

# How Britain could afford to pay for war

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In 1940 the UK was in the early throes of the second world war, fearful of its capacity to fight and finance another great conflict. That year, John Maynard Keynes published *How to Pay for the War*, a financing plan for a time when UK public debt already exceeded 100 per cent of GDP.

Today, war is a possibility but not a certainty. That makes decisions on how far and fast to raise defence spending difficult — more so given competing spending priorities and a UK public debt ratio approaching 100 per cent of GDP.

Some governments have acted decisively. Germany has committed to hitting the Nato defence spending target of 3.5 per cent of GDP by 2029. The UK government's defence investment plan is, by contrast, already six months late and only intends to reach 3 per cent by the end of the next parliament.

On both national security and growth grounds, there is a strong case for bringing the commitment forward to this parliament not the next one. But doing so poses difficult questions that echo Keynes, including public acceptance given competing spending priorities and the financing plan.

A survey of more than 1,000 people conducted for the FT by Ipsos shows that increased defence spending is high on the public's priority list, ranked fourth behind health, immigration and housing. Around four in ten think it should increase, but six to seven in ten would support the move if it boosted apprenticeships and jobs, infrastructure and innovation.

On the financing, public support is spread between higher taxes (especially on the wealthy), reduced public spending (especially on welfare and pensions) and higher borrowing. On the last about a quarter say they would be willing to buy "war bonds", with demand across the age and socio-economic spectrum.

Interestingly, those views echo parts of Keynes's 1940 financing plan. He proposed a system of forced saving — compulsory savings from income, repaid with interest through a tax on wealth. With compulsion replaced by voluntary tax incentives, a similar scheme could work today.

The UK public holds more than £2tn in bank deposits, most earning a negative real return. Extending tax incentives for investment in war bonds — for example, through a temporarily higher threshold for individual savings accounts, pension relief or inheritance tax — could readily tap this pool. Given public demand and tax incentives, this would lower government financing costs, while yielding a higher return.

Extra borrowing of, say, £10bn-15bn a year would add only modestly to government debt issuance and Isa take-up. There could, nonetheless, be concerns about extra borrowing at a time of bond market precarity. To neutralise the risk, two additional measures are needed.

First, the step-up in defence spending should be targeted at revitalising jobs and growth. The IMF has argued that increased defence spending may not deliver high growth multipliers. But as British pop icons Fun Boy Three and Bananarama taught us a generation ago, and the public survey illustrates, it ain't what you do, it's the way that you do it.

A defence plan tackling UK youth inactivity at source — through a supersized apprentice programme — would yield significant growth and fiscal benefits, as the Milburn review demonstrated. A plan that offered a springboard to the UK's strong and long pipeline of defence-tech companies could yield similarly large growth benefits.

Second, the cost of extra defence spending needs to be met as much from reduced public spending as higher borrowing. The inability of the government to make meaningful cuts to public spending is its fiscal Achilles heel. This vulnerability can only be treated by taking politically costly action to curb public spending materially.

Of the options, replacing the “triple lock” with a single lock to inflation-index state pensions (as with all other benefits) is both fiscally prudent and socially equitable. It would yield a high and rising fiscal dividend, of perhaps £5bn. Recycling this into supporting youth employment would boost inter- generational equity.

Key elements of Keynes's 1940 plan were adopted by the Attlee government after the war. Public debt relative to GDP roughly halved in each of the sub- sequent three decades, alongside healthy growth and high employment. Fortune favoured the bold then and is likely to do so again today.