

# Funding the Future

Article URL

Published: January 12, 2026, 5:52 pm

---

I often wonder when it might be that the idea that we tax and then spend will be replaced with a proper understanding of the government spending cycle.

As a matter of fact the thing that identifies the modern state is not its ability to tax. It is, instead its ability to create money. Impressive as the ability to tax is, the fact that a state can declare a currency to be the legal tender of a country and in most of those where the rule of law is reasonable that currency is then used for the vast majority of transactions within that place is the surest indication of state power that there is.

Many economists and most central bankers would have it that this power to create money is, however, devolved to commercial banks. I suggest to them that this is wrong. Those banks can create loans and overdrafts, for sure. And the money that these facilities create is used as currency, for sure. But they can only do this on two conditions. One is that they subject themselves to quite detailed regulation of their power to create money. The other is that they will clear all the payments that they make through the central bank reserve accounts that they must maintain with the central bank (in our case, the Bank of England) of the jurisdiction that creates the currency these commercial banks primarily deal in. In other words, these commercial banks are simply agents of the central bank when it comes to money creation.

What is more, the money created by commercial banks is particularly volatile. It behaves pro-cyclically (there is more of it in good times than bad). And it is always subject to relatively short-term notice when it comes to life expectancy, by which I mean all of it is subject to notice when it comes to its own destruction, which happens whenever the loan that created it is repaid. As a mechanism for funding the state it is far too volatile in that case.

So, we are ultimately dependent on state-created money to underpin the functioning of our economy, all of which is made by the government running a deficit. That deficit is simply a record of the fact that the government has spent more into the economy than it has taxed back out. The rest is left as a promise to pay (which is even printed on bank notes) that might one day be cancelled by way of a tax demand, in settlement of which the government promises to accept the currency it created.

So what comes first? Very obviously the spend. If tax destroys money (as it does) that cannot happen before the money was created. And since the money was created by government spending that spend has to come first. We live in a spend and tax economy.

Now note that despite this obvious fact the country's economic and political commentators have got very excited this week that tax revenues have proved to be higher than expected so far this year. They are saying that this creates a pool of money that Rishi Sunak might spend. It's as if they still believe that tax funds spending, when glaringly obviously it does not and cannot. And, of course, they do believe that: their ignorance of how government creates and destroys money is complete, as is their ignorance of the fact that money creation pays for all government spending.

So, for the record, let me make it clear that Sunak has no unexpected bonus. Instead what we have is a shortfall of cash in the economy. More money has been destroyed than was expected. That must mean there is less money in the economy than was anticipated. And, given that the economy is already under economic pressure from a cost of living crisis what that means is that the consequence of this overpayment of tax is not good news, but is instead bad news. If £30 billion of extra tax has been paid that is money not available for other use when keeping the economy solvent with readily available cash to fund spending is vital.

According to commentators, Jeremy Hunt is not going to be spending his 'windfall'. It will instead be used to reduce the national debt. That is one of Sunak's stated five goals if you recall his announcement of his five big objectives in January. So this money will not be replaced, which it could be by increasing government spending on decent pay rises for those who need them, for example.

If commentators really understood money (and they don't) they would appreciate that this is not the moment to reduce the amount of government money in the economy. In fact, it is the moment when more is needed. And if they properly understood what is happening they would see Hunt's windfall as an indicator of a problem that can only get worse if these funds are not reinjected into an economy that needs them. But they don't understand this. And that is why bad economic decisions are being made.

One day I hope we will have some politicians who understand how something as simple as the government money cycle works.

It does not go tax or borrow and then spend.

It goes spend and then tax to control inflation whilst offering a government savings facility for funds then left untaxed in the economy.

It's really not hard to work out unless you do not wish to understand it, of course. And that is the real problem that we face. Wilful ignorance is the last bastion that is

supporting neoliberal economic thinking. But at least that means that one day things must change.