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How Modern Monetary Theory Questions The Anxieties Around Debt

Modern Monetary Theory shifts our attention from fiscal deficit numbers on paper to the deficits that truly matter: the lack of good jobs, healthcare and climate action

Junaid Jahangir

Books, Economy, Editor's Picks, Features, Perspective

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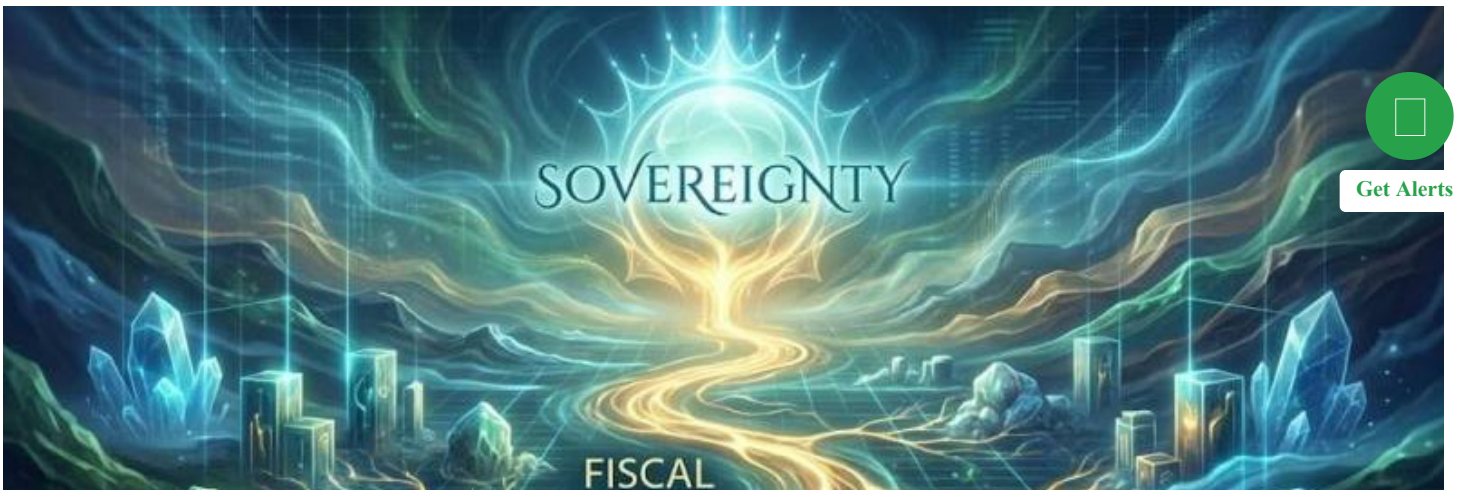

Recently, top economists and historians assembled by the Peter G. Peterson Foundation sounded the alarm on the $38 trillion national debt in the US. The debt amounts to 120% of the GDP. However, Modern Monetary Theory (MMT) would reject this framing.

We are told that a threshold has been reached and not much space is left to boost the economy during a crisis or for a major war, given security threats from Russia, China, and Iran. Additionally, we are warned that the favourable differential between fast GDP growth and low interest rates does not hold. There are also concerns on the dominance of the US dollar.

The problem is that the Foundation is being projected as “nonpartisan” whereas it has been critiqued for cutting social security benefits and supporting measures that reduce corporate taxes. Professor James Kwak has already cautioned about think tanks that promote economic arguments in favour of

corporate interests.

Another issue is that experts can err. This is evident from the Reinhart and Rogoff paper, which made the case for austerity. The noted economists found that a debt to GDP ratio over 90% slows down growth. However, a graduate student identified several basic flaws in their paper, which exposed their erroneous argument. Moreover, in terms of debt to GDP ratios, Japan is at 255%, Singapore at 168%, and Canada at 108%. The US is hardly an outlier.

Even if one does not buy MMT, it is not so much the debt but what debt is used for that matters. For instance, taking debt for white elephant projects (costly, large-scale projects that fail to deliver on value) is quite different from taking debt for high return investments in physical and human capital.

Of Life, Debt, Desperation And A Note In The Pocket

For mainstream economic theory, the condition for debt sustainability is that the interest rate lies lower than the economic growth rate. But MMT argues that the interest rate is under the control of the central bank

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MMT shifts our attention from fiscal deficit numbers on a paper to deficits that truly matter, i.e., lack of good jobs, healthcare, education, inadequate pensions, and the climate crisis. In this regard, there are books by MMT proponents like Stephanie Kelton and Randall Wray and their various critics.

Primers on MMT are readily available for general readers. Professor Steve Keen has argued that MMT is one of the most important alternatives to mainstream economics theory.

According to mainstream economics theory, the condition for debt sustainability is that the interest rate (r) lies lower than the economic growth rate (g) so that ($r < g$). This ensures that economic growth can cover the cost of debt. However, MMT argues that the interest rate is under the control of the central bank.

According to MMT, a government that issues its own currency, has a floating exchange rate, and does not borrow in foreign currency is monetarily sovereign. Having a floating exchange rate is important, as the central bank cannot control the interest rate if it decides to fix the exchange rate. Not borrowing in foreign currency is also important, as the government cannot print foreign currency to defray borrowing costs.

MMT critics argue that it is not applicable to developing countries that borrow in foreign currency. However, the US has maximum monetary sovereignty, and the US dollar is the world's reserve currency. This means that from an MMT perspective, the scaremongering on debt sustainability is overblown.

The Legal Struggle Against Modern White-Collar Crime

The US was able to inject trillions in the aftermath of both the 2008 financial crisis and the 2020 COVID pandemic without worrying about rising interest rates or inflation. Both these instances vindicate MMT in contrast to mainstream economic theory that teaches that increased spending and debt contribute to higher interest rates and inflation.

Obsession with war has already cost the US trillions with the fiascos in Iraq and Afghanistan. While corporate arms manufacturers made profits, no weapons of mass destruction were ever found, and the Taliban remain in power. More of the same with Iran is stupidity.

The same applies for Russia. Economist James Galbraith argues that sanctions have been a gift for the Russian economy. Moreover, the US continues to buy enriched uranium from Russia. Similarly, the US and China are too integrated. China invests dollars it earns through trade in US treasuries. It's not in its interest to bring the dollar down. The opportunity cost of war is too high.

Economist Keyu Jin argues that the focus should lie on developing oneself instead of bringing the other down. Competition is based on acquiring technological edge and war takes away from that endeavour. Thus, war concerns by think tanks are overblown.

Finally, the hegemony of the US dollar cannot be currently replaced by the Chinese yuan, as 90% of the global foreign exchange transactions happen in dollars compared to 6% in yuans. Even a critic of MMT like Professor Gerald Epstein argues that the dollar retains its hegemony because of network effects. This means that just as Facebook remains the paramount social platform, the dollar retains its hegemony. Additionally, even if the economic power of the US declines, its military and diplomatic strength imbues the dollar with power.

How Self-Love Can Transform Chaos Into Calm In Modern Life

Overall, instead of scaremongering on debt by think tanks with an agenda of their own in cutting social security and giving corporate freebies, the focus according to MMT should be on education, healthcare, good jobs, the care economy, and sustainability instead of deficit and debt numbers on a paper.

TAGS: US national debt crisis, Modern Monetary Theory MMT, Peter G Peterson Foundation critique, Stephanie Kelton economics, US dollar hegemony, debt to GDP ratio explanation, monetary sovereignty, Reinhart and Rogoff austerity, US

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Junaid Jahangir