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The Burden of the National Debt

Some of the discussion of fiscal policy proceeds as though there are no costs associated with an increase in national debt, while others suggest that the national debt which, on the National Institute forecast is set to rise to over 90% of GDP by 2015 is likely to become insupportable.

Martin Weale argues that there is no reason to expect the debt to become unmanageable and that concerns about default are misplaced. However, he also argues that, in the long run national debt resulting from government current deficits crowds out productive investment and that as a consequence the country is poorer than it would be without high levels of government borrowing. This then leads to problems in funding expenditures associated with old age. Rising house prices have similar effects, and it is important that policy-makers see these as a problem rather than as desirable.

From a policy perspective, the costs of rising national debt and reduced national wealth need to be traded off against the benefits of a continuing fiscal stimulus; there seems little case for an immediate fiscal tightening. But in the longer term the policy position needs to change very substantially.

- Over the period 1987-2007 the UK has had the lowest net saving ratio of all the advanced economies.
- Since the mid 1980s our produced wealth has fallen relative to income by about one year's GDP. This is similar to the effect of the Second World War.

The combination of an eventual fiscal tightening of 5-6% of GDP and the exchange rate reduction mean that the national savings rate is likely to rise towards the levels managed by our less profligate neighbours. It will put the economy on a much sounder footing for the future. But policy makers need to pay proper attention to national wealth in the policy framework which emerges from the crisis.

Martin Weale said "For years the economy has been saving very little and no one thought it mattered. In a prudent policy structure governments would look at the overall picture and not simply at their direct influence on saving"

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Thank you