DAN ATKINSON: Bankrupt Britain: The answers to the questions everyone is asking

By Dan Atkinson
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For the first time in more than 30 years, the old fear is stalking us once more, the anxiety we hoped had been dumped in the skip of history along with secondary trade-union picketing, Sunday afternoon pub-closing and The Smurfs.

The name of this spectre is the fearful question – is Britain going bankrupt? More pertinently, can Britain, or any other country, ever actually become insolvent?
The short answer is – yes.

In recent days, sterling's slide, plus spiralling Government deficits and a stubbornly wide trade gap, have combined to raise once more the phantom of national insolvency.

Can Britain, or any other country, ever actually become insolvent?

US investment guru Jim Rogers did his bit to frighten us when, last week, he advised that Britain has major problems and that wise investors would drop sterling like a hot brick.

We have been here before. From the post-war period to the late Seventies, the air was thick with talk of 'the trade gap', of 'a big American loan', of our having lived in a 'fool's paradise for too long' and of the UK economy resembling a somewhat bibulous customer in that mythical tavern, the 'last chance saloon'.

We have had a long holiday from this fear, from the mid-Eighties until now. The debacle surrounding sterling's ejection from the European Exchange Rate Mechanism in 1992 may have proved the last fling for the 'national bankruptcy' brigade but now the dawning realisation that our own recession is likely to be worse than those of other, comparable countries, and that this is in large part a result of our having lived far beyond our means for ten years, has reawakened the old ghost.

Britain's alleged bankruptcy, or near-bankruptcy, is now common parlance. But is this threat real and, if so, what do we mean by it?

Countries can go bankrupt. It does not happen very often, and the only recorded case of an orderly national insolvency, comparable to a corporate collapse, occurred in 1934, when Newfoundland – then a sovereign state – faced such a bleak economic outlook as a result of the Great Depression that it gave up its independence and effectively went into administration under a commission of civil servants reporting to the former colonial power, Britain.

In 1949, Newfoundland became a province of Canada, which it remains.

Since the war, such orderly resolutions have been few and far between. But definitions of bankruptcy have been far from fixed.

Is a trade deficit a sign of national insolvency or is the correct yardstick the state of the public finances? Should a government need to borrow from another government or – as Britain did in 1976 – from the International Monetary Fund, is that a sign of bankruptcy?

And the dreaded word 'default' – what does that mean, exactly?

Put simply, a trade deficit – a shortfall on our export earnings in relation to our import bill – may not be especially healthy in the long term but it is not an indication of insolvency.

This is a private-sector problem, financed by private-sector lending, such as between a global bank based in Atlanta and a housewife in Manchester.

A deficit on the public finances, similarly, does not mean the country is bankrupt, even if this deficit is bigger and lasts longer than originally envisaged.

For our Government to borrow from other governments, or the IMF, is much more worrying. But even then, if the reason has something to do with supporting the pound or similar, we are unlikely to be technically bankrupt.

And who is 'we'? Is it the country as a whole or simply the Government?

Actually, this last question is the easiest to answer. Governments can, in theory, default on their existing debts and open up fresh lines of credit with anyone still willing to lend them money.

Private businesses could ignore all this – other than the inevitable slide in the national currency – and go their own way.

In an extreme situation, a government could cancel the foreign debts of the nation's private businesses – a grand-scale, all-round debt default.

But no developed Western nation could behave in that way. Britain, with the City's international role, certainly could not.

So if our private debts – corporate and household – are binding, what of the Government's own borrowings? Short of an almost unimaginable cataclysm, no British Government would simply default on its debts.

Nor would it resort to the Zimbabwean hyper-inflation option of destroying the value of the debt by destroying the value of the currency.

But sinking tax revenues, caused by recession, and a sinking value for sterling could trigger a 'gilts strike' – a refusal by investors to buy British Government IOUs without a huge 'risk premium', in effect, an extra slug of interest to compensate for the risk that the UK authorities would not be able to pay what they owe.

So you think it could not happen? It did, in 1974, when the British economy appeared to be hurtling into oblivion.

The returns on gilts had to shoot right off the blackboard in order to attract any buyers. Yes, 1974 was a while ago but it was not exactly the Dark Ages.

And the City was more of a closed shop then, susceptible to Bank of England pressure to come to the aid of the country.

In today's very different, global climate, any hint that the Government's tax revenues may fail to meet the payments on its ballooning debts would trigger a mass sell-off in the gilt market, leaving the Government unable to roll over debts by selling new gilts, and having to face up to a huge chunk of its liabilities right now.

At that point, we would have reached the technical definition of insolvency – not the inability to pay one's debts in total but to pay them as they fall due.

Doubtless, the IMF or Washington or similar would see us through but that would not change the reality of what had happened – bankruptcy.

What would it mean? First, foreign travel would be practically impossible. Sterling would be a pariah currency, shunned by foreign banks, hotels, travel companies and airlines.

This in turn could lead to shortages of food and consumer goods, as paying for imports in sterling became desperately difficult.

Second, this would send inflation much higher as the import bill soared, and many firms relying on imported raw materials would go to the wall.

Third, a sharp divide would open between a minority of 'haves' in the new scheme of things and the majority, who would be 'have nots'.

In the former camp would be big industrial companies with multinational operations and plentiful supplies of foreign currency, along with big farmers (now able to set their own prices) and some exporters, for whom the fall of the pound would be good news.

The latter group would comprise most households in the country – now reeling from shortages and inflation. It would also take in the City, whose ability to operate globally would be severely hobbled by both the slide in sterling and by the more general loss of confidence created by the crisis.

Some may see this as poetic justice.Not that there would be any hiding place in the public sector. Our new creditors would demand swingeing cuts in public spending – real, painful reductions in both staffing and in welfare entitlements.

They would insist also on much stricter controls on mortgage lending and consumer finance.

And, for both the State and for individuals, interest rates would be much higher, far into the future. That is what happens when you have been insolvent – you have to pay a lot more ever to borrow again.

Ask anyone who has ever been made bankrupt.

Dan Atkinson is the author of The Gods That Failed, published by Bodley Head.

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