

Funding the Future

Article URL

Published: January 12, 2026, 5:38 pm

An email correspondent said this to me recently:

MMT puts the horse before the cart; but I suspect if you designed the harness well, horses COULD push carts, so do they in fact amount to the same thing: create-spend-tax versus tax-borrow-spend? Aren't you bound by the need to tax to preserve spending power, as well as by resources?

Has there been an economy which did the former, created money, spent it, and levied tax and managed to set the tax regime just right? I don't know. How did the early Soviet Union manage, Gosplan and all that? How about China?

I was amused by the question, but what it really amounts to is whether it makes a great deal of difference if tax precedes spending, as neoclassical and neoliberal economics would imply, or if spending precedes tax, as Modern Monetary Theory — or modern money, as I currently prefer to call it — suggests is the case.

Let me start by saying that in some ways, I am surprised the question is asked. It is akin to asking whether it matters if we drive on the left or the right, when, of course, it makes a difference to the way the UK works. And it is also akin to asking whether we breathe out before we breathe in, because it is clear that knowing the ordering is essential to our understanding of how lungs work. However, let me address the issue.

First, on horses, carts and sequencing, in any modern fiat currency system, whether that be in the UK, US, Japan and so on, the state's money has to exist before anyone can pay tax in it. You cannot, as a matter of simple logic, pay the government pounds that have not yet been created. That means that operationally the sequence is always:

- * The government, via its central bank, creates money.
- * It spends that money into the economy.
- * Some of that money is then returned in tax; some is swapped into government bonds; and some stays in circulation as the money supply that keeps the economy revolving.

MMT's "spend and then tax and issue bonds" is not a slogan so much as a description of this operational reality. This ordering has to be right: nothing else is possible.

In contrast, the orthodox “tax and borrow, then spend” story is a political narrative that denies that reality to make it look as if the government is financially constrained in the same way that households are. It is a deliberately constructed falsehood set up to deceive.

Once you see the actual sequence, a lot of the usual myths about “running out of money” fall away. So no, it is not just a matter of designing a different harness: the cart really does move because the horse pulls and does not push from the other end.

Second, are we still “bound” by the need to tax and by real resources? Of course, we are, but in a different way from the conventional story.

The real binding constraint on government spending is always the availability of real resources: labour, skills, energy, materials, and ecological space. If you try to buy what is not there, you get inflation or shortages, however you tell the monetary story. This understanding is key. Modern money does not say:

- * We can print money without limit, because that would be madness, and lead to inflation
- * We do not need tax, because we most definitely do
- * The state can grow without limit, because it cannot.

Those who say so do not understand modern money. What it does say is:

- * We can always spend when there are resources available to be used, and inflation will not follow. We can have full employment, in other words.
- * As Keynes put it, “we can afford whatever we can do”
- * It would, then, be irresponsible not to do so. Why, for example, leave people unemployed when there is no reason to do so, or not care when we can?
- * If there are things we want to do, but resources are not available, we can still do them, but only when we have used tax or regulation to free up resources for use in the desired way. The government is not neutral when it comes to achieving its objectives, using whatever is left over by markets: it can shape markets to limit their scope in meeting wants to ensure all needs are met as well.

In that case, tax then has three main jobs in an MMT framework:

- * To create and maintain demand for the currency (you need pounds to settle your tax obligations).
- * To withdraw spending power from parts of the private sector when their demand would otherwise clash with public purposes and push up prices.
- * To shape the distribution of income and wealth so that the economy is both more equal and more stable.

So yes, you “need” tax in the sense that if you never taxed, you would eventually blow through the real-resource constraint. But you do not need tax in order to “get the money” to spend. You need it to create the space in which that spending can take place without generating unacceptable inflation and to manage distributional outcomes. That is a very different policy frame.

Third, has anyone ever “set the tax regime just right”? No, of course they have not, but that is true of any macroeconomic regime. No Chancellor, operating under the old “tax – borrow – spend” fairy tale, has ever set tax or spending “just right” either. Governments grope, adjust, and learn, usually too slowly, and often badly.

The point of MMT is not to offer a magic formula that suddenly makes that calibration perfect. It is:

- * Descriptive, meaning that it is important to tell the truth about how the monetary system already works in a country with its own currency, central bank and floating exchange rate. Knowing the truth usually works better than building policy on the basis of fiction.
- * Normative, meaning that once we admit that truth, we can stop pretending that “there is no money” for things we can clearly resource, and we can instead organise tax, spending, interest rates, regulation and planning around the real constraints I have already noted

In that sense, much of what MMT describes already happens: the UK government already creates money when it spends and destroys it when it taxes. To some extent, QE made that apparent. What we have not done is align our fiscal rules and political narratives with that reality.

Fourth, what about the Soviet Union and China? They are interesting mainly as examples of something else.

- * The early Soviet Union relied heavily on physical planning and rationing. Money existed, but prices and taxes often played a secondary role to direct allocation of resources. The state still created the roubles, of course, but the main weaknesses were political and informational: lack of democracy, poor feedback, misallocation, and repression and not issues around “money creation” as such.
- * China today runs a hybrid system. There is significant state direction of credit through largely state-owned banks, plus extensive use of markets. The state can and does create money, but again the key questions are about who controls real resources, how power is exercised, and how the ecological and social constraints are managed. Neither system is an “MMT regime” in any meaningful sense. MMT is not a blueprint for central planning. It is a lens for understanding monetary operations in any system using state money. What those states then choose to do with that capacity, whether they be a democratic welfare state, or a system of authoritarian nationalism, or anything in between, is a political choice, and not something determined or even influenced by MMT.

So my short answer to my correspondent’s underlying question would be:

- * No, “create – spend – tax” is not just the same thing as “tax – borrow – spend” in a different harness. The sequencing is different, and once you acknowledge that, the politics that follow are also different.
- * Yes, we are bound by resources, and we need tax, but for managing inflation, power

and distribution, not to find money in the first place.

* And no, there is no historical nirvana where anyone “got it exactly right”. There is only the choice between telling the truth about how the system works and governing accordingly, or carrying on with fairy tales that conveniently justify austerity for some and indulgence for others.

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