Funding the Future

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I just posted this thread on Twitter:

The government gave some staff in the NHS a pay rise yesterday, and then said that the cost must come out of existing NHS budgets. It refused a pay rise to the police. It's as if they're saying there is a shortage of money. There isn't. A thread's needed to explain that.....

Once upon a time, before most people in the UK were alive, the value of money was linked to gold, either directly or indirectly via the fixed exchange rate we had with the US dollar. But that ended in 1971. In that year the dollar ceased to be linked to gold.

Since 1971 the result has been that all the money we have in the UK is what is called fiat money. That has nothing to do with an Italian car company. What it actually means is that all our money is just a promise to pay.

You should be pretty familiar with this idea. This fact is printed on all our bank notes. They are just what are called 'promises to pay'. And it so happens that mostly of us think that the government's promise to pay is a really good one.

There's good reason for thinking the government's promise to pay is good. First, it's responsible for making all our money. No one else is allowed to without a banking licence - and they're heavily regulated. The rest of our money it makes itself.

And there is no magic about the way the government creates the money it - and we - need. Parliament decides it wants to spend on something. It passes a law to authorise the spend, and the government then tells the Bank of England to pay the resulting bills.

The Bank of England has to pay whatever the government tells it to. Partly that's because it is owned by the government. Partly that's because the law says it must. It is not required to check whether the government has any money in its account first: it must just pay.

There is nothing very odd about this. After all, a bank can make a payment for anyone without there being money in their bank account. It just means that the bank is giving a person an overdraft. The government can have an overdraft at the Bank of England.

There are three differences between an overdraft you can have and the one the government has at the Bank of England. First, the Bank of England can’t turn the government down. Second, the overdraft has no limit. Third, there is no repayment required.

That is a pretty amazing facility that the government has. What it means - and a law of 1866, most recently updated in 2000 backs this up -is that the government can never run out of money. In an instant, whenever it desires it, the government can always have the money it wants.

The point I am making is that the government does not need tax to spend. Nor does it have to borrow to spend. Instead, all it has to do is tell the Bank of England to make a payment on its behalf and it will always do so, on overdraft.

This is not money printing of course: these payments are made electronically, so no printing press is involved. Instead, all that is required to create money is a computer keyboard in the Bank of England that is used to enter the data that increases the government’s overdraft.

Understanding this is vital to appreciating what is going on in modern politics. It is also key to understanding the biggest lie (I use the word appropriately) told by politicians of almost all parties which is ‘there is no money to do what people want’.

In the case of government it’s never true there’s no money to do what people want. The opposite is always true. There is always money to do what people want. The reality is that politicians have to decide which things they want, and the fact is that they do not want to admit that.

I stress, this is true right now with regard to the pay rises for the NHS and the police. The government will be claiming that they cannot afford to provide new money for the NHS and cannot afford pay rises for the police. But those claims are straightforward lies.

The government could provide the money for the NHS and the police. They just have to tell the Bank of England to make payment and the money would be created for the purpose. It really is that simple. So, why do the government not want to do this? There are a number of reasons.

First, and most important, we have a government that does not want to pay these pay rises. They know they could pay them. After all, they’ve created well over £300 billion of new money in the last year to pay for Covid, so they know how to pay. But they don’t want to.

We need politicians to tell the truth, to make honest decisions, and explain them to us. What we actually have are politicians who deny that there's money when there is, who say this prevents them making decisions when it does not, and who blame us for their own inability.

Lesson one from understanding money is that politicians don't want you to understand money because if you did then we could all hold them to account, and that's the last thing that they want.

Lesson two is to understand where tax fits into all this, which it does. It is true that making money without limit will result in inflation. Tax is the mechanism used to prevent inflation. It takes the money the government creates back out of the economy.

This is what the main purpose for tax is now. Tax does not exist to fund government spending. Money creation does that. Tax reclaims the money the government has spent into the economy. So when the government says it spends taxpayers money, that's simply not true. It doesn't.

To reiterate: the government spends its own money. It does not spend money that taxpayers have given to it.

The claim that the government had to tax to spend was true before 1971. When the value of the pound was linked to gold there was a real constraint on the amount of money a government could spend. If it could not get money from taxpayers or borrow it then it could not spend.

But this is now deepest, darkest history. There has been no such constraint for 50 years now. The government can and does create all the money it wants whenever it needs it and the role of tax is to limit inflation and to deliver social policy e.g. on income redistribution.

The process of government funding is that spend now always proceeds taxation. In a country like the UK, where the government creates its own currency, tax now never comes before spending. That is lesson three from this.

Lesson four is about borrowing. If the government creates all the money that we have (and ultimately, it does) then why does it need to borrow? The answer is that it does not. Actually, and as a matter of fact, the government does not borrow.

What the government does instead do is to offer people the chance to save with it. Government borrowing is another of these things that is now completely misnamed. What this supposed borrowing actually is might best be described as a giant savings bank.

When the government creates money and spends it into the economy not all of it is spent by those who receive it. Some of it is saved. And some of those savers want to save with the safest institution that they can find to hold their funds, which is the government itself.

The government is always the safest place to deposit money. After all, it can always repay. It can always create the money required to make that repayment so that it can never fail, unlike every other savings institution in a country.

So, people save with the government. It rations the number who can do so. If it didn't not no one might save with private banks. And it rations the value of savings it will accept by claiming that it still borrows to fund its spending. That's just another lie it tells.

Until 1971 it could have been argued that the government did borrow to fund spending because the amount of money it was allowed to create was limited. But now that is simply untrue. It can create all the money it needs. It need never borrow. It just offers savings accounts now.

Why do they lie about borrowing? Let's go back to the first lesson: because they want you to think that there is a limit on what they can do, and that as a result you cannot have what you want. The lie is there to make it seem as if that is true.

Lesson 5 is about the mysteriously named quantitative easing, or QE. QE is bizarre. Using QE, the government creates money on overdraft with the Bank of England (as it can) and then uses that money to buy back the savings bonds it has issued from the public.

To put it another way, given that these bonds are simply savings account balances, what the government does is force savers to take their money elsewhere. The savers in question then put it into housing or shares - and we get a boom in the price of both.

The government claims QE encourages risk taking in the economy. It hasn't. All it has done is avoid the pretence that the government needs borrowing to fund its activities during large scale financial crises, as we had in 2008/09 and 2020.

It so happens that QE also, rather conveniently for a government of the type that we now have, also creates asset price inflation that's made the rich richer.

But don't be fooled by claims that the government must reverse QE, or any other such nonsense, and must put money aside to do this. First, QE does not need reversing. Second, it never has been. But the third argument is the key one.

That third reason is that given that reversing QE would reduce the wealth of the wealthy and this government is dedicated to servicing the best interests of the wealthy and the City of London the simple fact is that QE is not going to be reversed.

Actually, the strongest likelihood is that we will get more QE the moment there is any threat of declining share or house prices: the government will keep the wealthy happy even if it claims it cannot fund a pay rise for the NHS and the police.

This last point is important: the government has used the power it has to create money - which is what really happens when QE is used - mainly to benefit the wealthy and not to help the majority in this country. They need to be called out for that.

So, in summary, money creation funds government spending. Tax controls inflation. No government needs to borrow; it does so only to provide a safe place for savings. And QE keeps the pretence that the government must borrow intact whilst boosting the wealth of the wealthiest.

Coming back to the NHS and police pay rises, what does this mean? That still needs a bit more explanation.

First, and vitally, there is no shortage of money to pay for these. Anyone who claims otherwise is lying and it’s quite fair to say so: the government can always create all the money it needs to make any payment it chooses.

Second, there need not be any tax increases to pay for these pay rises unless there is a risk of inflation as a result of them. Best opinion is that there’s no UK inflation risk now once short term supply chain issues are resolved - and they are not created by NHS pay rises.

Third, remember that these pay rises will in any case create additional tax payments, not just when paid but when the money received by nurses and the police is spent. So, critically, these pay rises have anti-inflation precautions built into them. No one says that, but it’s true.

Fourth, there will be no need for borrowing to fund these pay rises, because borrowing does not fund the UK government. There will be no money market revolt and no pressure on interest rates either as a result. Any claim to the contrary is wrong.

Fifth, what’s the reason why these pay rises can’t be paid then? There is none at all. I mean, literally none. If the government really thought nurses and the police were of value then they would pay these awards without hesitation. The fact is that they don’t want to pay.

Sixth, this is what needs to be understood. Once you know how the government funding cycle works and realise that the nonsense about balanced budgets is just a false claim by those who hate government and those who work for it because they despise the public interest, you’re free.

Free that is to call the government out. And free to tell them they are not telling the truth. And free to say that they’re making false claims about affordability, inflation, borrowing and interest rates.

Free too to say that they’re doing this simply to shrink the size of the state whilst using its power to create money not for the public good but instead, via the type of QE it’s decided to use, to promote the wealth of the wealthiest whilst leaving the rest behind.

And free as a result to imagine what we could do when the answer to the question ‘how are we going to pay for it?’ is ‘by using the power the government has to create money when there are useful things for it to do and the resources available to do them.’

You’re free to say “And don’t talk about inflation. That risk only exists if we overspend - and a pay rise for the NHS isn’t that. That also only happens if we have a non-functioning tax system to claim the spend back - and we have one. So, inflation is not a risk from this.”

Really, what you’re free to say is “Why do you hate the public services on which we depend so much that you are desperate to punish those who work in them?” That’s the questions that understanding economics permits. And it needs an answer.