

What's wrong with 'The Treasury View'?

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For more than a century, one economic idea has shaped British government policy more than almost any other: The Treasury View.

It sounds technical, but it affects almost every political debate you hear. Whenever politicians claim that “there is no money”, that government spending must be cut, or that public investment has to wait until taxes rise or borrowing falls, they are usually relying on this way of thinking.

In this video, I explain where The Treasury View came from, why it emerged in the 1920s, why Keynes challenged it during the Great Depression, and why, despite that, it continues to dominate thinking inside Whitehall today.

More importantly, I explain the hidden assumption on which it depends: that government must first obtain money through taxation or borrowing before it can spend. That assumption no longer reflects how a modern currency-issuing government actually operates.

Instead, I explain how government spending is authorised, how money is created, why taxation comes later in the process, and why the real limits on government spending are not financial but the availability of people, skills, technology, energy, materials and environmental capacity.

If the Treasury misunderstands how government finance works, it is no surprise that we have politicians making terrible political choices that are presented as economic necessities.

If you've ever wondered why Britain is told it cannot afford better public services, infrastructure or investment, this video explains the economic doctrine behind those claims.

<https://www.youtube.com/watch?v=N33sSSzi558?si=NS1BuJRDHM0IkQLJ>

This is the audio version:

https://www.podbean.com/player-v2/?i=7iua4-1b11cc2-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a

The Debate Ammunition for this video is available here.

This is the transcript:

There's something that you need to know about because it's really important in the economic life of this country, and that is what is called The Treasury view. This describes the underlying logic of the UK Treasury, based in Whitehall, which lasts from government to government, because it is the view of the civil servants who manage that department on behalf of the government, and supposedly on behalf of the Chancellor of the Exchequer, but who persist between governments and who have perpetuated this Treasury view for about a century or more now.

The Treasury view says something quite simple. It was created in the 1920s and 1930s, and it assumes that when the government spends, it uses scarce savings that would otherwise be available for use in the private sector. And so if the government spends more, the private sector spends less. Therefore, it is argued by the Treasury that public spending "crowds out" private investment. And the argument goes, again, inside the Treasury, that because the public knows more about what they want to spend on than the government does, private spending is always better than public spending and so public spending should be kept as low as possible. That is the Treasury view.

But this view is wrong, and it is wrong because underpinning it is a key, and hidden assumption: that the government must obtain money before it can spend. The assumption is that the government must tax or borrow before it can ever consider spending. And let me be clear, in the 1920s, when Winston Churchill took us back onto the gold standard for about six years, that was true. We did have to tax or borrow before the government could spend.

But what was true a century ago has not been true since 1931, sort of in the UK, and 1971, definitely in the UK, because that's when we broke the tie with the US on exchange rates and when the US broke the tie with gold, and so this assumption that the government has to tax or borrow before it spends is just wrong.

Why is it wrong? Because we have a government that creates and issues its own

money. When the government spends, it creates money, just as when a commercial bank lends, it creates money. That is absolutely, certainly true. The Bank of England has confirmed it to be the case, and yet the Treasury does not accept that. They do not think that the power to create the money that funds government activity is under their control, and yet it is.

And this view is, as a consequence, deeply damaging.

The view says that deficit spending cannot increase total output within the economy.

Why? Because it is said that it replaces private-sector spending instead. So, nothing new is created by government spending according to this view.

Now, Keynes challenged this view in the 1930s. We know he did. We know that he did so successfully. He changed the world's perception on deficit spending because he proved that, in times of economic downturn, the government had to spend because the private sector wouldn't. The fact that the Treasury assumed that the two are alternatives to each other was false.

But it's still the case that many in the UK Treasury, and other treasuries around the world, do not accept this reality of life. And that is the case in the UK at present, and is why the Treasury still says government spending must always be cut.

The reality is that government spending does something very different. As I've said very often on this channel before, but which I'll repeat now because a bit of reiteration never does any harm, the government authorises its spending not by looking at a piggy bank; not by checking its Bank of England balance; not by deciding whether it's got enough money coming in from spending or borrowing, but by passing a budget. That is what makes government spending possible in this country. When there is a legal budget, the Bank of England is required under a law created in 1866 to pay whatever the government instructs. It doesn't have to check whether the government has any money. It simply increases the government's overdraft. And that might only be for a few hours under the way the current system works, but that is exactly what it does.

Commercial bank accounts are then credited with the amount of money that the Bank of England has created. And those commercial bank accounts are then used to make the payment to the recipients of the money that the government wishes to spend; whether that be you, as an individual receiving a pension, a salary, a benefit or whatever it might be; or whether that be a company or somebody else who's providing a service to the government. It doesn't matter. That's the process that's always used.

And then tax comes later. Tax comes because if the government kept creating money, we'd get inflation. And so money is withdrawn from the economy because that controls the risk of inflation. And that money flows from you to a commercial bank, to the Bank of England, back to the Treasury. The process runs in reverse, therefore. And that's how

the books ultimately come broadly into balance, with government borrowing happening because the government chooses to provide a safe place of deposit to those who want to save their money with the government, not because that borrowing will fund spending. That's why the Treasury view is wrong.

When we look at this real way in which the money works within the economy, the government is not competing with the private sector for a stock of money because the government creates the money. In fact, the government expands the financial assets available within the private sector because it creates and spends money. Therefore, the real constraint on government economic activity is never money. The real constraints are people, skills, technology, materials, energy and environmental capacity. We have to live within the limits that climate change will allow.

But we still hear The Treasury View being rolled out time and time again. Politicians say we cannot afford it. There is no money. And so public investment is cut. Public services are allowed to deteriorate. Infrastructure is weakened. Growth slows, and living standards suffer, partly because social security is reduced as well. But not just for that reason. It's also because there isn't enough government spending in the economy to create what is called the multiplier effect, which is where one person's income is then spent to become another person's income, and on and on and on.

The shortage, then, is never money. The shortage is of political ambition, and The Treasury View now provides a convenient excuse to hide that lack of political ambition, coupled with the neoliberal desire to shrink the size of government.

The Treasury always asks, "Where will the money come from?" My view is they should say, "Do we have the real resources to do the job?"

The Treasury says, "If we can't find the money, we can't do it." My view is if the government could find the real resources to do the job, it should create the money to deliver the outcome because the money's always available.

The Treasury View mistakes a political choice for an economic necessity. A currency-issuing government is constrained by real resources and inflation, not by running out of its own money.

That's my opinion. What's yours? There's a poll down below. Let us have your comments.

Poll

[poll id="457"]

