

Economic questions: the Abba Lerner 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 its relevance is today. A list of all posts in the series appears at the end of each entry. The [origin of this series is noted here](#).

Abba Lerner fits very naturally into this series because he asked one of the most subversive questions in public finance: should governments judge fiscal policy by accounting rules, or by what actually works? His answer, called functional finance, directly challenged the moralised language that did, and still does, dominate debates about government deficits and debt. His thinking has become one of the underpinnings of modern monetary theory.

[Abba \(Abraham\) Lerner](#) (1903 - 1982) was one of the most original economists of the twentieth century, yet he remains far less well known than many of his contemporaries. Working alongside and extending the ideas of John Maynard Keynes, Lerner developed what he called functional finance, which is a radically simple proposition that cuts through much of the confusion surrounding government budgets.

Lerner argued that governments should not treat their finances as if they are households balancing their bank statements. He pointed out that the state issues the currency that the economy uses. Its fiscal policy should therefore be judged not by whether the budget is balanced, but by whether the economy functions well: whether people who want work can find it, whether inflation is controlled, and whether resources are used productively.

In other words, fiscal policy should be evaluated by its outcomes, not by accounting conventions.

*Hence the **Abba Lerner Question: If the purpose of government finance is to ensure full employment, price stability and social wellbeing, why do we***

continue to judge fiscal policy by arbitrary rules about deficits and debt rather than by whether it actually works?

The difference between sound finance and functional finance

Lerner contrasted two ways of thinking about public budgets. The traditional doctrine of sound finance treats government like a prudent household: deficits are dangerous, debts must be repaid, and balanced budgets are a sign of responsibility.

Functional finance rejects this analogy. A sovereign government's finances are not constrained in the same way as private finances because the state creates the currency used to pay taxes and settle obligations. What matters is not whether the books balance in any particular year, but whether fiscal policy achieves economic stability and social goals.

Balanced budgets may sometimes be appropriate. At other times, they are disastrous. The test is function, not form, hence the name given to this thinking.

Unemployment as a policy failure

For Lerner, persistent unemployment is evidence that fiscal policy is too tight. If people who want to work cannot find jobs, the government has failed to create sufficient demand in the economy. The appropriate response is straightforward: increase spending or reduce taxes until employment is restored.

This approach turns the usual narrative upside down. Instead of asking whether the government can "afford" to support employment, Lerner asks whether society can afford not to. Idle labour and unused resources represent lost production and unnecessary suffering.

Functional finance, therefore, places employment, not deficit reduction, at the centre of economic policy.

Inflation as the real constraint

Lerner did not deny that government spending has limits. The limit is inflation. When the economy reaches full capacity, and additional spending pushes prices upward, fiscal policy must adjust, either through taxation, spending reductions, or other measures that reduce demand.

This is a crucial point often missed by critics. Functional finance is not an argument for unlimited spending. It is an argument for using fiscal policy actively and intelligently, guided by real economic conditions rather than arbitrary financial targets.

In Lerner's framework, the constraint is not the size of the deficit but the availability of resources.

The politics of deficit fear

If Lerner's reasoning is so clear, why has it been resisted? One reason is political. The language of fiscal restraint serves powerful interests. It disciplines governments, limits public investment, and narrows the range of legitimate policy options.

Deficit anxiety can therefore function as a political tool. By presenting government spending as inherently risky or irresponsible, it discourages policies that might redistribute wealth, strengthen public services or expand social protection.

Lerner understood that economic doctrines can become ideological shields for existing power structures.

Functional finance and modern monetary debates

In recent decades, Lerner's ideas have found renewed attention through debates about modern monetary theory and fiscal policy in sovereign currency systems. These discussions echo Lerner's central insight: that governments must focus on the real economy and employment, productivity, inflation, and public well-being, rather than treating deficits as moral failures.

The persistence of austerity policies after financial crises demonstrates how far policy remains from this principle. Governments often tighten budgets precisely when the economy most needs support.

In Lerner's terms, this is the opposite of functional finance.

What answering the Abba Lerner Question would require

Taking Lerner seriously would require shifting the framework through which fiscal policy is judged. At minimum, that would involve:

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Evaluating government spending by its economic outcomes, not by deficit targets.

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Treating unemployment as a signal of insufficient demand, not as an unavoidable market outcome.

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Using taxation as a tool to manage inflation and inequality, not merely to "fund" spending.

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Rejecting household analogies in public finance, recognising the institutional differences between states and private actors.

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Designing fiscal policy around real resources and social needs, rather than financial myths about affordability.

These changes would not make policy reckless. They would make it responsive to economic reality.

Inference

The Abba Lerner Question reveals how much of modern fiscal debate rests on misleading analogies and inherited habits of thought. Governments that control their own currencies are not constrained in the same way as households, yet public discourse continues to treat budget deficits as evidence of irresponsibility rather than as policy tools.

Lerner's insight was simple but profound: the success of economic policy should be judged by whether it delivers employment, stability and shared prosperity. Fiscal rules that ignore these outcomes are not safeguards of prudence — they are obstacles to effective governance.

To answer Lerner's question is to recognise that public finance should be guided by purpose rather than by accounting ritual and that the ultimate test of fiscal policy is whether the economy works for the people who live within it.

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