

Tax and modern monetary theory: getting the facts right

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Jo Michell is an assistant professor of economics at the University of West of England with whom I have often crossed swords. He thinks himself to be in the left, and a bit of a tax expert. And he hates modern monetary theory. I think such an emotive work appropriate on this occasion.

He has just written an [article](#) for Tribune magazine under the title 'What should the left think about tax'. According to Torsten Bell of the Resolution Foundation in an email sent out yesterday this proves that *'Now while there are micro elements of this Modern Monetary Theory argument that are right, its big picture conclusion is what you might politely call garbage.'* That's some claim to make by the person who was Ed Miliband's chief of staff and who is still deeply influential in Labour, I suspect. So what did Michell say?

If I summarise his argument they are as follows (italics being used to highlight quotations):

1. The Tories are thinking about tax increases so Labour should be thinking about tax.
2. Labour is saying *that it is absolutely the wrong time to be talking about tax rises.*" This is correct from a Keynesian perspective, he says, but he thinks that some argue so from a different perspective.
3. These, he says, are those who argue that *there is effectively no connection between taxation and the size of the public sector: government spending can be increased to any desired level, it is claimed, without needing to worry about raising tax revenues to "pay for" it.* Michell argues that they say this because, as Michell agrees is the case, *the Bank of England — a public sector institution — is the issuer of pounds sterling.* He then claims that some say *as long as the Bank of England is willing to issue pounds on behalf of the government, the government can spend without needing to tax.*
4. As Michell notes, *the argument is technically correct in terms of the mechanics — the UK government will never run out of pounds.* But, he adds, *the conclusion that "taxes*

don't pay for spending" is incorrect.

5. At this point Michell goes into an esoteric discussion of what 'paid for' means, which includes the (stunning) revelation that in many cases that involves the reallocation of balances in bank accounts, and that absence of cash can then be a constraint on spending in normal circumstances, but given his previous conclusion, not for governments. From this he concludes *Given that a shortage of cash can never constrain government spending in the narrow technical sense, it is claimed, taxes therefore don't pay for spending. Spending is instead "paid for" by the Bank of England electronically issuing new cash.*

6. This, he notes *is technically correct — but it is a narrow, mechanical, and ultimately misleading definition of how the government "pays for" things.* This, he says is because *What really matters are the goods and services that cash balances purchase.*

7. He then goes on to say *The government can purchase these by printing more money if two conditions hold. The first is that there is some "slack" in the economic system: in other words, there are unemployed or underemployed people who can increase their activity to produce the goods and services. The second is that the private sector (households and businesses) is willing to hold the extra money created by the government. As he then notes To the extent that these conditions hold, there is indeed a 'free lunch' for the government, due to its ability to print new pounds.*

Let me be clear: to this point Jo Michell has not found anything to argue about with MMT. He has, in fact, said it's technically correct. He is right to do so. His only error to this point is with regard to his understanding of how bank payments work, which he thinks beyond the reach of MMT.

What he fails to note is that the reallocation of balance between bank accounts does not actually alter the overall sum of bank balances in existence. It's a telling omission on his part, indicating he has little understanding of central banking, which MMT requires. But having missed this point he then begins to turn on MMT. As a result my commentaries will now follow each of his arguments.

8. Michell then says *But while most economies do operate with some slack — there are always unemployed people — this capacity is not limitless. Eventually, a point will be reached where the goods and services purchased by the government cannot be newly produced, so the government will have to compete with the private sector for economic resources.*

MMT entirely agrees. This is not an argument against MMT. It is precisely what MMT says. There is slack. It's called unemployment, which MMT thinks should be eliminated, which it proposes to do by way of what might be called a Keynesian style stimulus until such time as that goal is achieved.

When that is achieved MMT says two things. Either the stimulus has to stop because the alternative is inflation because too much new government created money is chasing too few goods or, alternatively, taxes have to increase to reduce demand for private sector created goods so that the space is created for non-inflation inducing government spending. Tax, however, does not pay for that additional spend. Its role is to reduce demand to make space for that new government spend. It is, in other words, an instrument of fiscal policy that makes that relocation of resources possible. You would think the left would wish to embrace such an explanation, but apparently not.

9. Michell then notes that *Likewise, the willingness to hold cash balances is not without limit: at some point, those holding newly-created pounds will use these balances to spend on goods and services, or to purchase assets such as houses or stocks and shares. Investors may sell pounds in exchange for other currencies, reducing the international value of the pound.* At this juncture Michell is just wrong. Of course those newly created pounds might be used. That is, of course, the purpose for their creation. How else is demand stimulated? But Michell does not realise two things.

First, if a consumer spends they reallocate bank balances. They don't destroy them. The fall in the balance of the person who spends simply increases the balance in someone else's account. The overall cash held in central reserve accounts with the Bank of England does not change. If only Michell knew some accounting and basic double entry, on which secure foundation MMT is built, he would appreciate this.

If only he had the same understanding he would, secondly, also appreciate that if someone sells pounds to buy foreign currency someone else now owns the pounds they sold. Again, they do not disappear, as he assumes to be the case.

What is more, if he understood these things he would appreciate something much more powerful, and that is that there is only one thing that does change the amount of cash actually in issue, which as he notes is all ultimately government created, and that something is tax. Just as commercial bank loans are cancelled and the money that they create under government licence is destroyed as a result of bank loan repayment, so does tax cancel government money creation, which means that in MMT tax is the mechanism for controlling the money supply, and so inflation. But for the lack of understanding of the very basic issue of double entry book-keeping (a failing he has in common with many economists) he misses that quite essential point, which means MMT breaks economics from the shackles of neoliberal central bank, interest rate driven, inflation focussed control that does not only not work now (if it ever did without also destroying employment) but also destroys democratic accountability for economic management and passes it to the banking system.

It's a shame that Michell wholly misses the point that MMT restores economic power to the left. I am bemused as to why he wants to maintain neoliberal control instead.

10. Michell ploughs on. Having not noticed that MMT has already embraced his previous

arguments and turned them to good effect, he then says *There is, therefore, a limit to the extent to which the government can “pay for” its spending by printing new money. Beyond this limit, the government must either borrow, or tax. This is the sense in which tax “pays for” spending: it makes economic resources available to the government that would not otherwise be available.*

Which is precisely what MMT says. MMT is obsessed by inflation risk and that the consequences that failure to understand this risk might create. And it assigns to tax, for the reasons I have already noted, the task of countering that risk by withdrawing demand from the economy if it were to arise. Instead Michell makes a more limited claim:

By levying taxes, the government can reduce the spending of some individuals, or reduce spending on particular goods and services. For example, by taxing those on higher incomes, consumption on [highly-polluting](#) luxury consumption may be reduced. This means more resources are available for other activities, such as building transport infrastructure or providing for the consumption needs of care workers.

Which is as MMT would also have it.

And he continues:

The climate emergency and the pandemic require a fundamental restructuring of the economy. The scale of investment needed means that bottlenecks are inevitable, requiring reductions in expenditure elsewhere. More home insulation may require fewer new kitchens to be installed, for example.

I couldn't agree more. But what MMT does, by assuming that full employment is the objective, and by making clear that it can be achieved without inflation arising (which Michell has tacitly agreed, whether he appreciates it or not) is to suggest that debate on these resource allocation decisions is necessary because MMT makes clear that the state can demand that the necessary relocations of resources can take place. In other words, it empowers the state. Michell fails to understand that: he does not see that MMT empowers the arguments that everyone on the left should wish to partake in.

11. Michell then begins to fall apart. To put it another way, his very obvious lack of understanding becomes clear. From his previous argument he concludes that *It is misleading and unhelpful to [claim](#), for example, that a Green New Deal can be implemented without taxing the wealthy.* He adds *monetary mechanics are largely irrelevant — what matters is that the wasteful consumption of the wealthy must be reduced to make resources available for socially-useful spending.*

This is simply wrong for two really quite elementary reasons.

Firstly, Michell makes the mistake of thinking all pounds are equal. Given that no

government wants to tax (a claim I presume he would agree with) then when a tax is imposed it has to be chosen for a reason. In the case he notes, where he assumes that there is full employment and that the aim of tax is to redirect demand, aiming his tax increases at the wealthy makes no sense: the wealthy save all or part of their income. This should not be hard for an economist to work out: that is, at least in part, why they are wealthy. So, extra taxes on the wealthy will reduce their wealth (which is an excellent reason to tax them, if that is an issue, and might also reduce their excess cash holdings created by government spending, which is, again, another excellent reason to tax them) but it will not have much, if any impact on changing demand. They will still have the means to consume even if you tax them more. Don't get me wrong: I am not saying don't tax the wealthy. I am saying tax them for the right reason, which is that they are wealthy and that has harmful consequences for society, but don't then think this will have much impact on consumer demand, because it will not.

And this is where MMT wins. Unlike Michell, who is a simple 'book balancer' when it comes to tax and the public finance, MMT recognises (as I have stressed in my academic work and *The Joy of Tax*, as Stephanie Kelton has also done in *The Deficit Myth*) that what you tax really matters, and that this involves a vector of aims. Indeed, as I have long argued, including in peer reviewed journal papers, there are at least six reasons to tax, which are to:

- * Raise revenue, either to fund government spending or, alternatively, to reclaim the money that the government has already spent into the economy;
- * Ratify the value of the currency of the jurisdiction;
- * Redistribute income and wealth;
- * Reprice goods and services;
- * Reorganise the economy through what is called fiscal policy.
- * Raise democratic representation — people who pay tax vote;

The idea, that Michell puts forward, of book balancing, is not amongst these reasons because it is not necessary.

But this also puts other claims that Michell makes into context. For example, he argues that *The changes mooted by the UK Treasury include aligning capital gains tax with income tax, removing additional pensions relief for the better off and increasing corporation tax. These are progressive changes and long overdue. The changes also attract widespread [public support](#). Opposing them means siding with wealth over work and rich over poor.*

His implication of 'opposition' is that MMT would oppose such things. No I don't. Nor do I suspect anyone who really understands MMT would. I have promoted some of these ideas for a very long time, not least in *The Joy of Tax*. What he describes are wholly inappropriate tax reliefs and low rates because they reallocate wealth upwards, and

that is an issue that needs to be addressed. But that's the reason to do them, and book balancing is not.

And since Michell has already conceded that tax does not finance government spending he should agree when MMT says that these changes should be made because they are the right thing to do, come what may. MMT is empowering the left to do what is right.

12. Michell then argues that *At the same time, progressives must continue to argue for fiscal activism to maintain jobs and transform the economy. Claims that pandemic-induced increases in public debt [need to be](#) "paid back" are simply [incorrect](#) and should be refuted.*

I wonder what else he thinks The Deficit Myth is about? I have to wonder if he has read it.

13. So next he says *The public deficit will remain large until the crisis is over and the debt to GDP ratio will rise — that is exactly as it should be. The Bank of England can and should continue to use its money-issuing power ensure that the expansion of public debt can take place without generating financial or economic instability.*

I think he will struggle to find anyone in MMT who would disagree.

14. At which point Michell comes to what I presume he thinks to be his killer argument. He says *But tax revenues and the size of the state cannot permanently diverge. Those who want to see a larger and more effective state need to make the case for progressive changes to the tax system that will ensure that revenue grows at approximately the same rate as expenditures over the long run. This is not to say that the two should be equal: they should not. A public deficit has been the normal state of affairs for decades — but deficits cannot grow without limits.*

And let me assure him, once more, that not a person in MMT would disagree.

But what he fails to understand is that what MMT says that it is entirely happy with a balanced budget if sustainable full employment - the goal of left of centre politics these days, I would hope he agrees - is achieved. At that point of course MMT says tax and spend should equate. Taking more than spend then would create unemployment by reducing demand. Taxing less than spend at that point would create inflation. MMT spends a lot of time explaining why neither is necessary. So, quite literally, to claim that MMT says that spend can continue without tax, or that at a particular point spend should not equate with tax, or that deficits can continue growing without limit, is simply to promote a falsehood. Or garbage, to use Torsten Bell's language. That's not what MMT says.

15. And so is Michell's conclusion garbage by implying MMT is a programme to cut spending, when he says *We must not allow misguided arguments about "tax not paying*

for spending” to erode the tax base, increase inequality and open the door for free marketeers to argue for the need to cut back on essential social programmes. Literally nothing could be further than the truth about MMT.

Where MMT would agree with Michell is on his final sentence: *If we want to see systemic change, it’s time for the left to argue for progressive tax reform on its own terms.*

Which is, of course, exactly what MMT does, only on a vastly more informed basis than Michell is suggesting because MMT places tax within its true macroeconomic framing, which Michell wholly fails to do, and because MMT correctly explains tax’s relationship with fiat money, which Michell plainly fails to understand.

Michell and Bell rely on falsehoods to dismiss MMT. They plainly have not read it.

Their approach instead promotes the maintenance of the neoliberal system of central bank, interest driven, control of the economy that treats unemployment as a residual in the process of economic management, and considers those so unemployed ‘the price worth paying’ for inflation control. If that’s being left wing, I am flabbergasted.

And in the meantime, the fight for true left of centre policy continues, and Michell and Bell are not part of that process as a result of their commitment to policies antithetical to anyone of true left wing orientation, who must put people and not money at the centre of their politics, Which is precisely what MMT does, despite its name.