

Fisking Martin Wolf on modern monetary theory

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Martin Wolf has conceded that MMT is an economic truth [in the FT](#) this morning. The headline says:

States create useful money, but abuse it

The sub heading is:

To the extent modern monetary theory is true, it is unoriginal; to the extent it is original, it is false

To summarise, he says MMT is right: states can create money at will; money is given its value by taxation; states with their own central banks that do not borrow in foreign currencies cannot go bust and taxes do not fund government spending, he agrees the whole gamut. I could quibble, and purists will, but in essence he says MMT is correct. And, of course, he agrees it always has been so by saying there is nothing new about any of this.

That's the good news. Then comes the 'but'. He says this:

Money is a creature of the state. Modern monetary theory, a controversial account of this truth, is analytically correct, so far as it goes. But where it does not go is crucial: money is a powerful tool, but it can be abused.

That's partly because Wolf also makes some very basic errors. For example, he says:

[O]nly inflation sets limits on a government's ability to spend. But, if inflation emerges, the government has to tighten demand, by raising taxes.

This is not what MMT says. MMT does not say inflation imposes a limit on government spending. It says using all available resources - effectively available labour - imposes that limit. Then it says inflation follows if expansion continues. And it only says that is an issue if it is decided that the resulting inflation rate is too high. Inflation, per se, is not a limit. I suspect Wolf chose to get this wrong, deliberately. His narrative does not

work if he noted correctly what MMT said.

But his real disagreement is that whilst MMT is correct (subject to his own misconceptions) he thinks the policy implications are wrong. He says:

This analysis is correct, up to a point. It also has implications for policy. A sovereign government can always spend in order to support demand. Again, expansion of the central bank balance sheet does not make high inflation likely, let alone inevitable. Some believers in MMT argue that the power to create money should be used to offer a universal jobs guarantee or finance programmes such as the [Green New Deal](#) proposed by Democrats in the US. But such ideas do not follow from their analysis. These are just suggestions for where the state should spend.

Again, this is misunderstanding, whether deliberate or otherwise, by Wolf. These ideas, or at least variants on them, are a necessary part of MMT, but Wolf cannot change his world view to realise that. This is because Wolf is stuck with the dying idea that macroeconomic policy is all about the need for independent central banks to control inflation rates with the objective of delivering a stable value for money to support the property rights of the world's owners of debt - who are banks and the well off. This assumption drives Wolf's slightly odd explanation of the role of bonds in MMT, and his objections to it. These are threefold.

The first is that we do not know where full employment is in an economy with certainty. This is true. Wolf thinks this justifies not taking the risk of creating it. Unemployed and under-employed people, and people not fulfilling their potential, is a risk Martin Wolf is clearly willing to take to prevent inflation. Those suggesting MMT think that the wrong priority. This is also why he does not say what the spending MMT permits should be spent upon, having dismissed the choices those who propose MMT make: he, by implication, suggest that the state should not spend. He clearly thinks that it should sit and watch human potential go to waste. I will say no more on that.

Second, he says this:

A still more important economic mistake is to ignore the expectations that drive people's behaviour. Suppose holders of money fear that the government is prepared to spend on its high priority items, regardless of how overheated the economy might become. Suppose holders of money fear that the central bank has also become entirely subject to the government's whims (which has happened often enough in the past). They are then likely to dump money in favour of some other asset, causing a collapsing currency, soaring asset prices and booming demand for durables. This may not lead to outright hyperinflation. But it might lead to a burst of high inflation, which becomes entrenched. The focus of MMT's proponents on balance sheets and indifference to expectations that drive behaviour are huge errors.

This is pure 'bond fairy' nonsense. Even Paul Krugman (when not writing about MMT)

has debunked this sort of scare-mongering, time and again. But let's be clear why. First, people can't dump money. Ultimately, it's what they have to make exchange. So the idea that they exit money forever is absurd. They will not do that. Instead, they might speculate. And as MMT makes clear, let them try. The government simply has to respond by buying the gilts they want to sell. It can. It is doing so regularly through the QE programme, so the mechanism exists, and as Japan proves, there is no real limit to how much of that debt the government can buy. In that case, a market panic, deliberately generated or otherwise, can always be neutered. No country is beholden to speculators in its bonds or currency, which it creates and the supply of which it controls if the core MMT conditions prevail. The only reason why this might not be true is if there was a central bank not under government control that then permitted runs by not intervening. One presumes Wolf wants such central bank independence to permit this possibility, which suits his theory. And that is precisely why I oppose it.

And then there is Wolf's third objection. He says:

These mistakes are economic ones, but there is a related and far worse political error, as [Sebastian Edwards](#) of University of California, Los Angeles, has argued. If politicians think they do not need to worry about the possibility of default, only about inflation, their tendency may be to assume output can be driven far higher, and unemployment far lower, than is possible without triggering an upsurge in inflation. That happened to many western countries in the 1970s. It has happened more often to developing countries, especially in Latin America. But the economic and social consequences of big spikes in inflation can be very damaging.

Now we come to the core of Wolf's objection. It is, as he admits, political. And it is that politicians might use their judgements. Heaven forbid! Wolf is very clearly of the school that created economics to impose constraint on that judgement so that full employment, rising real wages and a redistribution from capital to labour may not happen. And now he is petrified that the so-called economics that underpinned that heinous political system is shown to be wrong the constraints must still be imposed because politicians - and so, of course, those who elected them - cannot be trusted with the economy. Only bankers can have such faith placed in them, according to Wolf.

But he is wrong, of course. The 1970s are not now. And the economics of that era, including the belief that money was still a scarce resource, are even longer gone. Instead we live in an era of perpetual underuse of labour, and of politics that, if given the choice to do something would rather not do it. We have stagnation, inequality and real poverty precisely because of the maintenance of the economics that Wolf now wants to perpetuate by fear alone.

And tacitly even he admits that. He has to acknowledge the power of the state to intervene. In his conclusion he says:

The solution, nearly all of the time, is to delegate the needed discretion to independent

central banks and financial regulators. Yet proponents of MMT are right that during a period of structurally feeble private demand (as in Japan since 1990) or a deep slump, a sovereign government must and can act, on its own or in co-operation with the central bank, to offset private weakness. There is then no reason to fear the constraints. It should just go for it.

We are back to basic errors here. We have endured structurally feeble private demand for a decade now. And we need a Green New Deal. We could deliver that GND without problem precisely because there is structurally feeble private demand without there being a shortage of resources or inflation. But when a central bank is told it may not deliver such a programme it is an impediment to progress. The result is we need to sweep away the central bank and the independence it has that is this impediment to progress. Or we, at the very least, need to change its mandate. Wolf's perception of what is normal is seriously awry and his ability to adjust his economics to suit that false perception is as adrift.

Wolf has conceded MMT is right. Now he needs to accept the consequences. Including that democracy by and for the people should prevail.