Funding the Future

Why more government spending can require more tax revenue

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I posted this video, which explains why more government spending in the UK is likely to require more tax revenue to be raised, at least whilst the benefits of that spending are generated if infaltion is to be avoided, on YouTube this morning:

https://youtu.be/jcWSrKeOb_0?si=vk6vVDzrcaViChB8

The transcript is:

Do we need to raise more taxes if the government is going to spend more? It's a really important question and one that people are asking me because I've written the Taxing Wealth Report. That shows that the government could, by simply changing the rules on some of our taxes with regard to the way that they impact on the wealthiest people in our society, raise up to maybe £90 plus billion of extra tax a year.

So, people are saying to me, do you think that's what we should do? And is that a precondition of making the extra spending that we want? Let me explain what the relationship between government spending, money and tax is, because that provides the answer to the question.

The government creates our money.

If you doubt it, look at a five-pound note. Who made it? Ultimately, all the money in our economy was made by the government, just like that fiver.

I know some of it is theoretically created by banks, but they can only do it because the Bank of England gives them a license to do so, and who owns the Bank of England? The government does. So, in other words, all the money that is ultimately created is done by or under license from the UK government.

How does that money get into circulation? In the case of the government, and they start the whole process rolling, it is by spending. That five-pound note was not gifted to somebody by the government, it was spent into the economy.

They used the fiver - of course they could have used a bank account as well, but in this case we'll say the fiver - to buy something. They spent. And then they taxed. It has to be that way round, because if they hadn't spent first of all, there wouldn't be the money in existence to pay the tax.

So, it's always spend and tax and never tax and spend in an economy.

But when we look at spend and tax, the tax element is there for one very important reason, and that is to cancel the spend. If the government did not tax, and it spent £800 plus billion a year into the UK economy, and therefore let all that money float free, we would of course have massive inflation.

Now, that obviously isn't possible, so therefore, you have to tax to prevent inflation. That's its primary purpose.

All its other functions - redistribution, repricing market failure, reorganizing the economy through fiscal policy, and so on. - those things are all secondary - important - but secondary to cancelling inflation.

Now, if we are at or near full employment, and we want to spend more - the government wants to spend more - the risk is that it will create inflation by doing so. So, if, as at this point of time, we are either at full employment or we have unused resources that can only be put into use gradually, we have to tax whilst those resources are put into use or else we create inflation in the meantime.

Then we could go into a vicious downward cycle, the benefit of that spend would not be received by society, and therefore things would fall apart. So, the tax is put into place because of the additional spend, but not to fund it. It is part of the transition process to let us grow, that we must tax more.

And that is why the Taxing Wealth Report talks about raising more revenue, because these issues are fundamentally related.