Funding the Future

Keynes vs MMT: which economic theory fits our world?

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Is Modern Monetary Theory just Keynes rebadged? Many think so—but they’re wrong. This video compares Keynesian ideas on borrowing and balanced budgets with MMT’s claim that governments create money when they spend. Understanding this difference changes how we think about debt, inflation, and what governments can really do.

https://www.youtube.com/watch?v=ZGFpBU37riM?si=rnFIFdWui-9ZSkA8

This is the audio version:

https://www.podbean.com/player-v2/?i=uxskt-194f714-pb&from=pb6admin&share=1&download=1&rtl=0&fonts=Arial&skin=f6f6f6&font-color=auto&logo_link=episode_page&btn-skin=c73a3a

This is a summary:

Summary

Both Keynesianism and MMT reject neoliberal “leave it to markets,” but they’re not the same.

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Keynesianism (1930s, gold-standard mindset): Treats government like a borrower facing money scarcity. Borrow in slumps, repay in booms; balanced budgets are a goal.

Inflation fear sets limits. Monetary policy (independent central banks, interest rates) is central alongside fiscal stimulus.

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MMT (fiat-currency world): The currency-issuing state can’t run out of its own money. Spending comes first; taxation mainly withdraws purchasing power to control inflation and anchors currency demand. Borrowing is optional—bonds are safe savings vehicles, not funding. The real constraint is resources and capacity, not finance. Policy should be fiscally led, with low/near-zero interest rates, aiming at full employment. Sectoral balances are key to understanding: public deficits = private surpluses.

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So what? Drop the household analogy. Judge policy by real outcomes (jobs, capacity, inflation), not the size of the deficit. Austerity is a choice, not a necessity. Keynes was right for his time; MMT is better suited to the post-gold-standard economy and offers a more effective toolkit now.

This is the **transcript**:

This video is about a really important topic. It's a little complicated, but I think it's worth your while to get your head around the difference between modern monetary theory (MMT) and Keynesian economics. Both of these have a strong appeal to people on the left of politics, but they're not the same and understanding the difference is really key if you're going to understand what we need to do to end up with the economy that we want. So let's delve into the details.

Let's be clear, both MMT and Keynesian economics emphasise the role of government in the economy. That's something that they share in common, and this puts them in direct contrast with the mainstream of neoliberal thinking, which, of course, says that government has no desirable role in the economy. So there's a clear dividing line between these two and neoliberalism, but that does not mean they're the same.

Keynesianism emerged in response to a crisis. Keynes was writing in the 1930s during the course of the Great Depression of that decade, and in some ways, MMT emerged in the same way during the course of a crisis because there were crises in the 1990s, because there was a lack of understanding at that point about how banking, money, taxation, and everything should work, and it emerged in that decade.

They both share concerns about unemployment, and they both focus on the role of government in economic management. So there are common grounds. And during the course of this video, I'm going to compare those commonalities under a number of headings. But the point is, they also have radically different assumptions underpinning them about money and the role of government finance.

Let's start with Keynesianism, simply because it came first. Keynes wrote in response to the Great Depression of the 1930s.

His most significant work, his 'General Theory', was published in 1936. He showed that markets could stabilise at levels where unemployment could continue indefinitely. In other words, the assumption within neoclassical economics, which had been the norm at that point in time, that markets provided optimal outcomes, where all the resources of society were put to best use, was wrong.

It was a simple matter of fact that markets could deliver long-term unemployment, and that was clearly not optimal because he only had to look out of the window and see the resulting poverty that was being created during the course of that decade, and all the stresses that were created, which did, of course, lead eventually to the outbreak of World War Two.

Left alone, then he realised that the economy would not self-correct or restore prosperity. So he promoted the idea that active government intervention was necessary through fiscal stimulus to restore markets to a level where they could create and deliver full employment.

Keynes saw government as if it was a household. In this sense, he was remarkably like the neoclassicists of whom he was one in a sense. He was on the bridge between neoclassicism and the new world that was going to emerge after the Second World War, where neoclassical economics split into different schools, including Keynesianism and neoliberalism, and now others.

He thought that governments were financially constrained by the shortage of money. And we do have to put that into the context of the time. Remember, he was working with the gold standard. The UK had only just come off this standard when he wrote his General Theory. And the USA was still on the gold standard, and we had fixed exchange rates with the USA, and so, in effect, the UK remained constrained by the thinking of the gold standard. And that said that if a government wanted to borrow, it had to go into financial markets to secure the money it needed by paying a sufficient price to stop it from being used for some other purpose. It was assumed that there was a shortage of money in the economy and that the government could do nothing about it.

But despite this, Keynes said borrowing was justified in downturns to boost demand. He made the point that if markets had no use for money, then the government should put money to use to increase demand to the point where full employment was recreated.

But, and he made the point very clearly, this borrowing came with an obligation to make repayment. He saw that there might be a cycle wherein downturns, the government will borrow, and when things were going well, there would be repayment.

The reality is that this has never happened. Actually, neo-Keynesian thinkers, those who developed along Keynesian lines after the Second World War, but not strictly following what Keynes had to say, have rather abandoned that idea. But that was what Keynes originally said.

Modern monetary theory's origins are quite different. It emerged in the 1990s, and the underpinning assumptions are quite dissimilar to Keynes's because the world had changed significantly in the meantime.

In particular, the world had by the 1990s forgotten about the gold standard. There was no country in effect left on it. The USA was the last to leave in 1971, and we were now living in a fiat currency world. Fiat currencies are those that are made by governments and declared to be legal tender by law, but actually have no asset backing whatsoever. They only have value because the government issues a promise to pay on the notes that it makes and demands that payment be made to them for the taxation that is owing in the currency in question, meaning that the currency does, as a consequence, acquire value.

And what this suggests is that there isn't a shortage of money supply. In fact, as modern monetary theory points out, quite to the opposite of Keynesian thinking, governments create all the money that we use. It isn't some external force that gives it value. It is the government. And the money that we have is created by government when it spends, and it puts money into operation via its central bank operations. This insight transformed how we think about borrowing, taxation and deficits.

In MMT, spending comes first. Governments create the money to make the payments that they want.

Taxation and borrowing then follow.

Taxation is there largely to control inflation. In fact, that is its primary function, and borrowing is not necessary, but is undertaken to provide a facility to the City of London, in particular, and to other financial markets around the world, where money is to be deposited by those with wealth, but the money in question has been created by the government in the first place. So financing is, in this case, never a constraint. Unlike in the Keynesian worldview, in the MMT world, the constraint is not a shortage of money; it's the shortage of real resources.

And this difference is key to the understanding that one has to have of the differences between Keynesianism and MMT. Keynes still thought money was the constraint. And in the case of MMT, the constraint is the availability of real resources.

And this has consequences over a range of policy issues. And I'm going to explore these now, picking up in each case a topic and why Keynesianism, among modern monetary theories, see them differently.

Let's start with debt. Debt was seen by Keynes as a liability, creating a future obligation on government to make repayment. It had to be sustainable relative to GDP, and large deficits were only tolerated temporarily. So, in other words, Keynes assumed that governments would always want to run periods of surplus in their own budgets, following periods of unemployment and depression or recession, because they would wish to repay debt. Over the long term, Keynes believed that balanced budgets were desirable because he assumed that money was the constraint on government activity.

He did, therefore, subscribe to what was then the neoclassical view and what is now the neoliberal view, which is why Keynesians, by the way, now are neoliberals, that it's money that does constrain government and that they must run balanced budgets as a consequence; an idea, which, of course, modern monetary theory says is false.

Modern monetary theory views debt in a very different way. Public debt is not seen as a burden on future generations in MMT. It is simply a record of private sector savings lodged with the government in the MMT view. This is what it thinks what is called debt should be viewed as. It isn't a liability for repayment. It's a voluntary action by savings markets to place money in the safest place that they can, which is with the government. And government bonds are therefore just savings accounts. And just as we have no problem with banks taking in savings - in fact, we think they strengthen them - so, too, is that the case with governments. If people want to save with the government, that's good news. It strengthens the government by providing it with a line of credit, but there's nothing more to it than that. Issuing bonds is then a policy choice and not a necessity.

Let's then look at another key area of difference, and this time it's inflation. The Keynesian view of inflation was that governments could run deficits until full employment was reached. Now, to some degree, there is commonality here with MMT, as we'll see in a moment, but the point was that beyond that point of full employment, inflation was a major risk, and the focus was so heavily on money in the Keynesian viewpoint, which most people now forget, that the avoiding of inflation became the priority in Keynesian thinking. The overheating of the economy was something to be so definitely avoided that, in fact, inflation acted as a constraint on the idea of stimulus.

And so we see that now. This idea feeds into the idea that we have of austerity. It is actually a major problem for modern thinking on economics, because the neo-Keynesians subscribe with the neoliberals, with whom they basically share a lot of common ground these days, in thinking that austerity is necessary to prevent the risk of inflation. They're so frightened of it that they will not let the real economy work, and that is, of course, contrary to what Keynes was actually trying to say.

MMT takes a slightly different view of inflation. It does undoubtedly have an obsession with the subject, just as Keynesianism does, but it makes the point that because the government can never run out of money, money isn't the constraint on the system.

Inflation is also controlled by taxation because it is a monetary phenomenon. Again, they make the point that this isn't a phenomenon external to government. It is one created by government if it overspends. And so the emphasis is upon the government managing the real economy; the real economy being the one where actual transactions are undertaken to meet need. And the aim is to ensure that there's an equilibrium between the real economy and the monetary economy so that the government creates enough money to make sure that the real economy can function to its full capacity without inflation arising. And in this equation, tax is the balancing act.

So MMT is obsessed with the real economy, and Keynes is obsessed with money. This results in different policy tools being used between the two systems.

In Keynesian thinking, there is both fiscal and monetary policy. The government adjusts spending and taxation to stimulate or dampen demand, and central banks are used to adjust interest rates to manage investment and inflation.

In other words, Keynesian thinking is entirely consistent with the idea of independent central banks and this idea that somehow or other monetary policy and fiscal policy can be managed side by side with neither talking to each other, and that's okay with regard to the overall control of the economy, which, is of course, complete nonsense because monetary policy is the flip side of fiscal policy. Money and taxation, and therefore the level of deficits that are managed, are all related subjects. Keynes didn't really get that, and so Keynesian thinking is disjointed, whereas in contrast, MMT is connected.

In MMT, monetary policy is considered to be a blunt and often ineffective instrument. Changing interest rates is not promoted as an idea for controlling inflation, or stimulus, or anything else. And the reason why is it takes so long to have effect. On average, it's thought that it takes at least two years for a change in interest rates to have an impact on the real economy and by that time, whatever it was that you wanted to change has become deep, dark history, and you're probably looking at another totally different policy consequence by now, which may be favourable or unfavourable, but which has nothing to do with the problem you were talking about when you changed the interest rate.

So, instead, MMT looks at something that is much more direct, and that is fiscal policy. In other words, the difference between government spending and taxation. And it can either make change by increasing or reducing government spending or increasing or reducing taxation to find the right balance that suits the economy to drive it towards full employment, which is always the aim.

As a consequence, MMT normally promotes having a near-net-zero interest rate permanently. In other words, there should be no real interest payment, having allowed for inflation, and some people actually would prefer it to be below zero for that purpose. And there's also a focus in MMT on delivering full employment. Some people will talk about a job guarantee for that purpose. Others, like me, will put emphasis upon other measures, but the point is, full employment is actually the goal, and that is what is borne in mind when all of these other tools are used.

Keynesian framing is different, then, from MMT framing. Keynesian framing is influenced by orthodox metaphors, such as the household and its balanced budget. Debt sustainability is a priority for Keynesian framing because they think that there is a risk of borrowing too much and leaving a burden to future generations, because inside Keynesian thinking is this obligation to make repayment, which is nonsensical when we see debt through an MMT framing, and deficits are only tolerated in the short term, which again, is difficult to understand now because we've hardly had a surplus in any years since World War Two.

In other words, the whole of the framing of Keynesianism is in fact about fear of financial markets and the retribution that they might take if government does not follow what they wish to be done. And that, of course, feeds in to the whole of the policy crisis that we now see in the UK, where austerity follows because of a failure to think about the consequences of such a policy.

MMT rejects this framing. It rejects the household analogy entirely. It does not see government deficits as being a problem. It sees them as being the private sector surplus.

And something called the sectoral balances, which were created by an economist in Cambridge called Wynne Godley in the 1990s explained this in a way that Keynes could never have understood.

Deficits are a tool to create balance then. And not a tool which indicates mismanagement. The aim is to deliver full employment and not to create a balanced budget for the government. If the government can balance the real economy, its finances will, in the MMT model, and this has been demonstrated by people like Steve Keen, ultimately balance in a way that they could never do otherwise. And therefore, MMT has an entirely different view of the relationship between government and the economy, because the government is actually the driver and not the dependent agency within economic activity.

This then lets us view in summary the differences between Keynesianism and MMT.

Keynesianism is about borrowing, spending and repaying later, always being mindful of debt. The obligation on governments is to eventually balance their books, and to balance that against the obligation to provide growth, so they can have an imbalance in their books when the economy is suffering, but when it is booming, the expectation is that they should repay the debt that they have taken on.

This is fundamentally different to the approach in MMT, of course, and in fact, we haven't seen it, which is one of the reasons why Keynesian economics is largely discredited. Inflation, according to Keynes, sets the limits once full employment is approached, and central banks retain a very strong economic management role through monetary policy.

In contrast, and again, in summary, MMT says, governments do not need to borrow in their own currency, but they are welcome to take deposits from those who wish to place them with them. Spending in the MMT worldview creates our money. Taxation and bonds withdraw it from circulation, and in the case of taxation, quite literally destroy it. Inflation is then a true constraint, but the absolute underlying constraint is the capacity of the real economy to deliver for the people of the country. And it is that in MMT, which is the focus of government economic management, whereas in the Keynesian worldview, it is the government's own finances that are the focus of economic management.

This means that these two systems of economic thought are fundamentally different.

MMT is a post-Keynesian worldview. As I said at the beginning, there are some similarities, including the belief that the government should play a role in the economy, but to pretend that they're the same is a deep mistake. Neo-Keynesianism, just like neoliberalism, needs to be consigned to history. It is a part of history. The world that it described, the world that gave rise to it, is no longer with us. MMT describes the world as it is and provides us with tools to manage that economy. We need an MMT worldview if we are to have successful economies in the future, and governments that know what they're doing.

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