

Funding the Future

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I published the next video in the Economic Truths series this morning. In it, I argue that as a matter of fact, tax does not fund government spending because government money creation does that. So why do governments tax? There are six good reasons to do that.

<https://www.youtube.com/watch?v=rFHvyiXuxAM>

The [video can be viewed here](#).

The audio version of this video is here:

https://www.podbean.com/player-v2/?i=buphn-168db9f-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=8bbb4e&font-color=&logo_link=episode_page&btn-skin=ff6d00

The transcript is:

Tax does not fund government spending. I've already explained that in this series on Economic Truths. But in that case, what is tax for?

I argue that there are six reasons why a government should tax, and all of them are important, but none of them involve the funding of government spending.

The first and most obvious reason why a government taxes is to reclaim the money that the government has spent into the economy by way of its spending.

It spends using the power given to it by Parliament to tell the Bank of England to give it an overdraft to pay out on whatever programme has been approved as part of its legislation. So, it can always legitimately spend without having tax in the bank first of

all. And that's fine. That's exactly what happens.

But, if you keep on spending in that way, everyone knows - literally everyone knows - that you will generate inflation because you cannot spend one trillion pounds a year, as the government of the UK does, and not tax that money back if you want to avoid inflation. So, tax reclaims the money that the government has spent into the economy, and it does that for one absolutely fundamental purpose, and that is to literally cancel the money in question to prevent it creating inflation at whatever we have set as an inflation target.

Now, note that if we set an inflation target of 2%, that means that the government should always run a deficit, because that will require there to be extra money in the economy to make sure that as the value of money slowly declines against the real value of goods, there is more money available to service the economy, which now requires more of that cash in circulation to keep the economy going.

So, an increase in the money supply as a consequence of running a deficit and not matching the government's income with its expenditure is perfectly okay and even necessary.

But that's only the first reason why the government taxes. The second reason why the government taxes is to force the currency that it alone declares to be legal - which in the case of the UK is sterling - into use in our economy.

Now, this sounds slightly perverse, but bear with me. If we have to pay a large part of our incomes in tax, and as a matter of fact, we do, and as a matter of fact, businesses do, then it makes no sense for us to transact inside our economy in any currency other than sterling, because we would otherwise incur a foreign currency translation risk if we were to trade in the UK in say dollars or euros or yen or whatever else. Instead, we mitigate that risk of having sold in one currency and having to pay our tax in another one by using sterling all the time. And that's exactly what the government intends that we should do.

After all, if it can force us to use its currency by requiring that we pay tax in it, and it does, then it can also get control of our economy because it can control the money supply. So, tax has this fundamental role of giving the government control of the economy. We don't really notice that on a day-to-day basis, but that's the second reason for tax.

The third reason for tax is a social policy objective. The government of the UK has for a long time wanted to redistribute income, at the very least, inside this country.

We all know that the income distribution in the UK is heavily skewed. Those at the top of the scale earn vastly more in proportion to those at the bottom of the scale. And, whilst those at the top of the scale can spend whatever they like on anything they like,

and almost certainly have large quantities left over at the end of every week, month or year, those at the bottom of the scale are struggling.

So the government does try to redistribute income, and to a much more limited extent, it does try to redistribute wealth in the UK. And the tool that it has available to it to do this is, of course, taxation.

We have a sort of progressive income tax system in the UK. The capital gains tax system isn't very good. The VAT system is regressive, in other words, those on low incomes pay more proportionately than do those on high incomes. And that's also true of things like, well, council tax, and petrol tax, and tobacco taxes, and alcohol taxes. But there is some redistribution as a consequence of taxation without a doubt.

More of that is achieved through the benefit system rather than the tax system. But the tax system helps. And, therefore, this is the third reason to tax.

The fourth reason to tax is to address another failure within the market system. We all know that the market misprices certain goods and services because markets don't have to take into account what are called externalities.

If we did not take into account the externalities created by carbon fuels, we would not address the problems created by them for our climate. We know that those externalities exist.

We also know that other things create externalities. Tobacco causes a health externality. So does alcohol. And in its own way, so does gambling.

And all of these things need to be taxed to correct for the fact that they impose a cost on society. So we use tax to impose that cost to partly recover money, and partly to discourage these activities which are harmful.

We can also use tax to encourage things that are good. For example, there is no VAT on books. People are being encouraged by the VAT system to buy books, as they are also encouraged to partake in education, and other such things. So, the tax system is a force for change to correct market failure.

The fifth reason for taxation is to deliver the government's industrial strategy. The government of any country has an industrial strategy, even if the industry they're trying to promote is the financial services sector, as it is in many countries around the world. But it could be to promote the steel industry, or agriculture, or whiskey production, or whatever it might be by creating taxes, tariffs, and other regulatory charges, that actually promote some activities and discourage others. And the tax system is perfect for this process, particularly with regard to providing investment incentives.

Tax can deliver an industrial strategy. So that is the fifth reason for tax.

The last reason for tax is perhaps the most esoteric, and yet also, again, one of the very important ones. Tax actually represents one of the fundamental powers of the state.

The state can impose its will with regard to the creation of a legal tender. The state can also force us to pay tax to make us use that legal tender. These two rights are fundamental to the power of the state. And let's be honest, it does control large parts of our lives. We willingly allow the state to do that because we think that overall, the outcomes to us are beneficial and the evidence is pretty strong that it is.

Of course, we'll grumble. There isn't a person on earth who doesn't grumble at some time about something the government has done, but we give the government that power.

But on the other hand, if we have taxes that impact on people, what we also encourage people to do is participate in democracy because if you don't like what the government is doing, and you don't like the impact it has on you, particularly via taxation, you are encouraged to go out and vote.

It's my argument that tax not only represents the power of the state, but it represents, in a strange way, our power to control the state because it is through the ability that we have to indicate our preference with regard to such things that we can deliver a change in government. Tax motivates the whole participation process in democracy, therefore, and I think that's really important.

So there are six reasons to tax. But none of them involve funding government spending.

That doesn't diminish the importance of tax. If anything, it increases the importance of tax. Tax has the power to shape our society. I once wrote a book called *The Joy of Tax*, and *The Joy of Tax* was literally a description of this power to shape a good society. I believe tax can do that. That's why I think tax is so important. That's why I talk about it so much.