Funding the Future

Replacing our existing economic heuristics is essential…

Published: January 14, 2026, 7:54 am

I think it fair to say that whatever we once thought we knew about economics, we no longer know. Saying so, I am not talking that much about economics theory, which few have ever comprehended, and whose relationship with reality has been so remote for so long that this might be a blessing. I am instead talking about the economic heuristics that govern what most people think about the way that the economy works.

Saying this I am, of course, talking in part about the impact that modern monetary theory (MMT) has had on economics, but that is by no means all that I am referring to. For these purposes heuristics are those economic ‘rules of thumb’ that dictate our reactions to any economic news and very largely dictate the politics of economic decision making intended to placate the expectations of those willing to support a politician seeking power. These are things like:

- The books must balance
- There is only taxpayers money
- Government debt must be repaid
- We’re leaving a burden of debt to be repaid by future generations
- Tax pays for government spending
- Taxpayers’ money
- There is no magic money tree
- Inflation is bad
- Savings are good
- Unless we save we can’t invest
- We invest in the stock market
- If government spending goes up so must taxes
- Unless we keep debt under control our exchange rate will collapse
- We must keep the markets happy
- Businesses must maximise profits
- We can’t afford an ageing population
- We must save for our old age

There are more, of course. And they are routinely rolled out to support the maintenance of a failing economic system even though it is clear that they no longer hold true simply by observing the fact that they do not offer solutions.

What I want to stress is that even very good thinkers are constrained by such maxims. Martin Sandbu, who writes for the FT, is a good thinker, and yet he wrote this in an article very recently:

[The cost of the coronavirus crisis] is going to force a simple choice on just about every government. They can tolerate the high debt burdens indefinitely, rather than try to bring them back down to moderate levels. Alternatively, they can permanently increase the state’s tax take to balance the books and start whittling down the debt. Either way,

combining "responsible" policies on both debt and tax burdens is no longer an option.

And even this choice – whether to be "fiscally responsible" with debt or with taxes – is only available in a best-case scenario. We may have to jettison both and learn to live with permanently higher public debt and permanently higher taxes. This will be true if economies never recover to their pre-pandemic growth trend, which seems almost certain if another wave of infections forces a new round of nationwide lockdowns. The resulting permanent shortfall in government revenues would mean taxes having to be raised not to reduce debt ratios, but simply to prevent them from growing ever bigger.

Implicit in what Sandbu says is a remarkably limited range of comprehension when it comes to macroeconomics. He is suggesting that the available choices are:

- Tax increases, or
- Debt reduction.

Or, in some (and, maybe, many) cases:

- Tax increases, and
- High debt.

But he's quite simply wrong. First that's because he assumes increasing debt is a burden. According to current heuristics that's true. But that's because our heuristics also assume:

- High debt is associated with high inflation;
- That's because high debt is associated with excessive government spending;
- Excessive government spending is thought to push up prices because it creates labour shortages;
- Inflation is associated with interest rate rises;
- Interest rate rises increase the cost of debt servicing;
- Therefore more debt is a burden.

But the heuristics underpinning this logic are no longer true.

- Government debt can now be funded by QE at no cost;
- QE has created a situation where both short and long term interest rates are at record lows, and seemingly likely to stay there because QE as a policy instrument permits that;
- Inflation has virtually disappeared in most major economies, at least with regard to consumer prices, and whatever the level of debt;
- We now face massive labour surpluses, or unemployment;
- Even when we had higher relative employment rates we could not create wage inflation;
- High government spending is now considered necessary, and not excessive;
- The cost of debt servicing, even on higher debt volumes, is falling.

In this case the heuristic driven paranoia about high debt makes no sense. High debt is not creating high cost; it is not squeezing out other spending; it is not draining resources from the economy as much of the debt is being funded by QE; and anyway, debt self is being reappraised. That is for two reasons.

First, what has traditionally been called debt is now simply seen to be saving. And the government acting as the place of deposit of last resort is seen as being no bad thing.

So, second, what was once called government debt is not seen as the threat it was. In fact, it’s appreciated that it’s not really debt at all, but simply people’s savings, and since the government can set the rate on those savings it can guarantee to retIn them.

In other words, the heuristics that shackle even better thinkers simply make no sense.

So what should Sandbu have thought? That’s a much more interesting question.

First, his range of options was much bigger than he noted. The tax/so-called debt trade off is a false dichotomy when we know the government can now fund its activities to whatever extent it wants through money creation, whether by direct borrowing from its central bank or indirect borrowing via QE.

Second, we now also know that tax and so-called borrowing are simply ways of withdrawing funds from the economy to balance money supplies, fiscal stimulus and inflation, which gives them a very different purpose.

So, third, we can see that the tax and borrow (in the sense of current heuristic thinking) choices that Sandbu discusses are themselves both inaccurate mechanisms for describing the government financing cycle, and too limited as approximations to reality even if, as approximations, they were ever useful.

In that case the question he should really have asked was something quite different. His error was to begin with a question on finance, as if funding were the most important issue in macroeconomics. Of course, it is not. What he should instead have started with was the real question which now has to be addressed, which is what is the scale of government intervention in the economy that is required to meet the needs of society at this moment? Instead of obsessing about the funding this is, surely, the right question to ask?

There is, of course, only one available answer to this question. It is that the scale of government intervention in the economy has to increase. Some of that is because of what are called the automatic multipliers. Benefit payments will, for example, increase. So too will the costs of the NHS rise, even without Covid-19 being taken into account. But very clearly the government will need to do more than that: the cost of recovery, as well as rebuilding the economy on a new sustainable basis, will largely fall to it. The private sector has not got the confidence, or the capital, to take on that task. What is more, after likely massive rates of insolvency in that sector, and borrowing having already been pushed to its limits in many cases to cover losses, that sectors capacity - not least to take on further borrowing - will be greatly reduced.

So if Sandbu had an assumption to make it was that the government must spend more by necessity.

But there was another assumption he should also have made. That is that without government intervention there is going to be a liquidity crisis in the economy. Banks are not going to be lending with any enthusiasm. And companies are not going to be taking on new debt. This conventional source of new cash creation is not, in that case, available to the economy. And given that consumer credit creation is also likely to reduce with fewer people in employment that too will restrict cash creation opportunity. So, not only will the government have to intervene more actively in the real economy to drive recovery, it will also fall to the government to create the cash the economy needs to function as bank created funds reduce, at least relatively.

This just emphasises how wrong Sandbu’s limited choice of heuristic options is. Neither scenario he considers addresses the need for government cash injection into the economy. Instead, he concentrates on methods of cash reduction, simply because he never considered this issued as a part of the funding question. He ignored that government ‘borrowing’ reduces cash availability and that tax literally destroys government created money by taking it our of circulation. His available choices do then only include scenarios that can make the economy worse.

What should he have considered? The obvious answer is that he should have addressed the question as to what options there were for the government to increase money supply. That could be in three ways. One is tax cuts. An other is by QE, but it is cumbersome and indirect. The third is by direct government injection of funds as a result of the government spending funds created for it by the Bank of England. Any combination is possible. And both tax cuts and QE directly oppose the positions Sandbu takes of increasing tax or debt, the latter because QE reduces real net government debt.

The conventional heuristics fail us then. And they fail economic commentary too by appearing to reduce the choices available to us when every option needs to be available now. And that is why those heuristics are so dangerous.

Those heuristics have, in that case, to be replaced. But rebuilding heuristics takes major effort. Have we the time to do that? The wellbeing of billions of people ultimately depends on us doing so.