Economic questions: the Wynne Godley question

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This is one of a series of posts that will ask what the most pertinent question raised by a prominent influencer of political economy might have been, and what the relevance of that question might be today. There is a list of all posts in the series at the end of each entry. The origin of this series is noted here.

After the first two posts in this series, the topics have been chosen by me, and this is one of those. This series has been produced using what I describe as directed AI searches to establish positions with which I agree, followed by final editing before publication.

Why have I included Wynne Godley in this series when relatively few people have heard of him, and he has no major economic policy book bearing his name, despite his years of work as an academic economist, having previously been a professional classical musician? That is because he created the concept of sectoral balances, which are essential for demonstrating that a proper understanding of economics must be based on the fact that all actions have a reaction and that in every transaction there are always two parties. To suggest that the consequence for only one may be taken into consideration when considering economic policy is wrong, but commonplace, and it took a brave economist to point this out, and to rationally support their arguments, as Godley did.

As I explained in a glossary entry that supports this blog, comprehension of sectoral balances is essential to achieve a proper understanding of monetary macroeconomics within a modern fiat currency economy. It is not possible to achieve that goal using the standard approaches of neoclassical and neoliberal economics because they fail to take into consideration both the proper use of money within a fiat currency economy and the nature of economic relationships, most especially when it comes to the government and its role as the creator of the currency and borrower of last resort within the economy for which it is responsible. That is why Godley deserves a place in this series.

Wynne Godley was not a fashionable economist. He did not offer elegant optimisation models or reassuring market narratives. Instead, he did something far more dangerous: he insisted on accounting consistency. Godley's work was grounded in a simple, unavoidable truth, which is that in a closed system, financial flows must balance. What one sector spends more than its income, another must spend less. Deficits and surpluses are not moral choices; they are accounting identities.

From this starting point, Godley developed a framework of sectoral balances and stock-flow consistent modelling that allowed him to do something almost no mainstream economist managed, which was to predict crises before they happened, and explain precisely why they would happen. He warned repeatedly that policies designed to force governments into surplus would, by necessity, push households or firms into debt. He foresaw the unsustainability of the US boom of the late 1990s, the fragility of the UK economy, and the inevitability of the eurozone crisis. His predictions were not lucky. They were arithmetically inevitable.

Hence, the Wynne Godley Question: ***If the financial balances of the economy must add up, and governments can see this in advance, why do they continue to pursue policies that make crises inevitable and then pretend to be surprised when they arrive?***

Accounting as realism, not ideology

Godley's economic starting point was disarmingly simple. He said that you cannot ignore accounting identities. The government sector, the private domestic sector and the foreign sector together must sum to zero. If one sector runs a surplus, another must run a deficit. This is not a theory. It is a fact.

Yet modern economic policy routinely behaves as if this were optional. Governments talk about "balancing the books" without asking whose books will be unbalanced as a result. They celebrate public surpluses while ignoring the private debt that must emerge elsewhere. Godley saw this as not merely an intellectual error but a form of institutionalised denial.

The fallacy of virtuous government surpluses

Godley was particularly critical of the political obsession with government surpluses. A government surplus is often presented as proof of prudence and responsibility. Godley showed that it is usually a warning sign. If the foreign sector is in surplus, as it is for countries running trade deficits, then a government surplus can only be achieved by forcing the private sector into deficit.

That deficit must then be financed by borrowing. Household debts then necessarily rise, meaning financial fragility increases. A crisis becomes a matter of time, not chance.

Godley’s analysis revealed that what politicians call “sound finance” often amounts to deliberately engineering private instability.

Why crises are predictable

Because Godley’s models tracked stocks as well as flows, they revealed how imbalances accumulate over time. Rising private debt is not a neutral adjustment; it is a destabilising process. When income growth cannot support debt growth, collapse follows.

This is why Godley could predict recessions and crashes with unsettling accuracy. He was not forecasting sentiment. He was reading the balance sheets. Where mainstream economics saw equilibrium, Godley saw trajectories heading toward breakdown.

The fact that policymakers ignored these warnings is one of the great indictments of modern economic governance.

Europe as a monument to ignored accounting

The eurozone crisis was a textbook Godley moment. By removing monetary sovereignty from member states while allowing free capital movement, the euro locked countries into a system where trade imbalances could not be corrected. Surpluses in Germany required deficits elsewhere. Those deficits showed up as private debt in Spain, Greece and Ireland until the system broke.

Godley warned that the euro would fail without a fiscal union. He was dismissed as pessimistic. Crises proved him right. The suffering that followed was not inevitable. It was the price of ignoring arithmetic.

The moral dimension of consistency

Godley’s work carries a moral force that is often overlooked. Policies that ignore sectoral balances do not fail randomly. They fail by shifting risk and pain onto households, workers and the vulnerable. Austerity is not neutral. It reallocates instability downward.

By insisting on stock-flow consistency, Godley sought to force policymakers to confront responsibility. If a government chooses to cut its deficit, it must be honest about who will absorb the corresponding deficit instead. There is no escape from that choice, only denial.

Why Godley was sidelined

Godley’s approach was inconvenient. It stripped away comforting narratives about discipline, thrift and market self-correction. It exposed how fiscal rules, balanced-budget targets and austerity programmes are often incoherent. And it implied that governments have far more responsibility, and far more power, than they admit.

Mainstream economics prefers models that allow failure to be blamed on shocks, irrationality or bad luck. Godley allowed no such refuge. When the numbers did not add up, the policy was wrong.

What answering the Wynne Godley Question would require

To take Godley seriously would require a fundamental change in how economic policy is designed and justified. That would mean:

* Putting sectoral balances at the centre of fiscal policy requires asking who will run deficits when the government does not.
* Abandoning fetishism about balanced budgets means recognising that government deficits are often necessary for private stability.
* Using stock-flow consistent models in policymaking means tracking debt accumulation and balance-sheet fragility explicitly.
* Ending austerity economics requires acknowledging it as a recipe for private indebtedness and crisis.
* Restoring honesty to economic debate means admitting that fiscal choices redistribute risk, not eliminate it.

These steps would not make policy reckless. They would make it coherent.

Inference

The Wynne Godley Question exposes a deep failure at the heart of modern political economy: the refusal to accept arithmetic based on accounting logic that creates undeniable identities that policymakers cannot avoid. Godley showed that economies are not governed by moral stories about thrift and discipline, but by balance sheets that must reconcile. Ignoring those balances does not produce virtue. It creates a crisis.

That governments continue to ignore these truths, even after repeated disasters, is not ignorance. It is a choice, including a choice to prioritise ideology over accounting, narrative over reality, and political convenience over social stability.

Godley's legacy is therefore both analytical and ethical. He reminds us that economic responsibility begins with honesty about who bears the consequences of policy, and that pretending otherwise is not just bad economics, but bad governance.

Previous posts in this series:

* ***The economic questions***
* ***Economic questions: The Henry Ford Question***
* ***Economic questions: The Mark Carney Question***
* ***Economics questions: The Keynes question***
* ***Economics questions: The Karl Marx question***
* ***Economics questions: the Milton Friedman question***
* ***Economic questions: The Hayek question***
* ***Economic questions: The James Buchanan question***
* ***Economic questions: The J K Galbraith question***
* ***Economic questions: the Hyman Minsky question***
* ***Economic questions: the Joseph Schumpeter question***
* ***Economic questions: The E F Schumacher question***
* ***Economics questions: the John Rawls question***
* ***Economic questions: the Thomas Piketty question***
* ***Economic questions: the Gary Becker question***
* ***Economics questions: The Greg Mankiw question***
* ***Economic questions: The Paul Krugman***
* ***Economic question: the Tony Judt question***
* ***Economic questions: The Nancy MacLean question***
* ***Economic questions: The David Graeber question***
* ***The economic questions: the Amartya Sen question***
* ***Economic questions: the Jesus of Nazareth question***

* ***Economic questions: the Adam Smith question***
* ***Economic questions: (one of) the Steve Keen question(s)***
* ***Economic questions: the Stephanie Kelton question***
* ***Economic questions: the Thomas Paine question***
* ***Economic questions: the John Christensen question***
* ***Economic questions: the Eugene Fama question***
* ***Economic questions: the Thomas Hobbes Question***
* ***Economic questions: the James Tobin question***
* ***Economic questions: the William Beveridge question***
* ***Economic questions: the William Nordhaus question***
* ***Economic questions: the Erwin Schrödinger question***
* ***Economic questions: the Karl Polanyi question***
* ***Economic questions: the Richard Feynman question***

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