

## Tax does not fund spending

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Most people think tax pays for government spending. It doesn't. In a modern monetary economy, governments that issue their own currency spend first and tax later.

In this video, I explain the six real purposes of tax:

- \* ratifying the currency
- \* controlling inflation
- \* redistributing income and wealth
- \* repricing harmful activity
- \* strengthening democracy
- \* organising the economy for public purpose

Understanding this changes everything about austerity, social security, inequality and public services.

If we want a politics of care instead of a politics of fear, we need an honest debate about tax.

<https://www.youtube.com/watch?v=FlqoKpIKNz4?si=FY3AHwR7UA9pkUz5>

This is the audio version:

[https://www.podbean.com/player-v2/?i=gp2ks-1a59f83-pb&from=pb6admin&share=1&download=1&rtl=0&font=Arial&skin=f6f6f6&font-color=auto&logo\\_link=episode\\_page&btn-skin=c73a3a](https://www.podbean.com/player-v2/?i=gp2ks-1a59f83-pb&from=pb6admin&share=1&download=1&rtl=0&font=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a)

This is the transcript:

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People keep asking me why we tax. Most people think the obvious answer is to pay for government spending, but that is wrong. Tax does not fund spending in a modern monetary economy, and that's what we live in. So today I want to explain the real reasons why we tax, because understanding this changes everything about politics, democracy, and economic justice.

We're told that the government must tax before it can spend, but that is the household budget analogy, and it is false. Governments that issue their own currency spend first and tax later. So the question is not: how will we pay for it? The question is always: what is tax actually for? And there is no one answer to that question. In fact, I suggest that there are at least six different answers to that question, what is tax actually for? And these are the main subjects of this video.

Let's look at the first reason: it is to ratify the currency.

Now that sounds a little obscure, but what it means is that the state demands that we pay our tax in its own currency. So in the UK, we must pay our tax in pounds. In the USA, we are paying dollars. In many European countries, we are paying euros. In Japan, we'd pay in yen, and so on. The point is this: when the government forces us to pay tax in the currency that it creates, then it basically forces us to use that currency within the economy itself, because if you owe tax in pounds, you need pounds to make the payment. And very few people will take the risk of trading in one currency and paying their tax in another. Why? Because, of course, there's an exchange rate risk and cost involved if you do that, so people don't.

That means people do begin to, and always will accept the pound in payment for whatever it is they want to buy. Of course, that's not just because it's legal tender, it's because it becomes custom and habit to use the pound all the time. And so tax gives a currency like the pound, the dollar, the yen, the euro, its value. Precisely because there is tax, we use it, and therefore the currency is literally given value by the exchange process of which it is a part. Tax creates demand for money, and in the process, it creates value. This is basic monetary theory, but it's ignored by orthodox economics.

So, what is the second reason to tax? That is to reclaim the money that the government has spent into the economy. The government spends first into the economy. It always does. It does not need tax revenue sitting at the Bank of England to be able to spend. It does instead simply run up an overdraft at the Bank of England to do that, and it is legally permitted to do so. So, then, tax reclaims part of the money that it has spent into the economy.

Why do that? Well, there are a number of reasons. First of all, and most importantly,

that is to control inflation. We don't want runaway inflation, and we do know that if you print money without end, then of course you will get that. Let's not be silly about it; that's an obvious statement of fact. There is a fine line to draw. We do need to create money. We do need to have a growing money supply in the UK because we have a growing economy, a growing number of people, and we also want to fuel a little bit of inflation because a little bit of inflation is good for any economy, because it actually makes everybody feel better. It also fuels demand. If people think that the price is going to be higher next year, they buy now, that tends to create the growth that governments crave.

So this is important. Tax literally reclaims money to ensure that economic management can take place, and in the process, it does something else as well, and this is quite important. By taking money out of the private sector economy, space is created for the supply of public services. If we only permitted a private sector economy, then there would be no room for a state health supply. There would be no room for state education. There would be no room for a defence industry. Whatever it is you want, you can insert whichever public services of concern to you in that space, and you will get the same answer. Without actually having tax to create the room for those services to take place within the economy, then they could not.

So tax does actually regulate demand in a very real way, whilst creating this opportunity for public services to be supplied. But nothing I have said negates my claim that tax does not fund the government. It has a role in regulating the economy. It controls inflation. It makes room for services, but it does not come before spending. It comes after spending.

And everything I've also just said does one other thing. It makes clear that all the arguments around austerity are nonsense because we can manage the process of spend and tax to ensure that we never ever need a programme of austerity in the UK.

Let's come to the third reason for tax then. This one is more straightforward, thankfully, and it's about redistributing income and wealth. We know we have a problem with inequality in the UK, particularly with regard to wealth, but also with regard to income, because markets concentrate wealth. They over-reward the wealthy because the wealthy can capture assets, and once they've captured assets, they tend to accumulate yet more wealth and therefore more income derived from wealth. The process is never-ending and ever concentrates both wealth and income in the hands of fewer and fewer people. And if we are to have a balanced economy, if we are to have an economy that can grow, we need to reallocate income from those who've got it and wealth from those who have it to those who have not, because only by doing so will we ensure that people have the money to spend to keep the economy growing as we wish, and to avert deep poverty.

So in this sense, tax is how democracy corrects the imbalances that markets create. Progressive taxation reduces inequality; it is as simple and straightforward as that, and

around the world, we can see the evidence. The OECD publishes particularly good information on this. It doesn't fund social security, public services, education, and health, but without redistribution, there would be none of those things because space for those things is created within the economy by taxation, but they support this process of redistribution because, without social security and taxation, we could not tackle the inequality that exists inside our society, and as a consequence, we would not have a thriving economy. That is the reason for redistributing income and wealth.

So what is the fourth reason to tax? It is to reprice goods and services. We do this because we know that tax changes behaviour. We can, for example, tax those things that pollute, and we do that every day because we pay excess taxes, as some people would think of them, when we buy petrol, diesel or whatever else.

And we also tax things that cause harm. Things like tobacco, alcohol, and maybe gambling. These all corrupt, and the consequence is we change behaviour by imposing taxes on these things over and above the normal rates of tax that we would otherwise charge within the economy. So we use tax to change behaviour.

We also tax speculation. We have to, because if we did not, we would have too much money concentrated on that activity and not on productive activity within the economy. One of the big problems we have is that we do not tax speculation enough. If we taxed it more, we would end up with a better economy.

The same is true with regard to monopoly profits. We could impose extra taxes on companies which have monopolies, like banks, large retailers, and, for example, online services in some cases. We can all think of companies who dominate markets there, and if we did that, we might also challenge the monopoly profits that these companies are able to make and reprice goods and services so we would get a more level playing field with regard to competition.

We can put tax on all these things, but we can also subsidise things. We can subsidise care, we can subsidise green investment, and we do subsidise education and health. These things can be done.

One of the perverse things we do is that, actually, we put tax on work when we want to create work. National Insurance in this sense makes no sense at all, and if you only understand that tax reprices goods and services, and you need to send a signal in the right direction, we would never have ended up with Rachel Reeves's calamity around increasing tax on National Insurance for employers, because it is absurd that she did that.

Tax is then economic signalling. It tells markets what societies value, and that is fiscal policy in action. And that, and I stress again, is why we should increase the taxes on speculation, we should increase the taxes on monopoly profits, and we should reduce the taxes on work because that is what would make sense.

What's the fifth reason for tax? It is to strengthen democracy. Tax links citizens to the state. Yes, we vote, of course we vote, and that's important, but we don't vote every day. But we do pay taxes every day, and that's important to understand. Even if we only get our payslip once a month or whatever else, we are paying VAT, we may be paying our council tax on different days from those on which we're taxed on our income. The point is, tax is a continual process, and people who pay tax demand accountability, and that is what we should be doing with the government. It has power; we should insist on accountability. It's our right as a consequence of the principles of representation that should be implicit within democracy to expect that they are accountable to us. The idea of no taxation without representation works both ways. Tax builds citizenship, which is why tax justice matters.

And what is the last of the six reasons I have to tax? Well, it is because tax reorganises the economy. Tax is literally how we can shape the future. We could tax land speculation. We could tax excess profits from monopolies. We could incentivise green investment more than we do. We could support care, health, and education a lot more than we do. Tax is critical to planning in a democracy, and a democracy without planning isn't a democracy at all. You cannot have a democracy without a planned state because democracy is all about representing the interests of people and having a plan to fulfil and meet them.

It is how we move towards a politics of care, then. Tax is fundamental to that plan. What happens if we forget any of this? We get austerity, we get crumbling services, we get inequality, we get anger and the rise of the far-right. In other words, we get where we are. And that's because people have not understood the full purpose of tax. They thought the tax is there to pay for government services and therefore they've hated it, when in fact tax enables democracy, which underpins our society and which lets markets flourish.

The government isn't powerless once it can tax; that's the critical point. A government that understands taxes and how it can use them can have fiscal capacity, and fiscal capacity is a way of expressing political will. What we've lacked in this country and in many countries around the world is that political will to interfere to deliver what people want.

We've had the markets deliver what they want to the few who've benefited. Now we need the fiscal will and the political will to create what people need. That is why tax is so important.

When Rachel Reeves says tax must fund spending, she repeats a myth. Let's be clear about it, and yet we hear it time and time again. The myth is of the household budget analogy.

When politicians say they can't afford social security, housing, or the NHS, what they're really saying is they don't want to act because we know they have the capacity to do

so.

When the UK says it cannot afford public investment, or it cannot afford to pay for the green transition, or, and this one really offends me, it cannot afford to care, what we lack is honest debate about tax. Honest debate about who should be taxed? What particular transactions should be taxed? Should it be income? Should it be wealth? Should it be consumption, should it be land or whatever else? All of those debates are required, and the real purpose of tax is this. It's about:

- \* Sustaining a currency.
- \* Controlling inflation.
- \* Redistributing power.
- \* Shaping markets.
- \* Strengthening democracy and organising the economy for public purpose to meet need.

This is what political economy is all about. If there's no textbook nonsense here, this is reality.

So what should we do?

First of all, we should stop pretending that tax funds spending.

Second, we should design taxes for justice and sustainability.

Third, we should tax wealth properly, and I have, of course, explained how to do so in my Taxing Wealth Report. There will be a link down below.

Fourth, tax pollution and rentier income more highly than we do anything else because these are abusive of us, and therefore, they should pay a higher tax rate.

Fifth, we should use tax as a consequence of the way in which it can subsidise activity to invest in care, health, housing, and the green transition.

Tax is not a punishment. Tax is not onerous. Tax is the way we deliver civilisation, and if we want a politics of care, we must use tax to build it.

That's what I think. What do you think? There's a poll down below.

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Poll

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