

What MMT says: a chance for the critics to take a pop

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One of the regular stream of commentators who claim that MMT is wrong about everything it says has appeared on the blog.

So, I issue a challenge. What is wrong about the following, which is what MMT says?

First, in a country with a fiat currency, which means that there is no asset backing to the money in circulation, which money does as a result only get value as a consequence of a government's promise to pay, there is, at least in theory, no limit to the amount of money that a government can create.

Second, a government creates money every time it spends because it instructs its central bank to extend it the credit to do so on every such occasion. It is not constrained by the availability of taxation funds when doing so: money can always be created by a bank on demand and at will, and central banks will always do this when instructed to do so by the governments that own them.

Third, to prevent this new money creating excess inflation a government has to tax to withdraw currency from circulation. This is the primary fiscal purpose of taxation, although tax also has other, as significant, purposes as noted below.

Fourth, the government does not need to borrow if it runs a deficit. Firstly that is because it can, at least in theory, simply run an overdraft at its central bank, on which no interest may be charged. This negates the need for borrowing. Second, government borrowing actually makes little apparent economic sense in an economy using the fiat money of the national government because the money that is supposedly borrowed has already been created by the government when injecting cash into the economy through its spending. But that does not mean that a government should not appear to borrow. A government has a social duty to be the borrower of last resort to its population and financial system. That is the function of government borrowing, and it is a vital role in the efficient operation of any fiat currency using economy.

Fifth, the same social obligation means the government is not indifferent to the way in which taxation is levied, or to non-payment of tax, even if sufficient tax is collected to secure the fiscal balance that it desires. Tax might have a primary goal of controlling inflation, with the secondary advantage that the tax charged for this reason provides the currency with value, but tax also has the other deeply significant social purposes of correcting income and wealth inequality; repricing market failure; delivering fiscal policy by incentivising or penalising certain activities and by reinforcing the social contract that exists between a government and its electorate. Tax is a reflection of the values of the society we live in and is the primary mechanism any government has for reinforcing them. For MMT to be indifferent to taxation is, therefore, completely incorrect. It would also mean that MMT was indifferent to the distribution of impact of taxation, both nationally and internationally, and that is not the case.

Sixth, the fact that the government spends first, and taxes second, means that the answer to the question 'how are you going to pay for it?' is always available to anybody who understands this process. A government decision can always be paid for, presuming the actual resources required to deliver it exist within the economy, simply by commanding the central bank to pay for it and then arranging, if necessary, for the additional tax due on the income that has been generated (because all government expenditure is, by definition, somebody else's income) to be collected.

Seventh, the realisation that a government that only borrows in its own currency cannot, as a result of this understanding, ever default on its own debt because it can always issue the instruction to its central bank that the payment of that debt be settled, is also of considerable advantage. Such a government should never be beholden to financial markets if they do not overheat their economies.

And that's it. There are of course implications of this understanding, most especially with regard to the goals of economic policy, who that policy prioritises and how, but these follow on from the above understandings, which are critical.