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One of the most important things to understand about how government finances work is that in a country like the UK, which issues its own currency, has its own central bank and a reasonably well-functioning tax system, government spending always comes before tax is charged, and has to do so as a matter of fact. That simple fact changes everything. There are a number of reasons.

Empowering macroeconomic management

First, it means the government is never dependent on tax receipts to spend. If the UK government wants to pay for nurses, teachers, or infrastructure, it does so by instructing the Bank of England to make payments. That creates new money in the economy. Only after that money exists can it be taxed back.

In fact, and rather importantly, unless the spending came first, the money to pay tax due would not exist because it is, of course, the job of the government to create money, and it can only do that by spending it into existence.

This being said, the only constraint on this spending is the availability of the resources to buy. So long as they exist, the expenditure can always take place without the risk of inflation. The consequence is that understanding this permits policies of full employment and economic growth to be pursued in ways that would otherwise be impossible. Understanding that spending precedes tax does then allow for macroeconomic management that is otherwise impossible.

Avoiding the curse of the household analogy

Second, reversing the sequence, i.e. believing that tax must come first, traps policy thinking in the household analogy. Households do need income before they can spend. Governments do not. When politicians think otherwise, they create unnecessary limits on public investment, cut services, and pretend there is “no money left” when the only real constraint is the availability of resources, skills, and technology.

Understanding dependencies

Third, the two perspectives rest on fundamentally different assumptions.

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Tax and spend assumes that the state is dependent on the rest of the economy; spend and tax assumes the rest of the economy depends on the state.

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One assumes the books must be balanced like a household; the other recognises that this is not only not necessary for a currency-issuing government, but is not desirable, because the state is the only sustainable low-risk supplier of the new money that a growing economy with desirable low rates of inflation requires to function.

Liberating tax to work for society

Fourth, spending-first thinking makes clear that tax has a fundamentally different and more adventurous role to play in the economy. It is not there to “fund” spending, but to:

* Manage inflation.
* Give value to money by requiring that government-issued currency be used within the economy since tax has to be paid using it.
* Shape the distribution of wealth and income.
* Encourage or discourage certain activities in society.
* Manage the economic cycle.
* Reinforce the social contract between a government and those who elect it.

Tax is, then, more like an economic steering wheel. It is not a fuel tank.

Making clear political possibility

Finally, if you think spending comes before tax, you realise that austerity in the face of unused capacity is a political choice, not an economic necessity. You see that the government can always act to maintain full employment, support the green transition, and tackle inequality. You also see that the real limits are ecological and social, not the Treasury’s bank balance.

The difference between “spend first” and “tax first” is massive. One liberates public policy to meet social and environmental needs. The other chains it to an entirely false idea of financial constraint. And that matters enormously when it comes to our well-being.