

Is world leading NHS care an affordable proposition?

Published: January 13, 2026, 6:10 am

In October 2017 the [Progressive Pulse blog](#), which I publish but rarely appear on, posted the following blog which appeared under the above title. I think it worth repeating now. What the authors showed was that we could have had world class care by now. We haven't. And that is this government's fault:

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Introduction:

The unquestioned assertion that a highly developed currency-issuing nation cannot afford high-quality healthcare [1] is based upon a set of inter-related and almost universally-held false assumptions:

- * Money is in limited supply (as there is no 'magic money tree').***
- * Taxes fund government spending.***
- * Private banks lend out pre-existing savings.***
- * NHS spending is a burden on the economy rather than a boost to the economy.***

1) Money is created 'out of nothing' on bank computers

In 1973 the Bretton-Woods international exchange rate system, where currencies were ultimately pegged to the price of gold, was formally ended. Since that time we have used an international [fiat monetary system](#) where the value of each currency is determined by the workings of international financial markets. Fiat (Latin: 'let it be made') money is created from nothing

on the basis of a promise — a promise to deliver goods or services in the future. Only if we believe in these promises and the systems that support them, does money have value.

The following description of the monetary system and its components is highly schematic to aid elucidation of the underlying principles. Money is created either when the government spends or when a bank makes a loan.[2] We can think of government spending and bank loans as the beginning of two interconnected money circuits. The government and bank circuits form the duopoly of money creation, rather like the pulmonary and systemic circulations of the cardiovascular system only in this case the circuits work in parallel. Both circuits are supported by the central bank which creates a unique type of money held within the bank known as electronic reserves (Figure 1). To extend the analogy of the cardiovascular system, the central bank is akin to the heart, individual bank accounts would be equivalent to the capillaries and the wider economy would be the working cells of the body.

The two monetary circuits commingle through banking transactions so bank money and government money become indistinguishable to bank account users. After money is created it flows through the economy and eventually returns to the issuer.

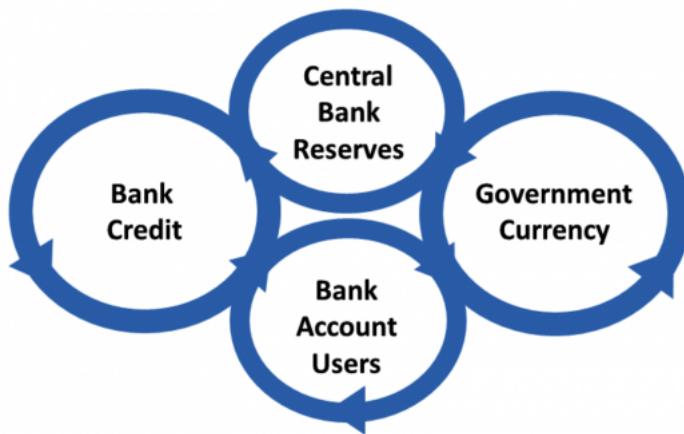


Figure 1: Schematic diagram of the monetary system of a sovereign nation. Bank account users cannot distinguish the origin of their deposits.

2) The government money circuit — taxation removes money from the system

In the government circuit, money is spent into the economy and is effectively cancelled when it returns to the government via the payment of taxes. The collection of taxes is not a prerequisite for government spending as many people assume, but exists at the end of the government money cycle when taxes removed prevent too much money being created. Taxation mainly helps to control inflation and alter peoples' behaviour in a way that should be

beneficial to all. The net result of deficit spending is to leave savings in the form of Government bonds. or (Figure 2).

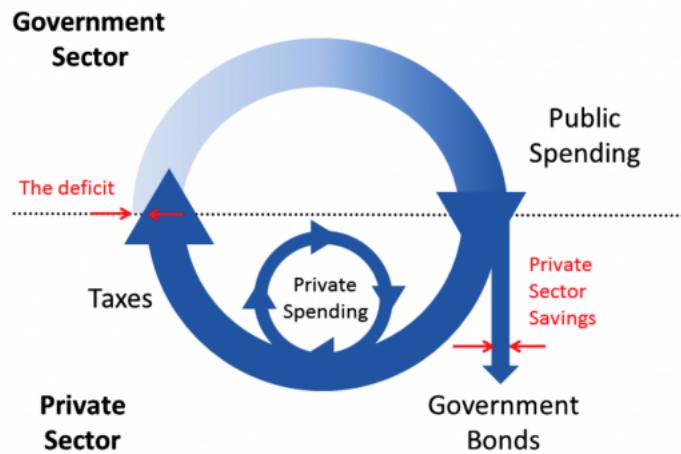


Figure 2: The government spend and tax circuit with a deficit. The difference between spend and tax equals private sector saving and is known as the deficit.

Conversely a government surplus (where taxation exceeds spending) would destroy these savings. The superficially sensible idea of running a balanced government budget simply prevents saving in the private sector. This is illustrated in models a) and b) within Figure 3. In a) the government injects money via a fiscal stimulus in year zero. Taxation means that over time all this money is returned. In b) the public choose to save a fraction of their income which leads to the deficit. Savings simply delay the return of money in the circuit. In other words, the private sector is only able to save money because the government supports this activity by running a deficit. The government circuit is leaky by design. For example, people are encouraged through tax breaks to save for their future (e.g. pensions & ISAs). Therefore, the national debt is not what we currently owe.

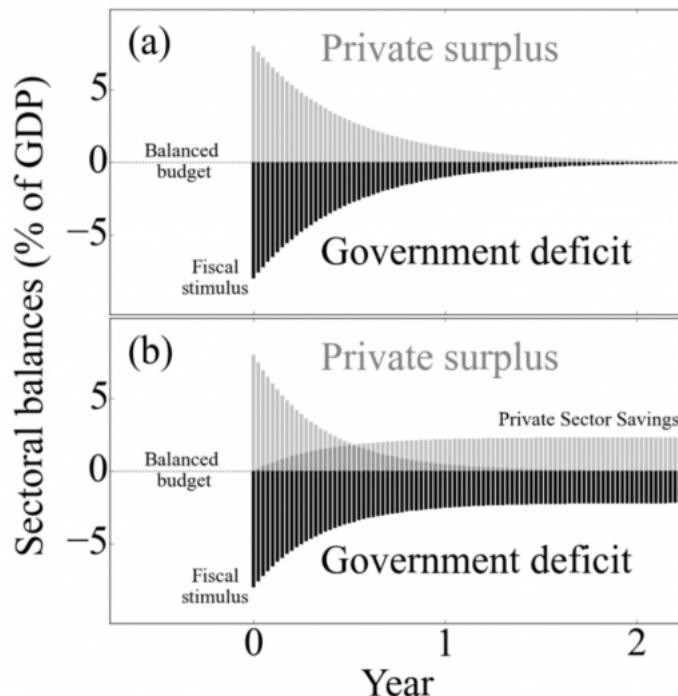


Figure 3: (a) model which shows that after government spend (fiscal stimulus) if people do not save then all the money comes back as tax, whereas if people save this leads to the deficit (b).

3) The private bank money circuit — banks create credit and don't lend out savings

Most of our money is created in the form of bank loans (credit). When a loan agreement is signed the bank creates a new bank deposit to the value of the loan in the borrower's bank account. Money is returned to the bank by the repayment of the loan plus interest (Figure 4). Similar to government spending, bank lending influences private sector behaviour but the allocation of money creation is not democratically controlled. The primary purpose of bank lending is to enable individuals and businesses to function and to generate profits for the bank and long-term.

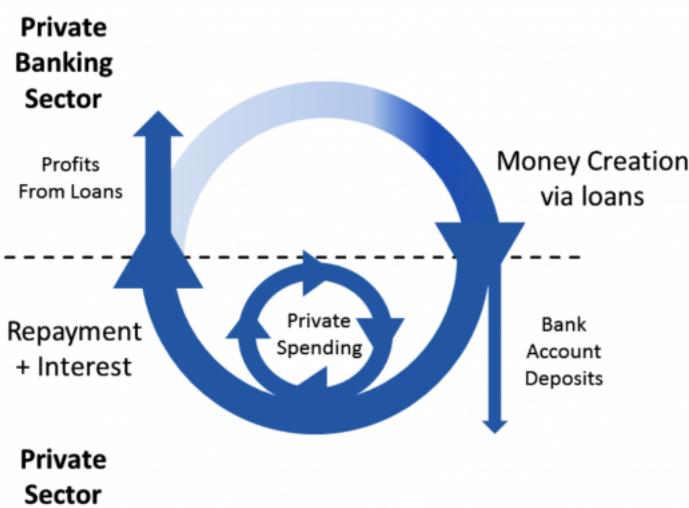


Figure 4: The bank circuit where loans concurrently create bank customer deposits and private debt leading to bank profits.

Banks must have a licence issued by the government to create money in this manner and aspects of their activities are regulated. However there are no formal economic, social or environmental responsibilities associated with the creation and allocation of bank credit despite the significant influence these decisions have over our lives. Bank credit creation is predominantly distributed towards land (property) and financial asset speculation which dwarfs their support for entrepreneurship. The majority of UK small businesses are actually self-financing.[3]

As the proportion of unproductive private debt increases in an economy a correspondingly increasing proportion of economic output is directed towards servicing this interest-bearing debt. Consequently the private bank money circuit tends to be inherently destabilizing as it drives assets towards the already wealthy making the economy increasingly fragile.

What are the outcomes when the two circuits combine?

If all the money was returned to the issuers the quantity of money would go back to zero (the balanced budget illustrated in Figure 3a). In practice the rate of new money creation is usually higher than the rate of money cancellation and the total amount of money in the economy grows over time to support economic growth (Figure 5). Ideally growth in the money supply should match the growth in economic activity, such that prices remain roughly stable and we maintain confidence in the value of our currency unit. Control of the rate of money creation and destruction in the government and banking circuits are known **fiscal** and **monetary** policy, respectively

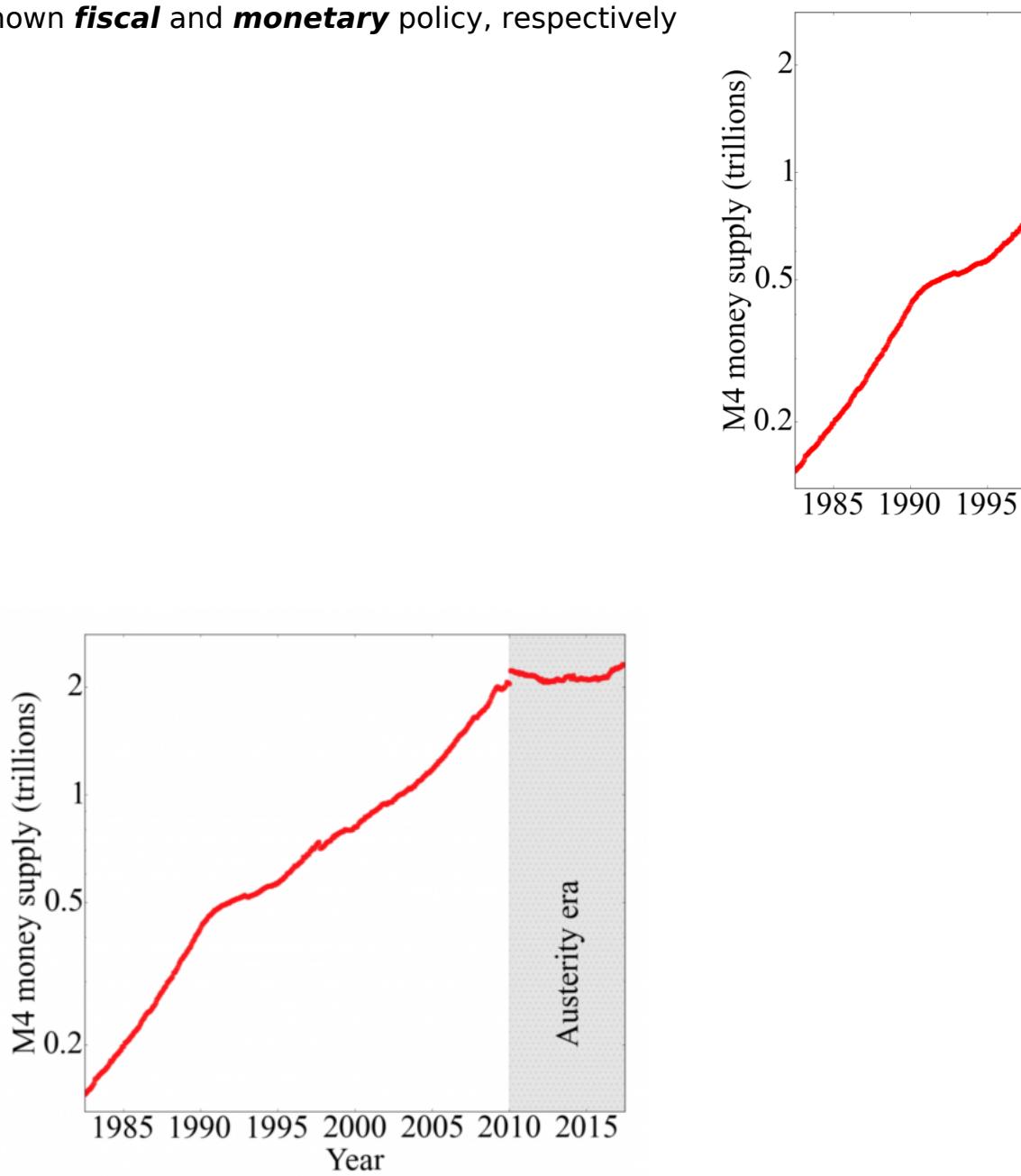


Figure 5: UK Money (M4) Supply 1987 – 2017. Source: Bank of England.

The money supply increased significantly in the decades prior to the Global Financial Crisis (circa. 2007) primarily through bank credit expansion. In contrast, between 2009 and 2014 net credit was negative.[3] As bank credit creation wavered from 2008

onwards, government deficits rose to prevent a deflationary depression. The actual sector balance data for the UK is shown in Figure 6 and there is similarity with the simple model we presented in Figure 3. Note that the rest of the world is a net saver of UK money (these savings have to be spent in the UK ultimately). Note also that when these three sectors combine, the balance is near zero as this is nothing more than an accounting identity.

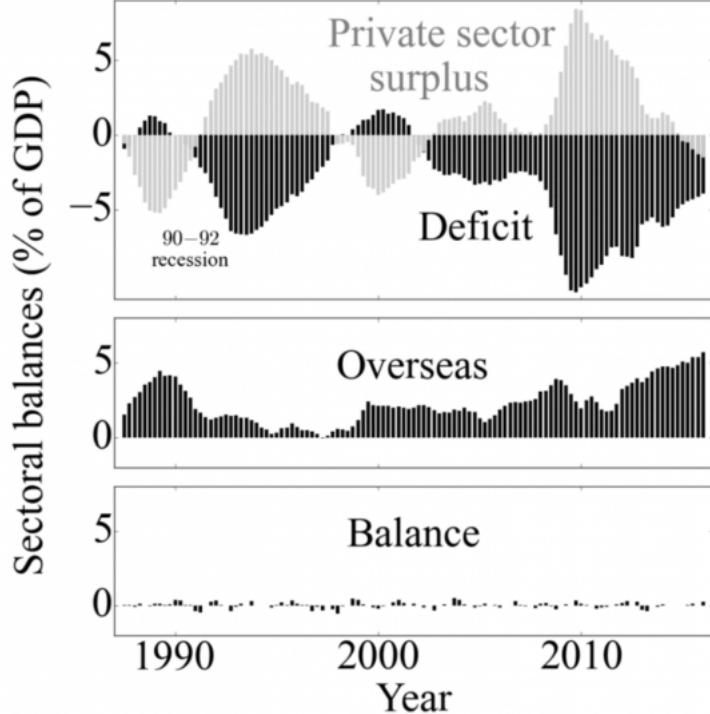


Figure 6: UK sectoral balances data from the ONS. The inverse correlation between Private and Public sectoral balances. Private sector savings mirror the public sector deficit as illustrated by the model in Figure 3.

Why two circuits?

Why do we need this duopoly of both a government circuit and a banking circuit? Why do we need both fiscal and monetary policy? As money is a collective good, should we transfer all money creation powers to government and demote private banks to the role of intermediaries as some propose? Or could we hand over all money creation to private banks as free-market fundamentalists would prefer?

Put simply, the commercial bank circuit serves private needs while the government circuit serves collective needs. The bank circuit exists to serve individuals and 'capitalism', while the government circuit exists to deliver on democratically controlled promises.

Economists often call our collective interests **public goods**. The failure of the private interest bank circuit to provide public goods is easy to understand by exploring healthcare. The market solution is to cater for the patient offering to pay the most. Even worse, the market may deliberately create a scarcity in order to charge a higher price. A market cannot operate effectively in matters of life and death. Kenneth Arrow a highly-respected pioneer of neoclassical economics and winner of the Nobel Prize in Economics in 1972 wrote 'the laissez-faire solution for medicine is intolerable'.[4] In

situations where competition is not viable, where demand is unlimited like health, and supply delivers societal benefits, then collective democratic control is the optimal solution. The House of Lords Select Committee on the Long-term Sustainability of the NHS report in April 2017 reaffirmed that the principal method of funding the NHS should be via government spending.[5]

What has gone wrong?

The art of economic management is to balance fiscal and monetary policy. An over dependence of one or other is doomed in the long term. The core failure over recent history lies in the inability of politicians and central bankers to regulate the banks and to use fiscal policy appropriately. There now exists UK Department of Health data to support the assertion that government austerity may be the primary underlying cause for the deterioration of health inequality measures in England.[6]

‘In her present condition, Great Britain resembles one those unwholesome bodies in which some of the vital parts are overgrown...and through which an unnatural proportion of the industry and commerce of the country has been forced to circulate, (which) is very likely to bring on the most dangerous disorder upon the whole body politick’. When one considers the unhealthy dominance of the financial sector within the UK and global economy today, it may be surprising to discover that Adam Smith wrote these prescient words in the Wealth of Nations over two hundred and forty years ago.[7]

In a similar vein, using central bank monetary policy alone to rescue the global economy has been misguided. In 1969, the world-famous economist, Milton Friedman said ‘The available evidence . . . casts grave doubts on the possibility of producing any fine adjustments in economic activity by fine adjustments in monetary policy’.[8] More recently, Mark Carney, the Governor of the Bank of England, reinforced this point in his ‘The Spectre of Monetarism’ speech published in December 2016 where he stresses that monetary policy needs to be in ‘better balance with fiscal and structural policies’.[9] The sudden change to no money growth after 2010 in Figure 5 is evidence of the complete failings of recent monetary and fiscal policy.

4) NHS spending boosts the wider economy in excess of the money spent

Fiscal policy is very powerful but needs to be carefully managed. The NHS was conceived and built in times of high national debt. This could occur because creation of money is not an inherent constraint. Thanks to the government spend and tax circuit, the NHS nurse, doctor, physiotherapist or pharmacist need not cost anything as long as (they serve a useful purpose and) the money spent on them is also spent. In fact, it is more likely that society will profit through ‘crowding in’ more economic activity through NHS employees’ subsequent spending and a healthier public.

It is estimated that the fiscal multiplier for UK healthcare spending currently lies

between 2.5 and 6.1. This means for every £1 spent on the NHS approximately £4 of economic activity results.[10] If you had a cash-back card that gave you £4 back for every £1 spent, you would not cut back on your spending! Only when we reach a position of over supply when NHS staff wait forlornly for patients to present do we reach a point where the multiplier falls to below one. We are, at present, an unsafe distance from a workforce oversupply scenario.

As a sovereign nation, the UK can always afford high quality universal NHS healthcare. Money is essentially an accounting system designed to facilitate our collective activities and development. Fiscal policy needs to be activated to meet the needs of our society as there is now observable failure of the prevailing reliance on monetary policy and preservation of rent-seeking private interests. It is evidently wrong to assert that healthcare access and quality is limited by the availability of money. The constraint, in truth, has never been the potential availability of money, but the desire to resource the NHS appropriately. In the words of John Maynard Keynes, 'Anything we can actually do we can afford'. [11]

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