

Infographic: Fiscal policy

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Two of the terms least understood in economics are fiscal policy and monetary policy. This deals with one of them.

Fiscal policy

What is fiscal policy?

Fiscal policy is how government uses:

- government spending, and
- taxation

to influence:

- the economy
- society
- inflation
- employment
- public wellbeing

It is one of government's most important economic tools.



Government creates the money it spends

Government spending begins when Parliament authorises expenditure.

Then:

- the Treasury instructs payment
- the Bank of England creates new government money
- commercial bank reserve accounts are credited
- recipients receive payment through the banking system

Government does not need tax revenue before it can spend.
Government does not need to borrow before it can spend.



Why tax exists

Tax is not primarily collected to finance government spending.

Its main purposes are to:

- withdraw money from circulation
- reduce inflationary pressure
- create demand for the government's currency
- redistribute income and wealth
- discourage harmful behaviour
- encourage desirable activity

Tax exists to create economic stability.
That is its purpose.



Government spending

Government spending exists to achieve public purpose.

It can:

- employ unused resources
- create jobs
- improve infrastructure
- provide healthcare
- fund education
- support social security
- encourage investment
- tackle climate change
- improve productivity

The question is never "Can government afford it?"
The real question is "Are the people, skills and resources available?"



Fiscal deficits

A fiscal deficit occurs when:
Government spending exceeds taxation.

The difference becomes additional financial assets held by the private sector.

A government fiscal deficit is therefore matched by someone else's surplus.

Deficits are accounting outcomes, not evidence of failure.



Fiscal surpluses

A fiscal surplus occurs when:
Tax exceeds government spending.

This means government removes more money from the economy than it creates.

Persistent surpluses may, and usually do:

- reduce private sector financial wealth
- weaken demand
- slow economic activity
- contribute to recession if carried too far



Fiscal policy and inflation

Fiscal policy helps manage inflation by balancing:

- government spending
- taxation, and
- available resources

Inflation occurs when spending exceeds the economy's capacity to produce goods and services.

If unused resources exist, additional government spending can increase output without necessarily causing inflation.



Fiscal policy supports society

Fiscal policy should help create the society people want.

Its objectives include:

- full employment
- economic security
- lower inequality
- strong public services
- environmental sustainability
- stable prices
- rising wellbeing

Economic policy should serve people, not abstract financial targets.



Fiscal policy is not about finding money. It is about using the government's monetary power responsibly to mobilise available resources, support society, and maintain economic stability through appropriate spending and taxation.

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<https://www.taxresearch.org.uk/Blog/>
Richard Murphy's blog on political economy