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# Role of Taxes in Modern Money Theory

Student Research Internship Report

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**Modern Money Theory (MMT)** is a heterodox economic perspective that explains how money could be created out of thin air. It counters the classical idea of inherently viewing an government deficit as a bad thing and a surplus as a good thing. This theory explains how the unlimited ability of the central bank and the government to create money into existence allows them the freedom to fund any project. MMT dictates that if more policymakers truly understood the power of paying for any economic which they encounter with the usage of money, they would be able to create a far more prosperous economy.

However, this dynamic of the MMT encounters a concern in front of all the economies of the world; if money as a commodity can be created by countries virtually out of nothing, it would not remain of any value to anyone due to its limitless possible supply. In such a case, no currency in the world would hold any intrinsic value, which is to say that the difference between the value of a US dollar and an Indian rupee would ultimately extinguish. While the belief that money itself does not hold any value of its own is quite popular, it is not necessarily true. This is because cash actually does have some utility value in the way it facilitates trade on an individual, national and global level. Most importantly, when it comes to paying taxes, all transactions are carried out through the medium of cash.

Understanding this dynamic leads to busting the popular myth of the "taxpayers money", which goes on to say how the government owes the public various services in return for the taxes that it chargers from people to supposedly "fund" such projects. This is a myth and is far from reality because the government does not need money from the public in the form of taxes to fund any projects as it holds the power to generate its own money.

Every citizen of a particular nation has to pay his or her taxes solely in the form of the currency printed by the central banking authority of that nation to its government. No other medium of money is accepted by the government when it comes to the payment of taxes. For example, if you are an Indian citizen, you are required to pay your taxes in the form of Indian rupees to the Government of India at the end of every financial year. If by any means you fail to do so, legal actions would be taken against you by the government. This alone creates a demand for the printing of Indian rupees every year in the Indian economy. This is actually one of the primary reasons why governments tax their citizens and not because they are looking for money to fund their projects. However, the reality brings forth another picture: the government creates this money to provide its citizens with a collectible

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currency that they would employ towards the payment of taxes. Moreover, in almost any given year the governments are likely to spend more money than it collects as tax from the citizens in various projects and this is not a problem because, as established earlier, they are the source of this currency to the private sector.

Another very important role that taxes play, especially when seen in the light of the modern money theory, is that of keeping the inflation rates in control. The world has witnessed countries like ~~the~~ Venezuela and Zimbabwe encounter massive inflation rates due to high amounts of deficit and more importantly, supply-side shocks. These are some real-world examples of the great limitation of when countries have had to run large deficits, for whatever reasons, recklessly in an economy. This situation causes a dramatic increase in the supply of money in an economy which thereby leads to an overall decrease in its value to a point where the economy operating in that particular currency reaches a vicious circle of having to run even larger deficits to keep up with the increasing inflation which results in causing even higher inflationary rates. This ultimately causes money (currency of a particular nation) to become worthless.

In addition to this, the currency that commercial banks create exceedingly outweighs the currency that is created by the federal governments of the world, the latter are not the sole creators of money in an economy. This means that controlling the supply and demand of money in an economy becomes much more difficult for its central bank and the government.

In reality, controlling the supply of money in an economy is the primary role of its government and central bank. Imposing taxes on the people of a country and controlling the tax and interest rates are how this inflationary control is exercised by the governments and central banks all across the world.