Funding the Future

Article URL

Published: January 12, 2026, 7:58 pm

There was quite a lot of discussion on this blog yesterday about modern monetary theory, so I thought it was worth checking whether the glossary entry on this subject was still relevant.

On review, I thought that the entry served its purpose, but it felt as if I had written it two or three years ago, as I had. My style has undoubtedly changed since then, so I redrafted it to add greater clarity to the arguments I had already made.

At the same time, I decided that it was appropriate to add to the glossary entry a list of myths about MMT that are commonly promoted by those who either do not understand it, or who wish to maintain the status quo, or who think that to discuss the power of the state to create money, and in the process liberate itself from the power of financial markets and the tyranny that they have created, is a betrayal of their undertsanding of the socialist cause since understanding how the economy really works today is, apparently, much less important than understanding what Marx might or might not have said 150 years ago.

This is the new entry:

Modern Monetary Theory

Modern monetary theory (MMT) explains how a government with its own sovereign currency and central bank actually finances its activities. In essence, such a government creates money when it spends and removes money from circulation when it taxes. Spending precedes taxation. Nothing in this cycle requires prior revenue.

MMT therefore describes the operational reality of public finance, not an idealised model.

Core propositions

First, a government that issues its own currency and has a central bank acting on its behalf does not need to tax or borrow before spending. All government expenditure is made possible by the central bank crediting bank ***accounts* as instructed by the Treasury. This is new *money creation*. Tax revenues and government borrowing may serve other purposes, but funding spending is not one of them.**

Second, the resulting balance sheet entry – the government's "debt" to its own central bank – is simply the record of the money it has created to support economic activity. Because the economy requires a stable and growing money supply, this liability never needs to be repaid.

Third, the primary fiscal tool for controlling inflation is taxation, which withdraws money from the economy. Excessive money creation causes inflation only when an economy has exhausted its real resources. Until then, spending can expand without inflationary pressure.

Fourth, tax plays a further role in giving the government's currency value. Because taxes can only be settled in that currency, economic actors must hold and use it, avoiding the exchange risk that would arise if they attempted to operate primarily in another currency.

Fifth, once its stabilising role is fulfilled, taxation becomes an instrument of wider economic and social policy. Taxes can be designed to shape behaviour, tackle inequality, and regulate economic activity — but not to "raise revenue" for spending, which has already occurred through money creation.

Deficits, borrowing and saving

Sixth, there is no requirement for governments in this position to balance their budgets. In a growing economy, ***deficits* are normal and desirable because they allow the money supply to expand in line with real economic activity. Government deficits are the private sector's financial surpluses.**

Seventh, such a government need not borrow from financial markets. It can always borrow from its own central bank. Bond issuance is therefore a choice, not a necessity.

Eighth, the government may nevertheless offer interest-bearing savings accounts or bonds as a safe place for the private sector to store financial surpluses. This is best understood as a deposit-taking service, not a funding mechanism. The central bank can always guarantee repayment by creating new money.

Interest rates and credit control

Ninth, the government does not require interest rate manipulation to manage inflation. It can instead use:

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changes in tax rates and tax design

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adjustments to the size of the ***deficit***

***
credit controls on commercial bank lending***

These tools directly address inflation's causes rather than attempting to slow the economy through higher borrowing costs.

Tenth, a low-interest-rate environment can support investment, reduce financial extraction from the real economy, and limit the upward redistribution of income inherent in high interest payments — promoting social and economic well-being.

Employment and real resources

Eleventh, a government with monetary sovereignty can pursue full employment because unemployed people and unused assets are evidence of slack in the economy. Bringing idle resources into use is not inflationary so long as they are genuinely unused.

This may include some form of job guarantee, but such a programme must sit within the wider system of social security and need not be the central pillar of economic policy. What matters is using real resources productively, not restricting spending to arbitrary financial limits.

Common Myths About Modern Monetary Theory (MMT)

MMT attracts persistent misunderstandings — often because critics attribute claims to it that it does not make. These myths usually arise from those who cling to the household-budget analogy or assume that government must behave like a currency user rather than a currency issuer. What follows corrects the most common errors.

Myth 1: “MMT says governments can print money without limit.”

This is wrong. MMT is explicit that the real constraint on government spending is ***inflation***, which arises when real resources are exhausted. The question is never “Can we afford it financially?” but “Do we have the labour, skills, energy, technology and ecological capacity?” MMT simply recognises that ***money*** is not the binding constraint — real resources are.

Myth 2: “MMT denies that inflation matters.”

This is also wrong. MMT treats inflation as central. It argues that taxation, credit controls, and strategic public investment are the most effective tools for managing inflation. It rejects the idea that raising interest rates to create unemployment is morally or economically acceptable when better tools exist.

Myth 3: “MMT claims tax is unnecessary.”

This is a false claim. MMT says tax is essential — but not for funding spending. Tax withdraws money from the economy to manage inflation, gives the currency value, shapes behaviour, tackles inequality and regulates markets. It is essential to macroeconomic stability. It simply does not fund government expenditure because the government issues its own currency.

Myth 4: “MMT says deficits don't matter.”

This could not be further from the truth. Deficits matter a great deal — but in the opposite way from conventional economics. A government deficit is a ***private sector surplus***. The issue is not the size of the deficit but whether it reflects appropriate levels of public investment, inflation control, and private saving. Balanced budgets can be actively harmful in a growing economy.

Myth 5: “MMT says government debt never needs to be repaid.”

Yet again, this is wrong. MMT notes that a government's ‘debt' to its own central bank is just the record of the money in circulation. Attempting to repay it would remove the money supply altogether. The government can and should redeem bonds issued to private savers when they mature, but this is a banking operation, not a funding requirement.

Myth 6: “MMT abolishes the need to borrow from markets.”

This is wrong in its implication. MMT says governments do not need to borrow from markets. They may still choose to issue bonds to provide a safe savings vehicle for pension funds and others. This, though, is a service to savers, not a funding mechanism. The choice is political, not financial.

Myth 7: “MMT promises free public services without consequence.”

MMT says no such thing, not least because MMT is not a manifesto; it is a description of how money works. It does not prescribe any particular spending level. It simply removes the artificial constraint of "how will you pay for it?" and replaces it with the real questions, which are:

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Do we have the resources?

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Is inflation under control?

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Is this socially, economically and ecologically justified?

Myth 8: "MMT is just quantitative easing by another name."

This reflects a profound misunderstanding of MMT. QE creates bank reserves but does not increase spending power for households or businesses because it swaps one financial ***asset for another and does not raise incomes. Government spending, by contrast, injects money directly into the real economy. MMT distinguishes the two clearly.***

Myth 9: "MMT assumes full state control of the economy."

MMT says no such thing. MMT works with any mixture of public, private and cooperative sectors. It simply clarifies the monetary framework within which those sectors operate. It removes false financial limits so governments can support full employment and stable conditions in which private enterprise can thrive.

Myth 10: "MMT is untested."

This myth might be the biggest of all those told about MMT. MMT is a description of what already happens in every country with its own currency and central bank, including the UK. The only question is whether policymakers acknowledge this reality or pretend the government is like a household.

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