

PROPORTIONAL REPRESENTATION

FOR THE NEXT GENERAL ELECTION AND THE GILT MARKET

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June 2026

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SUMMARY

Gilt yields are now at very high levels. They reflect a growing fiscal crisis which needs to be addressed urgently if we are to avert a re-run, far more damaging and long-lasting, than the collapse of market confidence following the ill-starred 2022 Liz Truss mini-Budget. A collapse so severe it could bring down this Government and pave the way for its replacement by one composed, or dominated, by populists, and thus of yet more turmoil, extending even to putting at risk the integrity of the United Kingdom. Measures must be found that will rapidly re-assure investors. So they need to be ones which impose no further strain upon the public finances.

This paper seeks to show that our First Past the Post electoral system, with its tendency, since 2008, but more seriously since 2016, to polarise and fragment our politics and encourage extremist, economically illiterate policies, which can capture the complete power of government on ever-smaller shares of the vote, has added a political risk premium to Gilt yields which now amounts to over one and a quarter percentage points on our government borrowing costs.

As soon as it were to become clear that the next General Election would be held under a proportional voting system, this premium would start to fall away, creating a tangible and rapid increase in the Government's fiscal headroom, but also obviously in the growth potential of the economy. The financial costs of such a change are negligible compared to those of all other policies presently under consideration by the new Prime Minister.

1. THE PROBLEM OF FIRST PAST THE POST

Ever since the last General Election, the issue of the inadequacy of our present electoral system and thus the illegitimacy of our Legislature and Executive have increasingly encroached upon the public consciousness. Then, the Labour Party won 411 seats on a United Kingdom (UK) wide vote of 33.7%, the Conservatives 121 seats on 23.7%, their lowest number of Members of Parliament since 1832, Reform 5 seats on 14.3% and the Greens 4 seats on 6.7%. Only the Liberal Democrats, of the parties contesting seats throughout the UK (excepting Northern Ireland) won a seat number, 72, which corresponded roughly to their vote of 12.2%. However, that was only 0.7% higher than in the previous GE in which they won 11 seats. The Scottish Nationalist Party won 9 seats on a UK vote of 2.5%, Plaid Cymru 4, on 0.7%, the various NI parties won 18 seats, on a vote of 2.7% (though Sinn Féin refused to take theirs) and the six independent MPs resulted from a vote of 2.0%.

The turnout, at 59.7%, the lowest since 2001, effectively meant the governing mandate was achieved with the support of around 20% of the electorate. And the combined vote share of the two main parties, the Conservatives and Labour, whose dominance has long been assured by the First Past the Post (FPTP) system fell to 57%, a record low.

Now, the dramatic rise in the polls since the last General Election of both Reform and the Greens, radicals respectively of the Right and the Left, has given us a situation in which five parties (and six in Scotland and Wales), ranging in support from around 15-25% are in contention, reducing the vote share of the Conservatives and Labour in the recent English local and Scottish and Welsh national elections to around 35%.

This implies that it is quite possible a governing majority in Parliament could be achieved at the next GE with less than 28% support. The dramatic collapse of approval over the past two years for the Labour Party in government, and the continuing, if now slower collapse of approval over the same period for the Conservatives in opposition, encapsulated in the astonishing fact we are going to have our seventh Prime Minister in just over a decade, has created a sense of systemic crisis without precedent in modern political history. FPTP voting, once prized for preventing weak, short-term governments and excluding extremism, is now an engine of both.

2. NOT JUST A DEMOCRATIC ONE BUT AN ECONOMIC ONE TOO

This has potentially catastrophic consequences not merely for our democracy, but inevitably therefore for our capacity to govern efficiently and effectively at home and to defend and promote our interests abroad, as well as for our British Union, social harmony and wealth creation. Consequences that have been highlighted by the collapse of Keir Starmer's premiership through its exposure of the extremely fragile state of our national fiscal position and the growing scepticism of investors, especially international investors, towards Gilts specifically and thus UK assets generally. Scepticism that is expressed in our currently high Gilt yields, which, as the benchmark "risk free" lowest reference rate, drive high borrowing costs for the whole national economy.

Interest rates obviously lie at the heart of capitalist performance, since they govern the cost of risk, time and liquidity. They determine not just how much government can spend before debt service crowds out other priorities, but how all future income is valued today and thus whether investment projects are viable, how much households can borrow and what enterprises must earn to justify expansion. When interest rates rise, the present value of future wages, profits, rents and tax revenues fall, investment thresholds rise, asset prices come under pressure and private as well as public balance sheets become more fragile.

And the determinants of a government's bond yields are not simply its immediate fiscal or monetary policy, but its entire economy. A rise in our government borrowing costs is not just an accounting issue for the Treasury: it is an economic judgement on the UK as a whole.

3. THE ECONOMIC JUDGEMENT ON OUR LOW PER CAPITA GROWTH

Fears about the fundamental strength of our economy have a long history. However, it is now widely recognised that the 2008 Global Financial Crisis (GFC) was a major caesura, since it may well have mortally wounded our previous post-industrial, global especially financial and related, services orientated economic model established in the 1980's by Margaret Thatcher.

Certainly, that model has seen further, progressive decomposition since we left the European Union (Brexit), the advent of Donald Trump and the Russian attempted conquest of Ukraine, a process that will probably be further amplified and accelerated by the crisis in the Gulf and its likely legacy.

From 2008 to 2016, the year of our referendum decision to leave the EU, the UK's per capita Gross Domestic Product (GDP) grew by some 3.1%, compared to Germany 9.0%, France 1.8%, the Netherlands 0.9%, and Poland 27.9%, whilst Italy declined by -7.4%, Spain -1.5% and Greece -24.6%. Over the same period, per capita GDP grew 6% in Canada, 8% in Australia and 6.9% in the US.

The UK's relatively strong position in Europe reflected the City of London's close ties to New York and the rapid recovery of the US from the GFC, whilst Italy, Spain and above all, Greece, of course, suffered (self-inflicted) wounds in the 2010-14 euro debt crisis, probably the most desperate and dramatic demonstration of the dangers of excessive deficits, both current account and fiscal, and of feckless and cowardly politicians and reckless and gullible capital markets, in recent history. France and Italy also suffered from the arrival, as a large-scale exporter in world markets, of China, notably in cheap copies of luxury goods.

Between 2016 and end 2024 (the latest complete data point), UK per capita GDP grew 4.5%, compared to 3.6% in Germany, 7.5% in France, 9.7% in the Netherlands, 11.0% in Italy, 9.5% in Spain, 19.1% in Greece, and 38.2% in Poland. Over the same period, per capita GDP grew by 5% in Canada, 3% in Australia and 16.1% in the US.

Our superior performance to that, in Europe, of Germany alone, post Brexit, is due almost exclusively to the uniquely adverse impact of the Ukraine war and the cutting off of Russian gas exports, upon which the Germans were overwhelmingly reliant, that has abruptly and massively raised their energy prices, coupled with the collapse of their hitherto signal dominance of China's investment goods and car market, owing to dramatically rising Chinese self-reliance in the sectors, and of export markets worldwide, owing to equally dramatically rising Chinese competition, notably in electric vehicles, machine tools and renewable energy infrastructure. It is a mark of German weakness, not UK strength: a point to which we will return.

4. ON OUR POOR PRODUCTIVITY GROWTH

The principal driver of our low growth is poor labour productivity. From 2008 to 2025, this improved by just some 5% in total, an average of 0.3% per annum, compared to 20% in Germany and the Netherlands, or 1.2% pa, 15% in France and Spain, or 0.9% pa and 55% in Poland, or 2.8% pa Italy performed the same as us.

Only Greece, where the legacy of the euro debt crisis, of which it was the epicentre, and the subsequent strains upon its inherently low-productivity, tourism-dominated economy from the Covid pandemic, Turkey's precipitous competitive devaluation of the lira and the war in Ukraine (combined with the likely scale of unreported, unofficial commercial activity which continues to depress the data) did worse than us, with effectively no productivity growth. Over the same period, productivity grew by 12% in Canada, or 0.7% pa, 10% in Australia, or 0.6% pa and 25% in the US, or 1.4% pa.

5. ON OUR CURRENCY DEVALUATION AND INFLATION RATE

The principal financial expression of our poor productivity is the persistent devaluation of our currency. In international markets, between the Global Financial Crisis and Brexit, sterling fell some -27% against the dollar and -1% against the euro. Since Brexit, it has fallen a further -6% against the dollar and -13% against the euro. Leaving the EU has led us to become more aligned to the dollar than the euro, potentially a problem if fears that the crisis in the Gulf and President Trump's policies on trade and security more generally precipitate a progressive de-dollarisation of the world economy, entailing a substantial long-term devaluation of the US currency comparable to the one suffered by sterling when it shed its status as a global reserve currency.

Domestically, our inflation performance has also been persistently poor. Between 2008 and 2016, our Consumer Price Index (CPI) rose, on average, by some 2.7%, compared with Germany 1.5%, France 1.3%, the Netherlands 1.7%, Italy and Spain 1.8%, Greece 1.4% and Poland 2.3%. We also did worse than Canada 1.8%, Australia 2.5% and the US 1.8%. Between 2016 and 2025, our CPI rose on average by 3.9% compared to Germany and Italy 2.8%, France 2.3%, the Netherlands 3.3%, Spain 3% and Greece 3.2%. Only Poland on 4.5%, owing principally to the impact of the war in Ukraine, performed worse than us. We also continued to do worse over this period than Canada on 3.5%, Australia 3.4% and the US 3.5%.

6. ON OUR CURRENT ACCOUNT DEFICIT

In large part, this devaluation reflects our persistent current account deficit. From 2008 to 2016, this went from some -3.9% to -5.5% of nominal GDP. Over the same period, Germany went from a surplus of 5.6% to 8.9% and the Netherlands from 5% to 9%. Italy went from a deficit of -2.7% to a surplus 2.5%, like Spain from -8.8% to 3.2% and Greece from -15% to 1%. Poland reduced its deficit from -6.5% to -0.3% as did France from -1.0% to -0.5%. Canada went from a surplus of 0.1% to a deficit -3%. Australia reduced its deficit from -5% to -3% as did the US from -4.8% to -2.4%.

Between 2016 and 2025 the UK deficit narrowed slightly to -4.0%, but ours remained the only major European economy still running a trade deficit, whilst Germany had a surplus of 5.8%, the Netherlands 9.1%, Italy 1.5% and Spain 4%. France and Poland both reached balance. Only Greece underperformed us, with a deficit of -6.4%. Outside Europe, Canada reached a surplus of +1% and Australia balance.

Our current account deficit is indeed exceeded by that of the US, which now stands at -4.5%. But it is scarcely in a comparable position to us. The trade openness of the US economy is some 25% of nominal GDP (of which 11% are exports) compared to 65% for the UK (of which 33% are exports). The equivalent number for the EU is 50% (of which 30% are exports) and for China 40% (of which 21% are exports). It is worth adding that in 2025, the EU as a whole had a current account surplus of 3.5% (and the eurozone of 1.6%) and China one of 2.5%, though this number is depressed by high Chinese payments to foreign investors and owners of intellectual property and a large tourism deficit. China's goods trade surplus is 6%.

7. ON OUR NET INTERNATIONAL INVESTMENT POSITION

Clearly, we have run current account deficits continuously since the mid 1980s, when the post-industrial, financial services orientated economic model of the Thatcher government was being created. We have funded this with capital account inflows, dominated by the financial centre role of the City of London, comprising investment income from foreign assets, but with an increasing reliance on domestic asset sales and Foreign Direct Investment (FDI). This is in sharp contrast to the industrial (and in some cases tourist) surplus models operated, or aspired to, by the countries of the EU, or obviously the commodity export and FDI models of Canada and Australia. From 2008 to 2016, the UK's Net International Investment Position (NIIP) deteriorated from some -15% to -25% of nominal GDP.

From 2016 to 2025, this deterioration accelerated, with the cumulative deficit going from -c.25% to -c.35% of nominal GDP. Only the US, which experienced a somewhat similar remaking of its economic policy in the 1980's, under Ronald Reagan, shows a comparable pattern, deteriorating, from -10% in 2008, to an astonishing -80% in 2025. But, as we have already seen (in sections 3 and 4), the US has a far more dynamic growth and productivity record than us, along with a far lower level of economic openness. Above all, of course, it enjoys the fundamental advantage of the dollar being the global reserve currency, which guarantees foreign purchases of its government debt and the premier international financial centre status of New York.

8. THE COMPOSITION OF THIS HAS CHANGED

The composition of the UK's NIIP has also changed. Between 2008 and 2016, we financed our current account deficit by about 25% through income from foreign assets and from international, principally financial and related, services, 35% through FDI, 30% through foreign purchases of our listed equities, corporate bonds and Gilts and 20% through foreign purchases of our property and infrastructure.

Since 2016, the contribution of income from foreign assets and international services has risen to about 35%, along with that from foreign purchases of our listed equities, corporate bonds and Gilts to 40%, replacing FDI, which has fallen to 15%, along with foreign purchases of our property and infrastructure on 10%.

The increasing contribution of income from foreign assets and international services, since 2016, has much to do with the devaluation of sterling. The share of these constituted by the financial services of the City of London over this period fell from some 26% to 20%, chiefly due to the drastic decline of its euro denominated business from 45% to 30%, as a direct result of Brexit. Sterling weakness also boosted the volumes of foreign purchases of our listed equities, corporate bonds and Gilts, the latter also assisted by the significant increase in issuance.

The declining contributions of FDI and foreign purchases of our property and infrastructure however are ominous, given that devaluation, rising global capital markets and the exceptional openness of the UK economy to such investments, especially from its principal sources in the US and the Middle East, compared even to the overall best European performer in this field, the Netherlands.

9. THE PROBLEM OF OUR DEBT, PARTICULARLY OUR FISCAL DEFICIT

Similarly ominous signals are sent by our high levels of debt, both public and private. In 2008, our fiscal deficit stood at -2.6% of nominal GDP. France then had a deficit of about -3.0%, Italy -1.3%, the Netherlands -0.2%, and Poland -3.6%, whilst Germany ran a small 0.1% surplus. Spain also was in surplus, albeit through revenues inflated by a soon to be systemically destabilising property boom. Greece, by contrast, was running the soon to be disastrous deficit of -10%. Canada and Australia ran surpluses of respectively 0.4% and 1.7% whilst the US ran a deficit of -2.9%.

By 2016, the UK's fiscal deficit was -3.3%. France was on -3.8%, Italy -2.4%, Spain -4% and Poland -2.4%. The Netherlands was in balance, whilst Germany, despite taking on a major part of the euro debt crisis bail-outs, had moved to a surplus of 1.1%, along with Greece, 0.7%, an astonishing turn-around. Canada was on -0.5%, Australia -2.5% and the US -4.4%.

By 2025, the UK had reached -5%, having peaked the previous year under the outgoing government at -6.1%. In the EU, only Poland, on -7% and France, -5.5% have higher fiscal deficits than we do. And in the Anglosphere, only the US on -7%. Germany was on -2.8%, the Netherlands -2.2%, Italy -3.5% and Spain -2.8%, whilst Greece ran a surplus of 1.4%. Canada was on -2.3% and Australia -2.0%.

The UK's historic public debt position is somewhat more favourable. In 2025, this stood at 100% of nominal GDP. In Europe, this was lower than Greece at 140%, Italy 135%, and France 110%. It was about the same as Spain, but higher than Germany at 60%, the Netherlands 45% and Poland 60%. It was also higher than Australia at 45%, but lower than Canada at 110% and the US 125%.

In 2008, as the GFC was beginning, UK private debt as a share of nominal GDP was some 190% compared to Germany on 86%, France 165%, the Netherlands 240%, Italy 125%, Spain 220%, Greece 120%, Poland 50%, Canada 170%, Australia 155% and the US 170%. By 2025 our share had fallen to 133%, putting us below France 190%, the Netherlands 165%, Spain 145%, Canada 220%, Australia 170% and the US 145%, but above Germany 110%, Italy 105%, Greece 95% and Poland 75%.

Of course, these numbers, though indicative, reflect a range of different circumstances: the impact of the GFC and the euro debt crisis and above all, the evolution of the financialisation of each economy. But for the UK, the most striking shift has been from being private debt to public debt heavy: the lasting legacy of the 2008-9 bank bailouts (the notorious "privatising rewards, nationalising risk").

A better measure is Gross National Savings (GNS) as a share of nominal GDP. In 2008, this was 15%, the same as the US and Greece, but below Germany 26%, France 22%, the Netherlands 28%, Italy 21%, Spain 22%, Poland 18%, Canada 21% and Australia 25%. In 2025, the UK's GNS of 17% was again the lowest amongst these countries apart from Greece 14%, which alone had deteriorated during this time, the lasting legacy of the euro debt crisis.

But the UK's improvement of 2% was the weakest apart from that of France and Spain which both had risen 1% to respectively 18% and 23%, the same as Canada's, which had risen to 25%. Germany had risen by 4% to 30%, the Netherlands and Italy by 3% to respectively 31% and 24% and Poland by 11% to 29%. Australia and the US had both risen by 3% to respectively 25% and 18%.

10. OUR DETERIORATING CREDITWORTHINESS

What increasingly distinguishes the UK is not simply the level of our trade and fiscal and private deficits, but the declining medium to long-term credibility of our capacity to fund them. This can be seen in our low rate of capital creation. In 2008, the UK's annual Gross Fixed Capital Formation (GFCF) was running at some 17% of nominal GDP, compared to Germany at 21%, France 22%, the Netherlands, Italy and Spain, 20%, Greece 14%, Poland 22%, Canada 24%, Australia 29% and the US 23%. In 2025 the UK was still running at 17%, compared to Germany 22%, France and the Netherlands 24%, Italy and Spain 21%, Greece still 14%, Poland 19%, Canada and Australia 25% and the US 22%.

It is also apparent in the UK's growth rates of real disposable household incomes before tax and benefits, or Cumulative Real Market Income (CRMI). From 2008 to 2025 this grew in low income households (the lowest quintile or Q1) by just some 2%, in middle income households (Q3) by 8% and in high income households (Q5) by 15%. This is a weaker performance than that of Germany, were the equivalent

numbers are 15%, 25% and 35%, France 5%, 15% and 20%, the Netherlands 15%, 20% and 25%, Spain 2.5%, 10% and 20% and Poland 90%, 100% and 120%. In Europe, only euro debt crisis hit Italy -2.5%, 2.5% and 7% and even more ravaged Greece -20%, -15% and -10% did worse. The numbers for Canada and Australia 7.5%, 10% and 15%, are only slightly better than ours, whilst the US 15%, 20% and 35% out-performed all the European countries we are following, except Poland.

11. THE GRIM SOCIAL IMPACT OF OUR ECONOMIC UNDERPERFORMANCE

The most striking feature of the US data is that it also shows the greatest increase of inequality. An increase which is even more pronounced for its top 1% in total wealth. Indeed, increasing inequality is plainly omnipresent.

However, the UK surely stands out, not just in being much closer to the US pattern than to that of Europe, but by the pitiless impact of its fundamentally feeble economic performance upon our most impoverished citizens. The point where all these statistics start to have a human face: that of their victims.

For our Q1 households are now some 20% poorer (on income v. expenditure including housing costs adjusted for real purchasing power) than their peers in the Netherlands (the equivalent to £3,500 pa) 18% poorer than those in Germany (£3,000 pa), 15% poorer than those in France (£2,500 pa), 13% poorer than those in Australia (£2,000 pa), 10% poorer than those in Canada (£1,500 pa) and 4% poorer than those in the US (£500 pa). They are just 4% richer than their peers in Spain (£500 pa) and 8% richer than those in Italy (£1,000 pa). Only Q1 households in Greece and Poland are significantly poorer, by respectively 53% and 25%.

12. THE RISING VULNERABILITY OF GILTS TO FOREIGN DIS-INVESTMENT

The deteriorating international perception of the security of UK assets entailed by these numbers is made potentially more problematic by the relatively very high proportion which are owned by foreigners (the notorious “kindness of strangers”). As regards our property and infrastructure, this has been tentatively estimated, in 2025, at 25%. Compared to Germany at 10% (6% from outside the EU), France, the Netherlands and Spain 15% (8%), Italy 8% (5%), and Poland 10% (5%). Whilst Canada is at 15%, Australia 18% and the US 5%. As regards foreign ownership of listed equities as a share of market capitalisation, in 2025, for the UK, this was around 60%, exceeded only by the Netherlands on 75% (though this number falls to 45% for non-EU investors), and higher than Germany and France 45% (25%), Italy 30% (15%), Spain 35% (20%), Greece 50% (25%) and Poland 20% (10%). Whilst Canada is on 40%, Australia 35% and the US 18%. In other words, our vulnerability to a downturn in global growth and equity investment is greater than that of most of our peer economies.

Foreign ownership is also prominent in UK Gilts. In 2025, it accounted for some 33% of the market. By comparison, the shares of government bonds of eurozone member states owned outside the single currency area, the appropriate parallel, are Germany and France 15%, the Netherlands 20%, Italy 8%, Spain 10% and Greece 5%. Polish government debt was owned 16% by EU and 10% by non-EU investors. As regards the other countries we are following which borrow in their own currency, only Australia on 53% had a larger share than us of its government debt owned by foreigners, whereas both that of Canada on 30% and the US 28% were lower.

13. THE RISING SPECULATIVE CHARACTER OF THE GILT MARKET

A further potentially destabilising factor specifically for Gilts is how their ownership overall is becoming more speculative and short-term. In 2016, some 13% of the market was owned by asset managers and bond funds, which alter their positions as economic conditions change, compared to 55% by pension funds and insurance companies, which essentially hold their positions to maturity. In 2025, these numbers were 32% and 25%.

Even more striking is the rapid rise of hedge funds as market participants, both as outright buyers and, much more problematically, as holders linked to highly-leveraged, complex yield curve spread, repo and swap transactions capable of radical unwinding in very short order. In 2016, this activity was estimated at 2% of the market. By 2025, it had risen to 12%, amounting to about 60% of total trading volume.

Against this is often set the exceptionally long average maturity of Gilts. What is probably now the principal pillar of stability for the market. In 2025, this was 14 years, compared to Germany and the Netherlands 7 years, France, Italy and Spain 8 years and Poland 5 years. Only Greece, because of its euro debt crisis bail-out, has a longer average maturity of 18 years. Our position is also superior to that of Canada, on 7 years and Australia and the US, 6 years.

This means that we need to refinance annually only 7% of our debt stock, compared to Germany and the Netherlands 15%, France and Spain 12%, Italy 13%, Poland 22%, Canada 14%, Australia 17% and the US 18%. However, it is an advantage that has been seriously undermined through the use by the Bank of England (BoE), between 2009 and 2021, of Quantitative Easing (QE).

14. THE IMPACT OF QUANTITATIVE EASING

This policy, the creation by the BoE, outright, of reserves (the notorious “printing money”) and using them both to buy Gilts and simultaneously increase liquidity for the banking system through the expansion of its own balance sheet (as well as, inefficiently, devalue sterling to improve the competitiveness of London as an international financial centre) was the key instrument of the Bank’s response to the GFC. The impact of this was clearly more serious than for any other major economy because

of our post 1980's model of extreme exposure to financial services risk, both at home and abroad. The BoE's liabilities are, of course, also those of the Treasury. QE was modelled, like so many of the Bank's policies, on the post GFC response of the US Federal Reserve. But it was continued far more amply than that, and than the broadly comparable European Central Bank's (ECB) Public Sector Purchase Plan (PSPP), launched in response to the euro debt crisis, first to cushion the economic strains of Brexit, and then of the 2020-21 Covid pandemic.

By matching lending to the Treasury on a scale which amounted, at its peak, to nearly 30% of the Gilt market, with deposits for the banking system for which the BoE pays Bank Rate, QE essentially shortened the effective maturity of that portion of the UK's public debt from an average maturity of 14 years to overnight (and thus from mostly fixed to variable interest rates). Since 2021, this process has been put into reverse by Quantitative Tightening (QT), but at the current pace, this will not to be completed before the mid-2030's and entails substantial capital losses for the Bank, estimated at some £125 billion, because its purchases of Gilts under QE were undertaken when yields were significantly lower. For this and other reasons, given the changes and challenges ahead, it is entirely possible that neither the Bank's balance sheet nor therefore the effective length of maturity of the UK's public debt will ever return to their 2008 state.

15. THE RISK OF INDEX-LINKED GILT ISSUANCE

Another problem is posed by our significantly greater issuance of index-linked paper, which obviously increases our vulnerability to rising inflation. Currently this amounts to about 25% of our debt stock, compared to 1% in Germany and the Netherlands, 10% in France and Italy and 4% in Spain and 2% in Poland. Greece has no index-linked government debt. Nor does Canada. Australia has 8% of its debt stock in such securities, whilst the US has 7%.

This profile is now potentially problematic for us, not simply, on account of our persistent propensity to higher inflation we have already noted (see section 5), but because of the immediate impact of the energy price shock from the current Gulf crisis. Something particularly flagged up by recent JP Morgan research (*Ward and Nokes JPMAM May/June 2026*).

16. OUR HIGH GILT YIELDS

All these issues are presented pre-eminently, and most purely, in the interest rates on our government debt. In January 2008, the UK 10-year Gilt yield was 4.5%, 0.4% above Germany on 4.1%, 0.3% above France and the Netherlands both on 4.2%, 0.3% above Italy and Spain on 4.3% and 0.1% below Greece on 4.6% and 1.3% below Poland on 5.8%. We paid 1.5% below Australia on 6% and 0.6% above Canada on 3.9%, and 0.7% above the US on 3.8%. At the beginning of June 2026, the UK paid 5%, 1.9% above Germany on 3.1%, 1.2% above France on 3.8%, 2% above the Netherlands on 3%, 1.6% above Spain on 3.4% and 1.2% above Greece on 3.8%.

In Europe, only Poland pays more than us, 0.8% on 5.8%. In the Anglosphere, Australia also pays 5%, whilst Canada pays 1.7% less on 3.3% and the US 0.5% less on 4.5%.

The usual way, of course, of presenting this data, so as to judge our real relative cost of money, excluding general factors affecting all currencies, is as a spread above or below either the 10 year German Bund, the de facto benchmark of the eurozone, or the 10 year US Treasury Bond, the benchmark for the reserve currency of the world.

From the start of the GFC until the Brexit referendum, this averaged +22 basis points (0.22%) above the 10 year US Treasury, reflecting sterling's closer linkage to the dollar following our leaving the European Exchange Rate Mechanism in 1992 and behind that, the close ties between the City of London and New York as financial centres. It averaged 84bp above the 10 year German Bund, reflecting the impact of the creation of the euro, the eurozone debt crisis and its resolution, all of which enhanced the Bund's European "safe haven" benchmark status. During this period, the UK looked, to bond investors, like a higher-yielding, but still mainstream advanced economy sovereign debtor, damaged, but not fundamentally so, by the GFC.

From the Brexit referendum to our actual departure from the EU at the end of 2021, our spread against Treasuries collapsed to an average -119bp, whilst against Bund it rose to +106bp, reflecting the BoE's decision to let sterling take the strain of that process by aggressively cutting interest rates directly and by QE. During this period, bond investors started to cease to see the UK as a mainstream sovereign debtor, but one with a structurally weaker growth, leading to lower-rate economy, created by its divorce from its largest trading partner, but had not yet made a definitive judgement upon its longer-term prospects once the immediate market disruption of leaving the EU passed.

From 2022 to now, our average spread against Treasuries returned to an apparently more normal -20bp, reflecting higher US yields from rising inflation and growing concern over the policies of the Trump presidency, but has accelerated its rise against Bund, averaging +148bp. As we have already seen, it now stands at around 190bp. It is clear that bond investors are now looking increasingly at the UK as having acquired a low growth, but high interest rate economy, because of multiple higher risk premia.

17. THE EURO

Before considering these in detail, it is surely worth remarking that over and above the striking decline in our relative position, what stands out from these numbers (and from the previous ones regarding foreign ownership of government bonds in section 12) is the stabilizing impact of membership of the euro. There is no question this has significantly reduced the interest rates paid by France, Italy, Spain and Greece, all of which have higher historic debt than us, alongside other relevant relative weaknesses.

Of course, renouncing the right to defraud creditors by devaluation is reassuring to the markets in itself, even without the collective peer pressure fiscal discipline provided by the Maastricht rules, which have the legal status of an international treaty. Albeit most imperfect, these are clearly superior to our own self-imposed "Fiscal Rules", which are purely political guidelines, "enforced" through the fiscal risk and sustainability reports of the Office of Budget Responsibility (OBR).

This is something the UK needs to consider very seriously, alongside the loss of euro business to the City of London, since Brexit, critical to our balance of payments. On this latter point, given the probable future decline in the dollar's reserve currency status, and the move to a world in which the Renminbi, the euro and perhaps other currencies share regional reserve status, and London's marginalisation or exclusion from being a financial centre for the European reserve currency, through the forthcoming European Capital Markets Union, could be a fatal blow for its status in foreign exchange (FX) trading, of which it is the world's principal hub, with some 38% of global turnover accounting for 25% of its international earnings. History has no examples of dominant financial centres long surviving without a home reserve currency.

So the continuing attachment to sterling in our politics, amounting to almost an article of faith, does seem aberrant. Furthermore, for obvious reasons, membership of the euro will certainly be a primary condition (second only to adoption of PR) for our ever rejoining the Union.

18. THE CORE OF OUR PROBLEM: DEBT SERVICE COSTS

But the main issue we must first focus on is the core of the problem the UK Government faces in the high level of our Gilt yields, which is, of course, the cost of servicing its debt. In 2025, our General Government Net Interest Expenditure (GNIE), was some £111 billion, composed of payments to holders of fixed-rate Gilts of some £60 billion, or 54% of the total, to holders of index-linked Gilts of £25 billion, or 23% of the total, to banks with QE at the Bank of England of £20 billion, or 18% of the total and to holders of Treasury Bills and other debt-related liabilities, such as the losses on QT Gilt sales by the Bank of England, of £6 billion, or 5% of the total.

That sum is about 4% of our nominal GDP. Only the US, on 4.5% of nominal GDP, had higher government debt service costs than ours. In Europe, Italy was on 3.5%, France 2.3%, Poland 2%, Spain 1.8%, Greece 1.8%, Germany 1% and the Netherlands 0.8%. Canada was on 2.5% and Australia 2.2%. It is also the equivalent of 151% of our current budget for defence, or 108% if we find the extra £29 billion needed to increase its spending to 3% of nominal GDP, the North Atlantic Treaty Organisation (NATO) target. It is 54% of the budget for health, 33% of that for welfare and pensions and 100% of that for education.

Reducing these costs is challenging because we are far from alone in being very fiscally strained. All the governments of the other countries we are following now need to issue more debt. The EU member states especially, like us, need to increase their spending, especially since the Ukraine war, on defence. The private sector too, everywhere, has a ferocious thirst for financing, notably for the new technologies and infrastructures of renewable energy, artificial intelligence and space: competition that is adding to upward pressure upon interest rates.

Taking all this data together, there can be no doubting the growing fundamental weaknesses of the UK economy in general and of the Gilt market in particular, since the GFC. Nor that these have become significantly more serious since, and thus surely to some considerable extent, because of, Brexit.

It is also obvious that they are posing a serious restraint on UK Government policy, as its difficulties over vital areas of public expenditure, notably defence, but also clearly welfare, health and education, become increasingly acute. And at the heart of this developing disaster are the high interest rates we are paying for our government debt.

19. BREAKING DOWN THE COMPOSITION OF OUR HIGH GILT YIELDS

So what are the various risk premia contributing to these and how can they be assigned more or less precise shares in basis points? To begin to address this properly and practically, we will first need to distinguish clearly between our long-term weaknesses, those that go back to 2008 and beyond, from the fresh factors which have exacerbated them since 2016, accelerating the deterioration of our position and precipitating our present, very pressing problems. And to further distinguish between those factors, since 2016, that whilst on-going in their effects, have been external and general, from the ones directly due to our own policy choices. For the beginning of any improvement in our condition must be that we first stop making it worse. The Government needs to identify what it can do now, that would significantly lower our interest rates, and in short order. For the matter is urgent.

So we must estimate the share of these attributable to our pre 2016 position and then undertake the same exercise for Brexit and whatever other fresh factors we can identify as either exacerbating our long-term weaknesses or adding new ones. Translating economic data in a meaningful manner to interest rates, particularly bond yields, is complex and highly conjectural, as well as highly controversial. It also seems rather under-researched, or under-deployed, which given the already noted, substantial increase of speculative activity in the market from hedge funds, to say nothing of the Treasury's and the BoE's interests in the matter, is perhaps surprising.

Nevertheless, a rough and impressionistic methodology can be improvised by looking at, for GDP, Rachel and Smith 2015 (BoE Working Paper 571), for productivity, Ready 2026 (Congressional Budget Organisation CBO publication 62373), current account deficits, Barrios, Iversen, Lewandowska and Setzer 2009 (European Commission Economic Papers ECOFIN 388), fiscal deficits, Gruber and Kamin 2010 (International Finance Discussion Paper OECD 1011), national savings, OBR Report for July 2025 (CP 1343), exchange rate and inflation risk, Hordahl and Tristani, 2007 and 2010 (Bank for International Settlements Working Papers BIS 228 and 325) and for investment, Cesa-Bianchi, Harrison and Sajedi 2022 (BoE Working Paper 990).

Using the UK's Gilt spread in the 10-year German Bund (since the US is not a comparable economy, see Section 6), the accepted most appropriate analytical benchmark, which is now some 190 basis points, as the control for an assessment, those studies indicate, very tentatively, that our pre-2016 persistent current account deficits comprise about 25bp of this, our high inflation and devaluation risk 15bp, our high fiscal deficits 15bp, our poor productivity 12bp, our low national savings 10bp, our low per capita GDP 8bp and our declining residual reserve/ investment currency status following the GFC 8bp, making a total of 93bp. This suggests that 97bp, so more than half, has been added since 2016.

How has this addition been composed? In large part clearly by a further weakening of the above factors, adding on some 18bp to the figure for our low per capita GDP, 10bp each to the figures for our poor productivity, high current account and fiscal deficits and inflation and devaluation risk. Over the same period, the post GFC-enhanced risk factor has unwound and fallen from the list. Taken together, these constitute net 50bp, therefore leaving us still to attribute 47bp.

20. SINCE 2016, THIS HAS NOT JUST BEEN BREXIT, BUT IT LOOMS LARGE

First, however, it is surely worth seeing how much of that 50bp can be attributed to Brexit. There is now an overwhelming consensus that the damage it has done to our growth, trade, investment and productivity is both serious and lasting, though the range of the estimated extent of this is broad. The National Institute of Economic and Social Research (NIESR), in 2023, projected or implied these at respectively -6%, -15%, -15% and -10%. The OBR, in its 2025 update of a 2020 study had -4%, -15% -10% and -4%. The Stanford University National Bureau of Economic Research (NBER), in 2025, had -8%, -6%, -18% and -3%. The Federal Trust's own 2025 review (*by John Springford*) of the data broadly agreed with the NIESR's -6% for GDP, the OBR's -4% for trade and productivity, but was more sympathetic to the NBER's -18% for investment.

Taking our numbers, and using the same methodology, we can, again very tentatively and indirectly, suggest the Brexit contribution to the current 190bp Gilt spread over Bund is 75bp. In other words, it seems that all the 50bp previously projected for the post-2016 deterioration in our, trade, investment and productivity performance should be attributed to Brexit. And then some: a 25bp Brexit component not attributable to its direct economic impact. Apart from identifying what that could be, we need to explain what seems like a significant under-stating of the post-2016 rise in Gilt yields. For there were clearly other contributors, apart from Brexit, over this period.

The year 2016 was, after all, with the first election of Donald Trump to the US Presidency, a global, not merely a British watershed. One which marked the beginning of the dismantling of almost all the then principal presumptions about the UK's place in the world. Of the continuation of global free trade and of the supposedly benign character of the increasing Chinese dominance of manufacturing, rather than its increasingly menacing character, which is returning the world to protectionism and trade blocs. Of the US' strong commitment to the North Atlantic Treaty Organisation, and thus to the "Special Relationship", rather than to the "New Monroe Doctrine" isolationism within "The American Island". Of Russia's pacific priority of integrating its economy into the West, and especially Europe, rather than into Asia, and especially China, let alone, with Beijing's backing, going so far as to actually seek a military confrontation with Europe.

Presumptions that certainly supported, at least for its elite (ideological and financial) adherents, their cerebral, and even some of their visceral case, for Brexit. The comprehensive demise of which clearly constitutes the main reason to undertake its complete reversal.

Obviously, Brexit has considerably increased our vulnerability to such external shocks by increasing our isolation, by definition from the EU, but also, indubitably, increasingly from the US, and more widely, notably with several key Commonwealth countries. Nevertheless, these developments would probably have disproportionately impacted the UK even without Brexit.

21. THE UK'S REAL POSITION IN THE BUND-GILT SPREAD IS MASKED BY GERMAN WEAKNESS

On the other hand, the same external shocks have also, though somewhat differently, definitely disproportionately impacted Germany. Indeed, in the short run, considerably more than they have us, as its already noted (in section 2), recent exceptional economic weakness, especially following the Russian invasion of Ukraine, shows. For this directly caused the abandonment, in March 2025, of the 2009 constitutional *Schuldenbremse*, limiting net federal borrowing to 0.35% pa of nominal GDP, the foundation of the Bund market's hyper strict post-GFC quasi reserve benchmark status, to allow the subsequent massive 143 billion euros increase in government debt to finance rearmament, which, in turn, has dramatically increased German interest rates. This has been estimated (Bundesministerium der Finanzen Stellungnahme 02/2025 and Goldman Sachs, Reuters 03/2025), presumably using a comparable methodology to that already applied here to Gilts, to having an impact of 120bp to 10 year Bund yields.

This means the real premium in the UK's position might actually be considerably worse than we have hitherto measured, and should probably be reckoned as more like 310bp, or 217bp added since 2016. This would easily accommodate a Brexit direct policy component to Gilt yields of 50bp and the 25bp not attributable to any specific policy effect.

22. PENSION FUNDS, COVID AND QUANTITATIVE TIGHTENING

It also explains how the OBR's July 2025 FRS 1343 report implied that the declining interest of UK defined-benefit pension funds in buying Gilts (already mentioned in sections 12 and 13) has added, since 2016, some 20bp to Gilt yields might fit into the picture. Then there is the impact of Rishi Sunak's 2020 increase in borrowing to deal with Covid, which was evidently excessive, given the state of our public finances. That may, by a comparable analysis, amount to 10bp. I say may, because the picture is clouded by the simultaneous deployment by the BoE of QE.

Finally, there is the impact of the BoE's post-2022 QT operation, unwinding the QE undertaken since 2009, which was stated, in its own August 2025 report, to be about 20bp. Taken together this implies the portion of the post 2016 rise in Gilt yields that can be allocated to specific UK policies rises to 100bp.

However, again we must include the German position on these additional items for the comparison with the Bund-Gilt spread. Germany has no equivalent issue to that created by the phasing out of UK defined-benefit pensions. But it did have a generous Covid relief program, albeit its fiscal unwind was more complete. Germany also undertook a sort of QT, as part of that process, though not to the disproportionate degree of the euro debt crisis, with the Bundesbank selling Bund on behalf of the ECB's eurozone-wide Asset Purchase Program, reversing its Covid-related revived PSPP operation.

Taking this into account, it is plausible to revise the number for Covid's contribution to UK Gilt yields to 5bp, and for QT to 10bp. All of which is indicative of a UK policy-generated contribution to the post 2016 rise in our public borrowing costs of 85bp, thus leaving a contribution which cannot be readily allocated to any actual policy of 132bp.

23. THE UNEXPLAINED 132 BASIS POINT RISE IN GILT YIELDS

So what could it be? We already know (see section 20) that there are 25bp linked to Brexit in that category, which it seems Samir Kadiric (IEEC May 2022) had in mind when he wrote of the "permanent damage to the UK's safe-asset reputation of leaving the EU". A further clue may be found in another sometimes-suggested, non-Brexit, policy candidate for adding to our present debt cost woes: the (also notorious) September 2022 Liz Truss mini-Budget. The immediate effect of this fiasco was very large. The 10 year Gilt yield rose by more than 30bp in one day, the biggest such rise since 1998. But the policy was swiftly and totally reversed. Truss resigned and was replaced by the, privately at least, more financially credible Sunak.

The episode's psychological impact still plainly persists, however, as also argued, for example, by Aikman and Zeng in their October 2025 blog, and could be 15bp. What about the remaining 92bp then?

24. THIS IS MORE THAN JUST LIZ TRUSS' "MORON PREMIUM"

That 15bp legacy of the Truss mini-budget was memorably named, shortly after her departure from office, by the Financial Times journalist, Louis Ashworth, the "Moron Premium". But that 92bp proves this single, if spectacular, instance of staggering fiscal frivolity is merely a very modest part of what analysts like Ioannidis 2021, Wadhvani 2024 and Goldman Sachs, Aikman and Vontobel/VoxEU all 2026, suggest is an ongoing and growing "political crisis premium" in Gilt yields. A seriously assessed, steadily-spreading and increasingly-insistent sense among investors that the British political system, once seen, whatever particular policy errors it might make at any given time, as unquestionably structurally sound and capable of selecting and sustaining sensible and stable government, is now drifting into a state of deep institutional instability. One that is open-ended, both as to its possible degree and duration. And that is already costing us 132bp on our interest rates.

25. THE POLITICAL RISK PREMIUM IN UK GILTS

If such is indeed the case, we have a big problem. For the leading literature on political risk premia, such as Alesina and Perotti 1998, Moser 2007, Pastor and Veronesi 2013, Baker, Bloom and Davis 2016, Hong, Ke and Nguyen 2024 and Handler and Jankowitsch 2025 are clear that these have a history of often being slow to form, without a significant impact upon investor confidence, until events suddenly attract the market's attention by breaking its previously solid assumptions, leading to the savage reactions which make them easily the most volatile of influences upon bond yields. This 132bp we are looking at has apparently been gradually, unevenly, but remorselessly accumulating since the 2016 referendum. It is already a significant figure, amounting to £13 billion pa, or 12% of our debt service costs, or 18% of the current annual MOD budget and 13% if that rises to 3% of nominal GDP. But it could go much higher.

A British audience can cavil at comparisons from 1970's, 80's and 90's Italy and South America, but the record strongly suggests it is most unlikely that the present political risk in the UK is fully discounted. At their peak, Italy's 10-year bond yields were a full 8% over Germany's, more than twice what was justified by economic fundamentals. The current real yield on 20 year index-linked gilts of some 2.2% is still some way below the last years of the Thatcher Government, when it was struggling to shore up its fragile fiscal and monetary credibility amidst an internal party and external national crisis over our future in Europe which, in all essentials, is still with us. A return to real yields of 4-5%, or more, given our now markedly weaker economic fundamentals, is perfectly possible.

A 100bp increase in interest rates from present levels could add to our annual debt service costs of 111 billion pounds, in year 1, approximately £10 billion, or 9%, which is now 13% of the MOD budget, or 10% if that rises to 3% of nominal GDP. By year 3, or the next GE, those numbers will be £18 billion, 16%, 24% and 18%. By year 8, the possible following GE, they will be £135 billion, 122%, 184% and 132%. A 500bp increase could add to our debt service costs, in year 1, £50 billion, or 45%, which is now 25% of the NHS budget. By year 3, those numbers will be £90 billion, 81% and 45%. By year 8, £135 billion, 122% and 67%.

26. THE "MAGICAL THINKING" ABOUT OUR ECONOMIC CIRCUMSTANCES BY OUR POLITICIANS

There is no shortage of commentators correctly condemning what Hannah White, in 2024, more memorably, called the "Magical Thinking" about government now omnipresent amongst politicians of all parties, with the established Conservative, Labour and Liberal Democrat leadership all too often feeling forced to mimic the more irresponsible and serially mendacious populism of other parties. None of our actual or potential rulers show any serious signs of facing up to the realities of our fiscal and wider economic circumstances and levelling with voters about the tough decisions which must be taken to cut spending and promote growth.

Chris Giles in 2022, Ben Ansell and Torsten Bell in 2023, Sam Freedman in 2024, Daniel Herring and Paul Johnson in 2025 and Helen Miller in 2026 have all contributed eloquently to this theme. Some, notably Raphael Behr, in his 5th of June 2024 article for Prospect, “Britain the puerile polity”, Sara Hobolt in her 13th of May 2026 London School of Economics paper and Martin Wolf, in his 24th of May 2026 article in the Financial Times “The infantilism of an ungovernable Britain” directly linking it to the deficiencies of our FPTP electoral system.

27. THE RISK OF FIRST PAST THE POST FOR THE NEXT GENERAL ELECTION

In this crisis, some responsible politicians are beginning to match the rhetoric of those commentators and reject the “Magical Thinking” as unworthy and unsustainable. But the Gilt market wants more than words. Nor will it wait. It needs an answer soon to what it now sees: which is no arrest of the political dysfunction dynamized by the GFC and Brexit, but instead its continuing acceleration.

In plain sight of investors is the rising risk of a British Government, after the next GE, led by either Nigel Farage, or even conceivably Zack Polanski, quite possibly with a mandate based upon less than 28% of the vote. Or a coalition led by Nigel Farage in which Reform have corralled a cowed and shrunken Conservative Party eviscerated of its more moderate elements. Perhaps needing support from the Ulster Unionists. Or a coalition led by Zack Polanski, in which the Greens have corralled a cowed and shrunken Labour party in a similar fashion. Perhaps needing support of radical independents. Or a fragile and unstable Labour-led coalition with the Greens and Liberal Democrats, reliant upon the support of Scottish and Welsh nationalists, whose professed priority is the destruction of the UK as well conceivably also some of those independents.

All of these outcomes are entirely plausible, and the first, and particularly the third, are actually in present polling, probable, under FPTP. None will offer a government capable of creating the national consensus that is essential to reassure the markets we will eschew fantasy politics and economics and tackle our deficits and other deficiencies in a timely and serious manner and stick to the measures we follow which inevitably must be sustained over the medium to long term.

28. THE POLITICAL RISK PREMIUM IN GILT YIELDS AND PROPORTIONAL REPRESENTATION FOR THE NEXT GENERAL ELECTION

Here is where this paper comes full circle. It surely is no coincidence that the decline in the vote share of the formerly two main parties, the Conservatives and Labour, which has been undermining the democratic legitimacy of FPTP, started to take off in 2008, following the GFC.

It led to the Conservative-Liberal Democrat coalition in 2010. The Conservative victory of 2015 owed much to the disproportionate cost in seats resulting in the 15% fall in support the Liberal Democrats suffered from Nick Clegg's conduct in the coalition, and to the threat from the United Kingdom Independence Party (UKIP, the precursor to Reform) and the resulting promise of a referendum on our membership of the EU. That referendum, and even more its result, itself significantly influenced by FPTP, since for many voters in safe seats it represented the first chance to cast a meaningful vote, shattered long-entrenched party loyalties. The post 2016 politics of Brexit further fermented the process by dividing and utterly discrediting the Conservatives, perhaps beyond recovery. The same may now, after the exceptionally distorted result in the 2024 GE, be happening to Labour. Few falls from a signal electoral victory in our political history have been as swift and striking as that of Keir Starmer. In other words, the decline in the democratic legitimacy of First Past the Post has tracked very exactly the deterioration of our economy since 2008 and its acceleration since Brexit.

So the political risk premium now in Gilt yields, at the very least to a most substantial degree, has a name: FPTP voting. Assessing this history, and looking forward to a new Prime Minister facing old problems that have, in recent years, been made much worse, and above all to the risks already set out of the uncertain and potentially deeply dangerous outcome of the next GE, the paramount importance, for immediate fiscal reasons, of changing our electoral system for that contest, is crystal clear.

The Gilt market is getting nervous. Those risks must be removed. That can only be done by the Government using its present majority to bring in PR for the next GE. The new Prime Minister must have the courage, the vision and the urgency of action to do so. Before it is too late.

PROPORTIONAL REPRESENTATION

FOR THE NEXT GENERAL ELECTION AND THE GILT MARKET

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