

Functional Finance



By Byron A. Ellis - August 19, 2013

Abba Lerner¹ stated that the first responsibility of the government is to ensure that the rate of spending in the country could purchase all goods and services produced at current prices. He was arguing that the government should not allow a loss of consumer purchasing power.

He understood that inflation would occur if total spending were higher than the level of goods and services produced, if it were less, deflation and unemployment would occur.

Today, however, most policymakers are not concerned with the demand deficit. Many support cutting government spending and transfers and restricting the money supply.

However, the economy cannot grow if consumers are unable to purchase all goods and services produced.

Lerner noted that taxation should never be undertaken to close the government deficit since its main effect is to reduce taxpayers' disposable income and increase government coffers. Expanding the government's coffers can be achieved by printing more money.

According to Lerner, taxation should be imposed when taxpayers should have less money to spend, for example, to lower the rate of inflation.

In terms of government borrowing, Lerner argued that it should only occur when the public should have less money and more government bonds. Likewise, government lending should only happen when it is desirable to increase cash or reduce the number of bonds held by the public.

Lerner's functional finance recommendations are like condition-based maintenance (CBM) practiced by maintenance engineers. It assesses and anticipates events that could degrade the economy and adjust to maintain stability.

This view is contrary to the worldview of free-market proponents; they believe that some abstract entities, the market, can assess and optimize the economy.

If maintenance engineers adhered to such belief, that some abstract entity optimizes machines' performances, the rate of mechanical failures would be astronomical.

¹ Lerner, Abba, 1943. "Functional Finance and the Federal Debt." *Social Research*, Vol. 10, No. 1, February, pp. 38-52

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