

# What Philip Hammond should be doing today

Published: January 12, 2026, 8:46 pm

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Philip Hammond is to make an economic statement today. It is expected that he will say that the UK is in better economic health than was expected in the budget last November. That is largely indicated by higher tax receipts, which imply growth. And, of course, it is now 'celebrated' that the government is covering its current spending with tax receipts, leaving only investment to be paid for with borrowing. I feel it is time for a quick Q&A.

## Should we be celebrating our new found prosperity?

I fear not. Remember we've lost out in a decade of growth as a result of austerity. Many people are still worse off than they were in 2008. Much of the GDP growth we have seen is the result of population increases, much of which is from migration that may be a good thing, but which gives a false impression of the actual change in well being each person is enjoying, and the deficit was always going to fall anyway: the collapse in tax revenues in 2009 was always an aberration that would have largely reversed, come what may. We have as a nation suffered enormously to get to a position on the deficit that investment in 2010 onwards could have delivered so much better, with almost no downside for the UK as a whole.

## But what about the debt?

Let me quote [Tory MP John Redwood](#):

*I have not been worried about the state deficit for sometime, ever since Mr Brown found out that the UK state can literally print money to pay its bills. Mr Osborne, originally a critic of this in opposition, then discovered its charms in office as well. It turned out to have no adverse consequences on shop price inflation, though of course it caused massive price inflation in government bonds, because it was accompanied by severe pressure against bank lending to the private sector to avoid an inflationary blow off. I always adjust the outstanding debt by the £435 bn the state has bought up, as this is in no sense a debt we owe. So our government borrowing level (excluding future state pensions which some here worry about and which have always been pay as you go out*

*of taxation) is modest by world standards at around 65% of GDP, and at current interest rates is affordable.*

*Most of the state debt we owe to each other anyway. The government owes it to taxpayers who own the debt in their pension funds and insurance policies. The state can always raise enough money to pay the domestic bills backed by the huge powers to tax, and as we have just seen when credit expansion and inflation are low it can also use liquidity created by the monetary authorities.*

There is, then, no debt issue to worry about. The debt we have is the UK's money supply. All it represents is uncollected tax. In the meantime it's the essential lubricant to make economy work and the safe place of saving for your bank and pension fund that provides the essential security you want from our financial services system. If you want to remove government debt this security disappears and your savings will be at vastly greater risk. Is that what you want? Oh, and you will also have to pay for that reduction. It is achieved by collecting more in tax than is spent, which is enforced saving by any other name. And saving of that sort shrinks the economy by reducing government expenditure as a proportion of GDP, meaning those queues in A&E would get much longer.

### So are these the conditions in which Hammond should spend more now?

Yes, of course he should. But that's not because he has money in his piggy bank from those extra tax receipts. That is not the way in which government spending is funded. As a matter of fact all government spending is funded by the Bank of England making the money available to the government in its bank account. This is the same, identical, process as that used by a High Street Bank when advancing an overdraft to a customer who has yet to be paid the income out of which the bank confidently expects it will be repaid (or it would not advance the loan). We know this is true in the case of the government. Since 1694 it has been running an overdraft - the national debt - and what that proves is that it has, at last since then, always spent in advance of getting in the tax revenues that appear to cover the cost of the spending. There's just one massive difference in this case. Unlike a household the government can simply print new money if it wants to cover its debts. We know that is true now: quantitative easing proved it. £435 billion government debt has been cancelled in this way, and again Tory MP John Redwood has provided the evidence that even Tory MPs know this to be the case. In that case tax is not absolutely necessary to pay for government spending, because it can happen anyway. What tax actually does is reduce the risk of inflation as a result of that government spending. That's something quite different, and a truth that Philip Hammond should be facing, but isn't. But whether he admits it or not, this current situation provides no better or worse reason for more spending now than existed in the last few years: the budget balance simply does not matter: in itself it's a completely pointless book-keeping goal revealing a small minded approach to the management of the government's role in the economy that fails to take into account all the enormous

consequences of what it can do for the common good and instead sacrifices them for the sake of a dogmatic goal that has no real economic consequence at all.

### But if tax is all about controlling inflation, and that's rising shouldn't Hammond be wary about more spending now?

A good question. It has to be understood that there are at least two types of inflation that we need to worry about.

One is demand pull inflation. This happens when the economy is overheating and there is excess demand as a result creating a shortage of supply of critical factors of production, but for the most important of which is labour. This means wages rise as employers bid to get the people they need, and so prices rise as people spend the extra money in their pockets for which, however, there is not an increase in production to match. This is the type of inflation that extra taxes can address: by simply removing money from people's pockets by increasing the amount of tax that they have to pay then tax can reduce the excess demand in the economy. This works.

The second type of inflation is cost-push inflation. This arises when a factor beyond the control of the domestic economy increases prices in it. An example would be the change in the exchange rate that came as a result of Brexit. This approximate 10% adjustment in the value of the pound did, inevitably, impact domestic prices because we have to pay for those things that we import, which were now more expensive. No amount of adjustment to UK taxation could alter the fact that these additional payments were due. The result is that it would be pointless to adjust UK tax to address this issue: the only way to do so would be to either reverse the Brexit decision or to improve the attractiveness of UK exports to more than offset the additional cost of imports. Tax cannot change outcomes here. Interest rates can, but only at considerable cost to many households who are deeply in debt.

The fact is that we have cost-push inflation in the UK. We do not have demand pull inflation. Therefore this is not the moment to deflate the economy to address the issue: that can actually only make things worse by reducing our cost effectiveness in producing goods for export, so threatening the balance of trade even more.

At the same time remember that there are many people who think that 3% inflation is quite acceptable: to percent limit is, like the goal of balancing the government's books, and entirely arbitrary target without particular proven merit and there might be good reason for thinking that a higher rate of inflation could be of benefit, not least in reducing the value of outstanding debt by private individuals, which is a major threat to economic well-being.

### So why should Hammond spend more now?

The answer to this question is really very simple. Philip Hammond should spend more

now because there is need to be met, and that is the whole purpose of government spending. when there are unused resources in an economy and there is unmet need, whether that be for healthcare, education, infrastructure, social care, improve pay for those who have suffered the impact of austerity, all there is a need for greater transfer payments to address issues arising from inequality, then it is the governments job to make sure that resources are put to use and that transfer payments take place. It is simply negligent for it to do otherwise. and the fact is that right now we know that all these things are required, and we also know that in the sixth-largest economy in the world it is ridiculous to pretend that we cannot afford decent health care, education, support for those at risk, a proper judicial system, adequate policing, appropriate defence, and so much more. In that case of course Hammond should spend.

### But won't this create inflation?

It is very unlikely that this additional expenditure will create any significant new inflation, although there may be a short-term impact will have little consequence. What it will create is new growth. What new growth creates is new tax paid, because that is the inevitable consequence of people having higher incomes. It will not, therefore, necessarily create any greater imbalance in the government's expenditure, overall. It will increase investment, and that is good from long-term prospects, and for the exchange rate, and so for the control of cost push inflation. And it will put the millions of people who are currently in part-time employment or in self-employment's very marginal worth and which pay very little in the jobs they really want, and which will add value for the UK economy as a whole, meaning that overall we would be vastly better off. I am not saying the tap needs to be turned on forever: the investment that must be made to achieve this goal should, for example, be of the type which can be turned on and off. Investment in social housing rather than in massive infrastructure projects is a good example of the type of investment where this is possible. But for now the expenditure is very definitely desirable.

### And what else should Philip Hammond be doing?

There is so much wrong with the UK economy that it is hard to know where to begin but I would start with:

- \* A review of corporation tax to ensure that overall yields increase. An Alternative Minimum Corporation Tax should be on his agenda, as should full public country-by-country reporting to reveal who is, and is not, paying appropriate tax.
- \* A review of the role of wealth tax in the UK to tackle inequality.
- \* Creating a Money Commission to make clear how the UK will manage its central bank, national debt and the relationship with money after Brexit.
- \* The creation of a proper National Investment Bank, able to issue bonds in its own right, to provide people with the identifiable secure savings structure that they desire

that will let them see that their money is being used to find the long term future for this country that they want.

- \* Tax reform to remove the vast majority of incentives for saving within that tax system which only subsidizes the wealthy and increase inequality at present.

- \* A plan to cancel student debt.

I bet he will not do any of this.