Funding the Future

Bond markets do not rule – governments do

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James Carville, adviser to Bill Clinton, once said that if there were reincarnation, he would like to come back as the bond market, because then he could “intimidate everybody”.

The Financial Times has [repeated that line in an editorial](), claiming that bond investors continue to exercise power over governments and that unless “government spending is brought under control”, financial markets will impose their will.

It will not surprise readers of this blog to know that I think this view is nonsense. It may suit bond dealers, bankers and financial journalists to repeat it, but it is built on a false premise about how governments work.

First, governments do not borrow in the way households or companies do. A household has to earn money before it can spend. A company has to make profits, or raise capital or debt, before it can invest. Governments with their own central banks do not face these constraints. When a government spends, it creates money. That is a simple fact of modern monetary systems. The Bank of England, the Federal Reserve, the Bank of Japan and most other central banks all issue the currency in which their government’s debts are denominated. They have acknowledged that fact. QE proved it. The FT and commentators deny that reality.

That fact is that reality shows that so-called “borrowing” is not a necessity. It is a policy choice. Governments issue bonds because they wish to offer safe assets to the financial system and because they want a mechanism for influencing and managing interest rates. But they never need to issue bonds to fund spending. That spending always happens first because only the state can create the money, which the private sector then, later, uses to buy government bonds.

Second, the FT’s narrative flips reality upside down. The article suggests that bond markets set the rules and that governments must cut spending or raise taxes to please them. In truth, bond markets only function because governments guarantee their existence. Without the state’s promise to stand behind its own currency, there would be no “safe asset” for investors to buy. Nor would there be the structures in which bond markets can operate. Bond dealers are not doing governments a favour. It is governments that create the conditions in which bond dealers profit. To suggest otherwise is to grant the City of London and Wall Street a veto over democracy.

Third, deficits are not a sign of weakness. In fact, they are the foundation of private wealth. The FT's editorial bemoans rising government debt-to-GDP ratios since 2007. But what it ignores is the fact that these rising rates are a measure of the growing accumulated savings of the private sector, held safely in the form of government bonds. When governments run deficits, they are allowing households, businesses and pension funds to hold wealth in the safest form available. To call this a problem is to misunderstand the whole architecture of modern finance. It is also to ignore the real issue of growing inequality.

Cutting deficits, as the FT urges, would mean cutting private wealth. That would, unless properly planned, undermine, not stabilise, economies. It would appear that they have no comprehension of this issue, which I will be addressing in my series on quantum economics very soon.

Fourth, the idea of “bond vigilantes” is a myth. The FT might as well be reporting that the City's high priests are demanding the sacrifice of virgins, so inaccurate is their portrayal of reality when they suggest that such fictional entities control what government might do.

That said, of course, bond prices go up and down, and yields fluctuate. But the idea that markets will “impose discipline” on governments is hollow. At any time, the Bank of England could step in to set yields where it wants them to be. It did precisely that during the 2010s, and again during the Liz Truss crisis in 2022, when pension funds faced meltdown. In a matter of days, the Bank bought gilts and restored calm.

That episode showed something vital: the bond market only exists at the grace of the central bank. Far from intimidating governments, bond traders live under their protection.

Fifth, the FT’s so-called “solutions” are dangerous nonsense. The article suggests governments must cut benefits, suppress public services, and avoid taxing wealth to appease markets. This is the politics of cruelty dressed up as financial wisdom. It amounts to saying democracy should be subservient to investors’ fears. In fact, the real task is the opposite:

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We need governments to guarantee public investment in housing, healthcare, education and the green transition.

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We need progressive tax systems not because they “fund” spending, but because they shape a fair society and tackle inflationary pressures when they arise.

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We need central banks to recognise their role as backstops to government policy, not as supposedly “independent” agents serving the City.

In summary, the FT’s editorial line gives the impression that elected governments are mere playthings of the bond market. That is not true. Governments make our money. They spend first. They guarantee the conditions within which bonds are traded. The danger is not that markets will impose their will. The danger is that politicians believe this myth and impose needless austerity on their own people to keep traders happy.

That is not an economic necessity. It is political cowardice. And it is time we called it out.