

Funding the Future

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I posted this video on YouTube this morning.

As I wrote in the explanatory note that accompanied it, probably the biggest challenge to understanding how the economics of governments really works comes from the need to understand that governments of the sort we have in the UK are not funded by taxes. They are funded by central bank money creation. Tax exists to control inflation (and tackle inequality, market failure and other things). Until it's appreciated that spending creates taxation and not that tax funds spending, nothing else about how the government works makes sense.

<https://youtu.be/xnYhGD7xNig?si=490WFCSpARCXmkpz>

The transcript is as follows:

Taxes do not pay for government spending. It is one of the hardest things that anyone has to get their head around when they really come to understand economics. that taxes really do not pay for government spending. I promise you it's true.

Every single penny that the government spends is created by the government. Let's be totally honest, you do know that. If you pick up a five-pound note, it says, 'I promise to pay the bearer on demand the sum of five pounds'.

They haven't paid the bearer on demand five pounds. They promise to pay the bearer on demand five pounds.

Why? Because money is debt and the government has created a debt to you.

So where does tax come into all that? Tax comes into all that because when you pay your taxes, the promise the government has made that it will accept your money in payment is fulfilled. They'll take your money back. in payment of your debt.

Let me be clear what happens then in the real financial world that we actually live in.

Whenever the government spends it simply extends its overdraft with the Bank of England. Day in, day out, that's what happens. And then it asks us to pay tax because if it allowed all that money to float around the economy, of course we would get inflation remarkably quickly.

So, it asks us to pay tax to cancel the impact of the new money that it has created. And that cancellation is by taxation, and it's there to control inflation.

The spend comes first. It's paid for by money created by the Bank of England.

The tax comes second. It's there to control inflation, to ensure that the value of the money that we have in circulation remains broadly steady over time. That's the goal.

But it's never the case that the tax pays for the spending. The spending has to come first, or the money doesn't exist with which the tax can be paid. It's really that straightforward.

It takes a lot of effort to reverse what you've always thought, that tax pays for spending, to realise that spending actually pays for tax.

But it is literally true that without government spending, there could be no tax paid. There could be nothing, in fact, because there'd be no money at all.

So we have to get our heads around that fact because then we truly understand how the government functions and then we can talk about what it can do with this extraordinary power it has to create money at will, whenever it wishes, if it wants to, to deliver the outcomes that we as a society want, balanced by the taxation that we pay to control the inflationary consequences of doing so.