

*The Deficit Myth*  
*Modern Monetary Theory and How to Build a Better Economy*  
Stephanie Kelton  
London: John Murray Press, 2020, £30.00 (h/b)

### **Bartholomew Steer**

**T**his is a book designed to change the world. It takes on big issues, addresses them in terms that ordinary people can understand, and leaves the reader with the impression that, after reading the book, nothing will ever be the same again.

The author is an American economist, who had been acting as an adviser to Bernie Sanders and to the US Senate Budget committee. She is a Professor of economics and public policy and writes for Bloomberg, the *New York Times*, *Washington Post* and the *Los Angeles Times*. Until recently I had never heard of her but her cause was taken up by Richard Murphy in his 'Tax Research' blog<sup>1</sup> and the publication of the book on 16 June 2020 was trailed as a big event.<sup>2</sup> Reader, I bought the book and read it immediately.

What caught my eye in progressing through the book was the presence of Wynne Godley – a name probably familiar to readers of a certain age. Kelton pays tribute to him for essentially teaching her the outlines of his theory which now bolsters her book.

Godley's theory is contained in a book of his published first in 2006 but relaunched in 2012.<sup>3</sup> The problem has been that Godley was an economist's economist, given to expressing himself in abstract equations not easily

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<sup>1</sup> <<https://tinyurl.com/ybspnljy>> or <<https://www.taxresearch.org.uk/Blog/2020/07/08/modern-monetary-theory-gets-to-westminster/>>

<sup>2</sup> She was profiled in *The Times* magazine on 13 June. See <<https://tinyurl.com/y8j5zxgu>> or <<https://www.thetimes.co.uk/article/stephanie-kelton-why-mmt-is-key-to-post-covid-economic-recovery-hwdd65g57>>.

<sup>3</sup> W. Godley and M. Lavoie, *Monetary Economics: An Integrated Approach to Credit, Money, Income, Production and Wealth* (London: Palgrave Macmillan, 2012)

accessible to the general public. The word has spread however<sup>4</sup> and went mainstream when Democrat politicians used it to justify killing off austerity economics and to present monetary expansion as a means of funding spending programs in the US.

Wynne Godley you may recall as the ex-HM Treasury economic modeller and leading light of the Cambridge Economics Policy group. He opposed membership of the EEC during the 1975 referendum and supported the so-called Alternative Economic Strategy. This was developed to oppose the monetary orthodoxy that was used to first hobble the Labour Government of the 1970s and then to crucify the UK economy when Margaret Thatcher gave the UK monetarism at full throttle.

Although he wrote articles from time to time in the *London Review of Books*,<sup>5</sup> the task of fully articulating his ideas took longer than he had intended and filled his life until he died in 2010. We learn from the *LRB* that Frank Kermode, a colleague at Cambridge, encouraged Godley to complete his book (at least) as a counter to suicidal thoughts at the end of his life.

Kelton, in contrast, is a populist, keen to simplify and communicate clearly what she describes as six myths dominating the thinking and actions of politicians and policy makers of both main parties in the US (and the UK). She seeks to destroy these myths, expressing it colourfully in her phrase that her aim is 'to drive the number of people who believe the deficit is the problem closer to zero'.

The myths are:

- *That national state should budget like a household*: it should be the job of government to ensure assets and workers are fully employed and not to cut spending for no economic purpose.
- *Deficits are evidence of overspending*: in fact most of the time deficits are too small, not too big.
- *Deficits will burden the next generation*: Kelton asserts that increasing the deficit doesn't make future generations poorer, and reducing deficits won't make them richer.
- *Public deficits crowd out private investment and undermine long term growth*: the reverse is actually true as public spending ends up in the private sector, which justifies and pays for private investment.

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<sup>4</sup> <<https://tinyurl.com/y4mk6h66>> or <<https://www.vox.com/future-perfect/2019/4/16/18251646/modern-monetary-theory-new-moment-explained>>

Kelton has written about her monetary theories in the *Financial Times*. See <<https://tinyurl.com/y9j7n39q>>.

<sup>5</sup> <<https://www.lrb.co.uk/contributors/wynne-godley>>

- *Deficits make a country dependent on foreigners:* Kelton describes this as wilfully misconstruing (for political purposes) how sovereign currencies actually work. Foreigners cannot influence the ability of countries like the US, UK, Japan, China and Australia who issue their own currencies. (This would not be the case if the UK had joined the EU single currency.) Buying goods from abroad is not losing and both sides have benefitted from increases in world trade.
- *Entitlements to social programs are propelling the country to long term financial crises:* instead what really matters is the economy's long-run capacity to produce real goods and services people will need, not its ability to meet arbitrary financial targets whose achievement reduce long term productive capacity and employment.

Kelton sees the real crisis as the numbers of children in poverty, inequality at record levels and the failure to anticipate climate change.

She understands the risks of inflation to be in overspending beyond the limits of existing capacity, not in incurring deficits. The national debt poses no financial burden while interest payments (as currently) are at a record low. Trade deficits are seen as increasing both wealth and collective savings as imports buy goods and exports generate sales. Social programs are always supportable and their impact results in gains to the private sector through the multiplier effect, as income is spent and multiplied.

The reaction to these arguments have been to claim that the old enemy of inflation has not yet been beaten and that increased spending would threaten both its return and the value of the currency, as foreigners see the risk of inflation reducing the real value of their holdings expressed in dollar terms and sell sterling denominated assets.

These arguments are not abstract. Real experiments are being conducted around the world. The experience in Japan is of massive increases in spending created by government with the aid of the Central Bank. This has led a very high level of national debt but accompanied by no surge in inflation or loss of faith in the Japanese economy in the long term – the opposite in fact. In contrast, the experience in the UK is that the austerity policies promoted by the Conservative governments since 2010 have resulted in more damage to the long term prospects of the UK economy and in its short term economic performance.

Kelton does not say that future inflationary pressures are not concerns that should or will be ignored, but accurately points out these are not current or likely problems in the foreseeable future. She merely asserts that governments have more monetary flexibility and means to address problems than has been recognised before.

From what I can tell by reading the text and searching other reviews,<sup>6</sup> no one is saying that the theory is wrong or that it does not accurately describe the real world; but what they are saying is that politicians cannot be trusted with the knowledge.

What we are seeing is the arguments of the 1970s and 1980s relived. In effect Kelton is championing neo-Keynesianism, more interested in reducing unemployment and boosting productive forces, and thus defeating a monetarism that is (like a scene from Groundhog Day) keen on re-fighting a battle against inflation, long after the world has moved on.

The twist to this tale, however, is that in the 1970s Tony Benn wanted an active industrial policy accompanied by a large boost to infrastructure spending and other support to industry. Because this would be prohibited by EEC rules, Benn was against EEC membership. In 2020 Benn's role is apparently being taken by Boris Johnston.

As evidence for this one can refer to his recent announcements in Dudley on 30 June which invoked Roosevelt's New Deal, a massive boost to investment and support to industry in order to overcome the adverse effects of the recession caused by the COV19 pandemic.

The Prime Minister also signalled an intent to change the government's own 'green book' rules that will make it easier to push projects past the Treasury<sup>7</sup> and to cut planning regulations. Johnson has form for making lots of noise in favour of grand projects without actually delivering very much, but he will probably will have more success than Tony Benn.

For example, we have seen him give HS2 the go ahead as Prime Minister, promise increased investment in the North,<sup>8</sup> and promise more investment in the NHS.<sup>9</sup> His chancellor in the Spring budget announced extra funds in science and research as well as £600 billion for roads, rail, broadband and housing by the middle of 2025.<sup>10</sup> Before he was PM, Johnson previously had put his neck out to support investment in Green

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<sup>6</sup> For instance <<https://tinyurl.com/y99exaqs>> or <<https://blogs.lse.ac.uk/lsereviewofbooks/2020/06/22/book-review-the-deficit-myth-modern-monetary-theory-and-the-birth-of-the-peoples-economy-by-stephanie-kelton/>> and <<https://seekingalpha.com/article/4355605-review-of-stephanie-keltons-deficit-myth>>

<sup>7</sup> <<https://tinyurl.com/y9lysfca>> or <<https://www.thetimes.co.uk/edition/news/rishi-sunak-pledges-treasury-rules-overhaul-in-budget-7psqxnn96>>

<sup>8</sup> <<https://tinyurl.com/yczpzccv>> or <<https://www.theguardian.com/uk-news/2019/dec/27/treasury-plan-change-rules-increase-investment-north-of-england-midlands>>

<sup>9</sup> <<https://www.bbc.co.uk/news/uk-politics-49867376>>

<sup>10</sup> <<https://www.bbc.co.uk/news/uk-politics-51832634>>

energy and this has been followed through now he is in No. 10.<sup>11</sup> There are suspicions that this may be for the purposes of electioneering and grandstanding: the council set up to monitor the official industrial strategy already reports backsliding;<sup>12</sup> and Policy Exchange, while supporting increased spending at this time, identifies opposition within the Conservative Party towards the very idea of an Industrial Strategy and the practical problems of delivering investment projects.<sup>13</sup>

Could it be that one of the influences upon him is modern monetary theory? Prominent individuals such as Andy Haldane of the Bank Of England and Adair Turner, ex head of the Financial Services Authority, have taken unorthodox positions suggesting that 'helicopter money' and other unconventional measures may be required in addition to quantitative easing to restore health to the UK economy. Kelton is thus arguably neither wrong nor alone in her quest.

The Labour Party establishment lost power by supporting orthodox monetarism in the mid-seventies. Even now it's timid in using the power of the state to promote the interests of its supporters because it remains in thrall to the myths exposed by Kelton. Under Ed Miliband's leadership, in order to burnish its economic management credentials, it entered an election campaign offering to spend less on the NHS than the Tories.

The Labour Party has recently completed a review of its defeat in 2019<sup>14</sup> and it is further dispiriting to see that it interprets a key issue as being that voters evaluated the promises made to boost spending and to invest (for example in free internet provision) as unrealistic and unaffordable.<sup>15</sup> It is safe to presume that most Labour MP's are unfamiliar with the arguments in Kelton's book and err towards traditional monetarism as a basis for running the country.

Bryan Gould, one of the few Labour MPs with any claim to economic expertise, was quoted as saying in a postscript to the travails of the Labour Party in the seventies and eighties:

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<sup>11</sup> <<https://www.ft.com/content/bdab7682-0638-11ea-a984-fbbacad9e7dd>>

<sup>12</sup> <<https://tinyurl.com/rqvt56z>> or <<https://www.theguardian.com/politics/2020/feb/19/watchdog-attacks-tories-for-neglecting-industrial-strategy-boris-johnson-uk-economy>>

<sup>13</sup> <<https://tinyurl.com/ydhjoop6>> or <<https://www.conservativehome.com/platform/2020/06/graham-gudgin-to-meet-its-infrastructure-ambitions-the-government-should-spend-more-on-capital-investment.html>>

<sup>14</sup> <<https://electionreview.labourtogether.uk/chapters/the-issues-in-this-election>>

<sup>15</sup> '... Labour's policies were individually popular, but the overall package raised concerns about affordability, economic risks or damage, a lack of realism and crucially, an inability to deliver on the promise of real change.' For source, see footnote 14.

'I found that most of my colleagues had no knowledge of economics and either steered well clear of economic policy – preferring to concentrate on more general topics such as foreign or social policy – or else they swallowed whole the current orthodoxy since they had no capacity to take an independent view. Gordon Brown fell into this latter category – Tony Blair the former. John Smith had only a rudimentary knowledge of economics, but was a little more confident on the nuts and bolts of tax and accounting. I don't think these failings are unique to the Labour Party. I think one of the reasons for all of this is that economists have made economics such an arcane science that most people are frightened off it.'<sup>16</sup>

Nothing seems to have changed much but Kelton wants to do something about it.

Could it be that modern monetary theory will provide the intellectual basis for Johnson to defeat the Labour Party for a generation to come by taking the theories of Wynne Godley more seriously than Labour? The more likely scenario remains that Johnson reverts to type and, after talking a good fight, will find distractions and excuses for neglecting to deliver on investment and spending promises. Is it too much to hope this gives an opportunity for Labour to seize the ideas and theories clearly laid out in this book? They are theories which seem to have widespread economic credibility and which promise to win support in good time before the next general election.

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<sup>16</sup> <<https://tinyurl.com/y8ccze3t>> or (<https://www.lobster-magazine.co.uk/free/lobster63/lob63-two-goulds.pdf>>