

The modern monetary theory glossary entry

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I promised a week ago that I would both publish a modern monetary theory (MMT) glossary entry and publish more about what I think MMT is.

11,000 words later this is the first outcome. It is the glossary entry, which summarises the essence of MMT, in my opinion. I am aware that not everyone will agree with it. Comments are welcome.

I will have a lot more to say on MMT as this week progresses.

Modern monetary theory (MMT) describes how governments create money by spending and destroy it by taxation.

MMT suggests that a government spends the currency that it wants to be used to make settlement of the taxes owing to it into the economy with the active assistance and support of its central bank when undertaking its routine spending, for the purposes of which expenditure the central bank provides all the money required by way of loans meaning that neither tax revenues or third party government borrowing are required to fund that spending although they might be for other purposes.

In more detail, it is suggested that the core assumptions of MMT are:

- * That a government that has its own central bank and currency, which currency is internationally acceptable, need neither tax nor borrow before spending because its entire government expenditure can be funded by new money creation by its central bank acting on its behalf, with the government then being indebted to its central bank for the sum expended.
- * A government that borrows in this way from its own central bank need never repay the debt it owes to its central bank because that debt represents the money supply of the jurisdiction for which it is responsible and that money supply must, therefore, be

maintained if the level of economic activity in that jurisdiction is to be sustained.

- * The primary role of taxation in the funding cycle of such a government is to control the inflation that might be caused by the excessive creation of new money by that government when fulfilling its expenditure plans.
- * The secondary role of tax in the government's funding cycle is to provide the government-created currency of a jurisdiction with value in exchange. That happens because if the tax owing to a government can only be settled using the currency that government creates those transacting in that economy who are likely to have tax liabilities arising as a result will not be able to afford the exchange risk arising from trading in any other currency.
- * Once these roles of taxation have been fulfilled the additional role of taxation for a government is as a tool for the delivery of its economic, social, regulatory and inequality agendas. The design of taxes for this purpose is, however, never intended to have a revenue-raising function to enable government expenditure to take place, that expenditure having already been funded by the central bank of the jurisdiction on the government's behalf.
- * A government in the situation described need not balance its expenditure and taxation income. In most situations that balance would, in fact, be undesirable. If the government has a growing economy and modest but controlled inflation within that economy, then the expansion of its money supply is essential, and that expansion of the money supply is best delivered by the running of government deficits. Such deficits represent a shortfall of tax receipts compared to government expenditure. This policy should be preferred to increasing the scale of private sector borrowing within the economy, which is the alternative source of new money creation.
- * A government in the situation described need never borrow from financial markets. That is because the government can always borrow instead from its own central bank. It has no dependency on financial markets as a consequence.
- * A government in the situation described may, however, wish to offer a savings banking facility to those in the jurisdiction for which it is responsible who wish to save in the currency that the government in question has created. It does so in its capacity as a borrower of last resort. This deposit-taking does not represent government borrowing: it is a banking arrangement. Even if the funds deposited with the government are then used to clear the apparent overdraft advanced by the central bank to the government the status of these deposits as a third-party bank or savings facility is not changed: the central bank can always guarantee the repayment of the deposits in question by the creation of new money, which is precisely why the government is able to offer this borrower of last resort facility.
- * A government in this position does not need to use interest rates to control inflation. It can instead use the following mechanisms to control:
 - * Varying tax rates over one or more taxes to tackle the cause of the inflation being suffered. New taxes may be required to assist this process.

- * Varying the scale of the deficit.
- * Credit controls to limit commercial bank lending.
- * A government in this position could seek to run a low effective interest rate policy within its economy to firstly minimise interest obligations to those to whom it provides banking facilities; secondly to provide the best possible environment for investment by lowering the cost of capital; and thirdly to minimise the upward reallocation of resources within the society for which it is responsible as a result of interest paid, thereby reducing inequality, which goals in combination have the best chance of delivering overall economic prosperity.
- * A government in this position can have a policy of full employment, knowing that until that point is reached, there will be under-used resources within that economy for which they are responsible, meaning that inflation will not be stimulated as a result so long as the resources put to use are those currently unemployed, whether they be people, physical assets, or intellectual property. This policy could include the provision of a job guarantee for all those seeking work within the economy who are unable to secure it, but any such policy must reflect the individual circumstances of the job seeker and be consistent with the overall delivery of social security within the jurisdiction for which the government is responsible, and cannot as such be a critical component within the economic policy of the government in question.