Funding the Future

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Definition

The **Full Funding Rule** is a self-imposed Treasury convention requiring the UK government to "fully fund" any fiscal deficit by issuing an equivalent amount of government bonds (gilts and **Treasury Bills**) **to the private sector.**

In simple terms, if the government spends more than it receives in taxes, this "Rule" requires that the government must "borrow" the difference by selling debt instruments to investors, even though, as the currency issuer, it can always create the money required to make those payments directly through the Bank of England.

Origins and purpose

The rule was introduced in 1981 by the then-Chancellor Sir Geoffrey Howe, under advice from the Bank of England. It formalised the monetarist turn in UK economic policy. Until then, the government routinely financed part of its deficit by selling Treasury bills directly to the Bank of England, a straightforward form of money creation.

Howe's change came during the early years of the Thatcher government, at the height of the neoliberal counter-revolution. It was intended to end so-called monetary financing and to reassure financial markets that the government would no longer create money to pay its bills. Instead, every pound of deficit spending would be matched by borrowing from the private sector.

This was sold as a measure of prudence to control inflation and restore discipline to public finances. In reality, it was a political device to create the illusion that the government's spending capacity depended on the willingness of private investors to lend it money.

The Rule was reinforced by Gordon Brown in 1998 with the creation of the Debt Management Office in the Treasury to manage public debt, symbolising the split of fiscal and monetary policy on the creation of the Bank of England's supposed independence.

How it works

Under the Full Funding Rule, the UK Debt Management Office (DMO) must issue new gilts equal in value to any fiscal deficit forecast by the Treasury, whilst day-to-day it issues Treasury Bills to achieve the same goal.

The proceeds of these sales are credited to the government’s account at the Bank of England late each day, the government's spending during that day having previously been drawn from that account using funds already created for the government by the Bank of England, making a mockery of the process.

The acquirers of the bonds and Bills in question make settlement of the payment due for them from their central bank reserve accounts, which have been previously inflated by the value of the government's spending on the day in question. In other words, the full funding rule is simply an accounting exercise to create interest-bearing deposits out of the sums the government spends to support the fiction that the government must borrow to spend, even though the reserves that investors use to buy the gilts come from money the government has already created.

Consequences

The Full Funding Rule has three major effects:

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It disguises money creation by routing it through financial markets rather than acknowledging it as a normal function of a currency-issuing state.

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It enriches the wealthy by providing a constant flow of safe, interest-bearing assets to institutional investors — effectively a subsidy to the financial system.

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It justifies austerity by sustaining the myth that public spending must be “paid for” through borrowing and that rising “national debt” is dangerous.

The result is a permanent structural bias in favour of the financial sector and against direct investment in public purpose.

Relationship to modern monetary operations

The contradiction at the heart of the rule was exposed by quantitative easing after 2009. When the Bank of England purchased hundreds of billions of pounds’ worth of gilts from private investors using newly created money, it reversed the Full Funding Rule in practice. The state effectively borrowed from itself, cancelling out its own debt.

This proved that the rule was never a financial constraint, and only a political one. It also demonstrated that there is no operational difference between money created via “QE” and money created for direct government spending. The only distinction is who benefits first.

Current status

Although rarely discussed, the Full Funding Rule remains the foundation of the Treasury’s fiscal framework today. It is embedded in the Debt Management Report and in DMO operating procedures. Successive Chancellors, whether Labour or Conservative, have all maintained it, citing what they call market credibility, yet its rationale has collapsed. The UK has long since left the gold standard. The Bank of England is nationalised. And QE has shown that the government can finance itself directly at any time.

In short, the Full Funding Rule persists as an ideological relic: a monument to the neoliberal determination to constrain democracy by pretending that money creation is a sin.

Why it matters

Understanding the Full Funding Rule is essential to understanding how economic power operates in modern Britain. It turns the government’s role as the currency issuer into that of a currency borrower, allowing private markets to dictate the limits of public policy.

Abandoning it would not mean uncontrolled money printing. It would simply mean acknowledging reality, that the true constraint on government spending is real resources, not the availability of financial tokens.

A democracy that cannot spend its own money for public purposes has surrendered sovereignty to superstition. The Full Funding Rule is that superstition, written into Treasury procedure.
