Funding the Future

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A while ago, I was asked to add an entry to this blog's glossary explaining what a theory is, the goal being to clarify why modern monetary theory is considered a theory. It was a good suggestion, but I did nothing about it because I was just too busy at the time.

Yesterday, as I began to feel flickers of life return and the grip of my cold/flu on my brain eased, I addressed a number of comments on the blog that had been waiting for attention for some time, and this was one of them.

The resulting glossary entry is as follows. And why give it attention now? That's because I am working on a Guide to MMT, to be available as a free download in the PDF Shop of this blog, hopefully in time for Christmas (to help you avoid all that mindless television). This might feature in it, but it's touch-and-go whether there is enough time to achieve this goal now. We'll see....

A theory is not a guess. Nor is it an ideology, a hope, or a political preference. As the philosopher ***Wilfrid Sellars*** ***once put it,*** ***a theory is a structured attempt*** ***to "explain how things hang together."***

In economics, that means offering a coherent account of how money, markets, governments and real resources interact; one that can be stated clearly, tested against observable facts, and used to make sense of what otherwise appears opaque.

A good theory does three things.

First, it provides a framework for understanding: a set of concepts that describe the relationships between actors in the economy. Without such a framework, facts sit in isolation, and policy becomes guesswork.

Second, a theory must fit the evidence. It must describe the world as it actually is, not as some would like it to be. Its assumptions must be explicit and open to challenge. If the data show that the theory does not correspond to reality, it is the theory that must change, not the world.

Third, a theory should generate insight. It should illuminate consequences, identify constraints, and highlight choices. Its purpose is not prediction in the sense of fortune-telling, but understanding in the sense of explanation.

It is on these grounds that Modern Monetary Theory (MMT) qualifies as a theory, and why claims that it is "not a theory" are simply wrong.

Why MMT is a theory

MMT offers a coherent explanatory framework for how money works in a modern, sovereign, fiat-currency economy. It begins from observable realities:

* Governments that issue their own currency cannot involuntarily run out of it.
* Taxes do not fund spending but create demand for the currency and manage inflationary pressure.
* Bank lending creates deposits; it does not lend out pre-existing savings.
* The real constraints on public spending are resource availability and inflation, not the state of the government's bank balance.

From these premises, MMT explains how fiscal policy, monetary operations, bond issuance, taxation, savings instruments and employment interact. It does so without appealing to fictional constructs such as "loanable funds," "crowding out," "government as household," or "bond vigilantes controlling fiscal space," all of which persist in mainstream commentary despite lacking empirical foundation.

Crucially, MMT's insights are testable against observable institutional reality. The operations it describes, such as how the central bank settles payments, how reserves are created, how gilt issuance functions, and how banks create credit, ***are all matters of fact. They can be inspected in government accounts, central-bank operating procedures and actual market behaviour.***

This is why central banks around the world increasingly produce explanations of money creation that align, often unintentionally, with the MMT description. The Bank of England's 2014 paper stating that "loans create deposits" is a case in point: it confirms, rather than contradicts, the core MMT framework.

Finally, MMT is a theory because it provides insight into policy choices. It clarifies:

* ***that the constraint on government spending is inflation, not solvency;***
* ***that unemployment is a political choice, not an inevitability;***
* ***that fiscal policy, not interest-rate manipulation, is the effective stabilising tool;***
* ***that public deficits correspond to private surpluses, and so cannot be understood in isolation.***

This illuminates what governments can do, not what they must do. It does not

tell politicians what values to hold or what outcomes to prioritise. That remains a matter of political economy. What MMT does is provide the theoretical scaffolding that makes reasoning about those choices possible.

Why this matters

Too often, economic debate is dominated by ideologies pretending to be theories. The claim that “government spending must be funded by taxes” is not an empirically grounded theory; it is a political assertion. So too is the idea that financial markets ration public spending. These claims persist because they serve powerful interests and because they have become embedded in public discourse. They are not grounded in how modern monetary systems actually work.

By contrast, MMT starts from operational reality and builds a coherent explanatory framework from there. That is what makes it a theory, and an indispensable one for any society that wishes to use its collective resources to deliver well-being, resilience and care.
