends there. There are four main drivers for a divergence in impact.

Asset backing is key. The UK holds minimal commercial assets to counterbalance colossal borrowing. Canada, by contrast, is backed by vast mineral and land assets, together with a robust Pension Plan. Whereas Canada has the assurance of a global-investment portfolio, the UK relies on future taxation.

The second major reason, and links to the first, is inflation vulnerability. About 25% of UK debt is index-linked and thus tied directly to inflation. The effect in Canada is minimal. A negligible fraction of Canadian bonds are inflation-indexed. Who holds the debt is also relevant. For the UK this means the Westminster Government, unlike Canada where it is dispersed. A crisis in one Province is highly unlikely to trigger a national currency crisis.

The fourth component is economic drag. This is very high for the UK with a rapidly-ageing population, low rates of productivity and a shrinking tax base. Canada's immigration policy is designed to prioritize applicants who can make an immediate economic contribution. An example is Express Entry candidates, invariably young and highly educated professionals.

Implications for Living Standards and Quality of Life

This is characterised by a paradox. Higher tax rates have the opposite effect, with visibly deteriorating public services. The impression is of higher government taxes even to stand still. Some may argue regress! Council Tax is one example. An inverse relationship exists between hikes in Council Tax and quality of services, aside from those jettisoned.

Businesses are increasingly reluctant to invest in long-term projects. given such economic uncertainty and fear of ever-increasing tax rises. The result is that productivity stalls or declines. Competitive ability is eroded, especially in relation to foreign competition.

Confidence matters hugely, both business and public. Reduced core resilience means that when the next inevitable global economic shock hits there is very little fiscal headroom to borrow safely. Inevitably, this means businesses and domestic households being highly exposed to economic volatility. The two are intertwined and affect living standards.

Why We Should Be Alarmed

The UK is not at risk of going bankrupt, or defaulting unless an absolute calamity arises such as losing economic sovereignty, but there, is and has been for many decades, almost arrogance in believing we can weather storms ahead.

The attitude goes back to days of Empire. It was a prime reason why, relative to the USA and Germany, productivity in Britain from 1870 to 1914 was way below these countries. Productivity has lagged even further since. Britain's place and standing in the world has declined, yet we still have an important part to play in diplomacy.

The metaphor of the Boiled Frog is highly relevant. A frog sits in a cold pan of water that is heated very gradually. Soon, the frog feels comfortably warm and dozes off. It awakens slightly as the water gets hotter - and dozes off again. The heat then becomes unbearable. Now fully awake, the frog tries to climb out. Too late!

The uncomfortable news is that the slow, imperceptible or otherwise, erosion of economic vitality becomes accepted as the new normal. Everything now feels and looks different to those who, such as myself, have lived and worked through buoyant and vibrant times.

Diverging Trends

Forecasts show that the UK's debt-to-GDP ratio will continue to creep upwards. The triple impact of healthcare costs for an ageing population, the lack of capital investment and low productivity all combine and coalesce to devastating effect. Canada's mineral and energy reserves provide a cushion. So does an intent that all make an economic contribution.

Final Observations

The headline debt number, in this case borrowing relative to GDP, matters far less than what is going on beneath the surface. That is where we need to prod and probe and ask searching questions – rather than accept a policy of carry on, almost regardless.

Since the millennium, public expenditure in real terms has increased by between 94% and 100%, depending on calculation factors. If the 2008 financial crash is excluded, and the Covid pandemic, the increase is between 75% and 80%. The UK is a welfare economy.

It is essential to insert caveats in the debate on national debt. Not considered are seismic events, such as the hybrid war with Russia heating up, even higher numbers of immigrants without value-adding qualifications and the effects of climate change. Water shortage with severe drought orders imposed is one example. The UK is badly placed to cope with these and other shocks, or as Harold Macmillan once put it, "events dear boy."

It is a sobering note on which to end an assessment of UK finances and living standards.

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