What’s the real reason why we tax?

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Most people assume that we tax to fund government spending, but we don’t in economies like that we have in the UK. Instead, we have an economy where the government spends by creating new money and tax then takes it out of circulation, and that creates a need for very different economic management from that we’re being offered.

https://www.youtube.com/watch?v=CxoF7GuFP5E?si=ZQwQ-L9Yk2AGoswl

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This is the transcript:

How does tax work?

Most people think that they pay tax so that the government is able to spend, and that, I've got to tell you, is complete nonsense. That is not how tax works, unless we are talking about taxes paid to the government of Wales, the government of Scotland, and to every local authority in the UK, when that is what happens.

But of course, the vast majority of the tax that you pay is going straight to the government in Westminster. And when we come to Westminster, tax does not work like that.

When the government in Westminster wants to spend, it simply increases its overdraft with the Bank of England. There is no way that the Bank of England can legally refuse a request from the government to make a payment if that payment has been approved by a budget that has passed Parliament.

There is actually an officer whose job it is to make sure that is the case, and those checks and balances do go on, but once the payment is legal, the Bank of England has to make it, whether there are funds available in the government's bank account or not.

And of course, that is entirely irrelevant, because first of all, the government owns the Bank of England and therefore it does whatever it says. And secondly, there is no limit to the overdraft that the Bank of England can extend to the government, whatever politicians might tell you. And therefore, the Bank can simply create new money on the government's behalf to make extra money. for any expenditure that the government requests.

However, and let's be honest about this, if they did that for, well, maybe more than a few days at a time, without thinking about recovering some of that money that has been spent into the economy, to make sure that we do not have too much money chasing too few goods, we would end up with inflation.

And so they have to do something to control that inflation, and what they do is they is want their money back. Bluntly, that is what tax is for. It is the government saying, can we have our money back, please, and creating mechanisms to ensure that they can get it. Mechanisms backed up, of course, by the rule of law, and ultimately by the power to punish if we don't comply. So, there are menaces attached, which some people call violent. I don't. But it is undoubtedly the case that we, as a society, consent to tax imposed in this way, because we think it's necessary to make sure that we have a smooth and operating society to live in.

But that means we should understand that tax is not paid to fund the government, but is paid to return the money that the government has spent to it so we do not end up with inflation.

If we don't understand that, we get the whole of our comprehension of economics wrong; the wrong way round, quite literally. And that's why I say wrong. Because we think that we live in an economy where we tax and then spend, when we actually live in an economy where we spend and then tax.

And that has to be the case. Just suppose that we had to pay all our tax using these things - £20 notes. How would we get hold of them if the government had not spent them into existence in the first place?

After all, there is no pile of £20 notes sitting around in our economy which you can go and pick up with a label on them saying, “Please use these to pay the tax bill when it comes in.” No, that isn't the way it works. The government spends. the £20 note into existence by buying something from us in the first place, whether that be a teacher's salary, or the services that they require to fuel their vehicles, who cares what it might be?

The point is, they spend first, we get the money later. And then we send it back to them.

Now that means that tax is not actually a revenue raising tool unless we are talking about, as I say, the devolved governments or local authorities. They are like households and businesses with regard to their operations but the government isn't when it comes to banking and it isn't therefore when it comes to tax, because it owns its own bank and is the only person who is allowed to literally create money.

So as a consequence, the government is in this different space. And it's our job to understand that. Because when we understand that tax is used to control inflation, it's liberated to do lots of other wonderful things instead.

It could be used to reprice goods and services that are wrongly priced by the market, like carbon, like alcohol, like tobacco, and all those things that are causing climate change now. They could all be repriced so that they do not cause harm.

We can also redistribute income and wealth, and society is better off with lower levels of inequality. There's no doubt, the evidence proves it, that when the gap between richest and poorest is smallest, overall levels of income are higher.

So, the government can do those things, and it can also use the tax system to encourage certain activities that it wants to take place. For example, it can take tax off things to make sure that they are more attractive to consumers than things that do carry a tax charge. So, this is a powerful instrument for social change.

But it's only a powerful instrument for social change because tax is used to control inflation and not to fund government spending. And when we also understand that, we realise that there is no imperative that the government must, as it is said, balance its books. Balancing your books is crazy in this situation.

Because, in fact, in a growing economy, there is a need for more of these things - £20 notes - in the economy, because there's more transactions going on, and therefore the government has to run a deficit; a deficit which means that there are more notes in circulation, or, in the real world, more electronic money in circulation than there would otherwise be, so that there is the liquidity available for all those transactions that we want to take place.

And the government also has to put money into the economy if there is inflation. And by and large, we're better off with a bit of inflation than we are with no inflation. No, inflation very easily tips into deflation and deflation is dangerous because once you get into deflation people stop spending in the anticipation that things will be cheaper next year, and you spiral into recession.

A bit of inflation avoids that, but that means the government also has to run a deficit to leave more money in the economy to make sure that there's enough money to go around. And it does that by not taxing quite as much of the money that it spends into the economy. out of the economy via the taxation system. Therefore, the money supply grows, but that's good news.

Unless you understand how tax works in the economy, you can't understand how government really works.

The trouble is we have an awful lot of politicians, including our current Chancellor of the Exchequer, who do not understand how tax works in the economy.

And that's why we're in a mess.