The Fiction of “Tax-Funded” Spending

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The Myth

In 1983 Margaret Thatcher declared that “*the State has no source of money other than money which people earn themselves. If the State wishes to spend more it can do so only by borrowing your savings or by taxing you more…*” Successive governments have acted on that belief as though it were fact. **It’s not.**

It is at best a profound misunderstanding and at worst a deliberate deception of how a sovereign, fiat-currency issuing government functions.

How Government Money Really Works

A sovereign currency issuer (like the UK, China, Japan and a few others) is a government that issues its own currency and controls its supply: when, where, and how much. By contrast, countries in the Eurozone cannot do this.

Fiat currency means money is not backed by assets, such as when our currency was limited to the amount of gold in our vaults. The UK left the gold standard in 1971 after the Bretton Woods system fell apart, and since then, money has been created by changing numbers in accounting spreadsheets.

If the government spends £10 billion into the NHS directly, this creates what we call “a deficit”. But this deficit is not like a bank overdraft or a debt because the government is not borrowing from anyone when it goes into deficit. It is simply issuing money into the economy.

Taxes Aren’t Revenue

Taxes therefore are not about generating ‘revenue’. If that were true, the government couldn’t spend anything before it received taxes from the public. If the public were creating money to give to the government, we’d all be millionaires, and then shortly after, arrested for forgery. The reason? The UK Government is the sole currency issuer of the pound. Therefore, it creates money by spending first, and taxes it back afterward. Spending precedes taxation. Taxes aren’t revenue, they’re a tool to manage demand and inflation.

Key Questions

Naturally, this leads to some unsettling – though extremely relevant and important – questions. Why is the government cutting public spending? Why is Rachel Reeves pledging to limit expenditure to what's raised through taxation? And why, when the government can issue its own currency, does it borrow at all? The answers to these questions form the basis of a total political, economic and social turnaround where taxing the "working people of Britain" (anyone who works to earn a living), and avoiding taxing billionaires, is recognised as a miscarriage of justice. So let's answer them in reverse order.

Why are we 'borrowing' money from the private sector to spend on the public sector? – Perhaps it's as John Kenneth Galbraith put it, an 'innocent fraud', whereby those insisting upon borrowing don't actually understand what they're doing.

The fact remains however, that since the government is the only one able to create net assets through spending, government borrowing is absurd. It's like having £1,000, giving your friend £100, then asking if you can borrow it back because you don't like seeing your bank balance say £900. To sweeten this deal of a lifetime, you promise to pay them interest on what you borrowed. In a few years, you give them their £100 back, plus interest. Now your account says £890. Oh no, better borrow more money to fill 'the black hole'. Borrowing is unnecessary and ultimately increases the deficit.

Ask yourself, if we can only borrow or tax in order to spend, how could we pay the interest on what we've borrowed? The truth is we simply change the numbers on the accounting spreadsheet. But Thatcherite thinking says we must privatise, borrow more, raise taxes, or cut spending.

Reeves' Doom Spiral

Now perhaps you can see the doom-spiral Reeves' fiscal rules are going to (continue to) create. Since taxes extract money from the economy and spending increases it, refusing to spend more than you tax creates a feedback loop of contraction, not growth, and an ever-shrinking budget for public spending. In a word: austerity.

The solution to this invented problem? More borrowing. The result? Collapsing public services and an expanding wealth and inequality gap. Extremely wealthy institutions – receiving government interest – increase their wealth, and the working class are stripped of theirs.

Either this is deliberate, or a dangerous and disastrous miscalculation on behalf of the Labour party and every political party that subscribes to the same incorrect belief that "There is no such thing as public money; there is only taxpayers' money." At the bonfire of the UK economy, Reform, Conservative, Lib Dem and Labour all propose diverting the fire to the schools and hospitals, while standing there with a hose.

Truth & Choice

If truth is important, then we need to stop pretending that the government must "live within its means." That metaphor applies to households, not to sovereign governments. Reeves' fiscal rules and a bid for a surplus government balance sheet do not promote stability or growth. They undermine both and push the vast majority of working people into debt.

Austerity is not inevitable. It is a choice disguised as necessity, rooted in a misunderstanding of how money works. If Labour wants to lead, it must stop managing Britain like a household and start acting like a government.