second, the need for high-quality labour market data obtained through survey analysis (chapter 6).

The book’s opening chapter discusses “manpower planning” techniques. This field, which had its heyday in the post-war period, is reminiscent of the golden age of central planning. In the second chapter, Hopkins goes on to provide a chronological review of successive theories of labour supply. Here, he focuses on the explanations advanced by each of these theories to account for labour market imbalances. The following chapter outlines the concepts used in analysing the functioning and structure of the labour market, together with related measurement concepts. Factors such as supply, demand and job quality are examined in detail. Issues like informal-sector employment and underemployment are considered in separate sections of chapter 3.

Turning from theory to practice, Hopkins then proposes an analytical tool, namely, a mathematical model designed to test the various theories and their implications empirically. His model, like any other, is a compromise that draws on different theories, imperfect statistical measures as proxies for particular concepts, and analysis of available data bases. Here, the author engages in some important thinking, which other books on the subject have all too often dispensed with. He also shows how his model can be used both to check for consistency between the labour market elements and agents represented, and to generate results that integrate the multiple interrelationships which exist between those elements and agents. An entire chapter (chapter 5) explains how the model was constructed and how to interpret results, based on a case study of Sri Lanka. This discussion is mostly organized around different “scenarios” or “alternative trajectories” from which development analysis can proceed. The connection with policy-making is made at the end of the chapter, in an illustration of the usefulness of this tool and its advantages for decision-makers and planners.

The sixth chapter highlights the crucial importance of information in planning, with an outline of several surveys conducted by the author on issues related to employment planning (in a broad sense). This chapter critically examines the problems posed by the concepts that are used, their transposition into a questionnaire, and their use as measures. This is the most interesting part of the book. It brings out the link between the work of survey staff and statisticians, on the one hand, and the concerns of database users, i.e. labour economists, on the other.

It is a pity the author does not elaborate more on his conclusions. In particular, he could have used his presentation of concepts and theories to synthesize a common body of knowledge, with the shortcomings of some concepts and theories being offset by the strengths of others. Also somewhat disappointing is the lack of reference to the institutional setting in which they were developed.

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This volume is the outcome of a conference on "Functional Finance and Full Employment", held at the New School for Social Research, New York, in the spring of 1998, in an effort to revive Abba P. Lerner’s lifelong effort to develop an alternative to the orthodox “sound finance” view of monetary and fiscal policies. Nell and Forstater have put together a set of thought-provoking papers that examine Lerner’s functional finance theory, linking it to transformational growth, full employment, price stability, labour market dynamics, as well as fiscal and monetary policies. Reinventing functional finance at this conference in 1998 was an attempt to counter the increasing enthusiasm in the United States for balancing the Government’s budget or even for running surpluses to pay off the national debt.

The conference was an unusual gathering of younger heterodox economists together with some of the major figures in 20th century economics in the United States, such as Richard Musgrave (Harvard University), the father of modern public finance, James Duesenberry (Harvard University), originator of the relative income hypothesis, Robert Eisner (Northwestern University), known for his pioneering work on budgetary policy and social security, and Robert Heilbroner (New School for Social Research).¹ This occasion also marked the last public appearance of Robert Eisner and Lynn Turgeon, both of whom passed away shortly after the conference.

The book is organized in six parts. In the introductory part, Heilbroner, Musgrave, and Nell set the stage for the broader discussion to follow. Nell rejects the Walrasian argument that the macro economy adjusts through a price mechanism. Indeed, he argues that the economy has no self-regulating features, “except in the government budget!”. Nell points out that sound finance and balanced budgets were appropriate for the craft economy, and that functional finance is appropriate for the economy of mass production and big government. Musgrave adds that “placing the active use of fiscal policy in cold storage involves a lost instrument and ‘paying off the debt’ is not the ultimate goal”.

Part two sets the historical background of the functional finance approach. David Colander shows that it was Lerner’s functional finance approach to fiscal policy that accompanied the Keynesian revolution in economics textbooks. This approach was attacked in the 1970s, and virtually disappeared after the advent of New Classical and New Keynesian economics. Colander claims that functional finance is consistent with multiple-equilibria models and rational expectations. It is in this sense that Colander sees the potential resurrection and development of functional finance. Forstater points to similarities and complementarities between Lerner’s functional finance and Adolph Lowe’s instrumentalism. He argues that a synthesis of their work “provides a framework for incorporating both monetary production and structural and technological change, and for analyzing both Keynesian and technological unemployment”.

Hans-Michael Trautwein presents Hans Neisser’s unorthodox quantity theory of money, making the case for activist government policies and showing the relationship between technological change and unemployment.

Perry Mehrling looks at functional finance in the light of Alvin Hansen’s views on the government role to provide social insurance, jump-start the stagnating economy, and act as a “balance wheel” to stabilize the economy over the business cycle. This leads Mehrling to address the role of functional finance in the present crisis of the welfare state.

Part three addresses the inflationary limitation of functional finance and countercyclical fiscal policy. Eisner demonstrates the empirical invalidity of the conventional belief in the relationship between unemployment and inflation. “The NAIRU [non-accelerating inflation rate of unemployment]”, Eisner writes, “is a dogma that has for too long undermined meaningful economic theory and paralyzed economic policy”. He argues that budget deficits should be allowed to increase the real value of private assets in the form of government debt until full employment is reached. Eisner’s chapter is followed by a transcription of an open discussion between him and the conference participants. Turgeon summarizes Lerner’s work on supply-side inflation, an issue of great concern for Lerner towards the end of his life. Fears of demand-pull inflation dominated the post-Second World War era leading eventually to the undermining of full employment policies until low levels of demand mixed with supply-side inflation, thus generating the stagflation of the early 1970s.

Musgrave shows the relationship between his three-branch model and Lerner’s functional finance. He argues that budgetary policy is a very complex process serving three functions, hence Musgrave’s three-branch model. The “Allocation branch” secures the efficient provisioning of public goods, the “Distribution branch” ensures their just distribution, and the “Stabilization branch” (equivalent to Lerner’s functional finance) involves the use of taxes and government spending as countercyclical tools to ensure full employment. Duesenberry critically surveys both theory and policy moves to trade off full employment against the reduction of inflationary pressures. He concludes that such trade-off was unnecessary and that it helped undermine the usefulness of fiscal policy and functional finance.

Part four deals with linkages between fiscal and monetary policies and argues against the conventional separation of the two. Randall Wray shows that money is created by government spending and destroyed by tax collection. A monopoly issuer of money, government does not need to tax in order to spend. Taxes only ensure the demand for money, give value to the currency, and drain excess reserves. Taxes cannot “finance” government spending because “spending” comes before “taxing”. The government does not need to “borrow” from the public either. Bonds are issued in order to provide the private sector with an interest-earning government liability to substitute for the non-interest-earning government HPM (high-powered money). In this sense, bond sales are seen as a tool of monetary policy rather than of fiscal policy. Open-market operations are then used to stabilize short-term interest rates around a desirable target, hence ensuring a favourable business environment. Wray also addresses the 1990s aphorism about surpluses that ought to be “locked away and saved” to “finance” government spending in the future. This, Wray shows, is a flawed argument that does not recognize that the government deficit (surplus) and the private sector’s surplus (deficit) are two sides of the same coin. Thus, the government’s deficit merely expresses the level of the private sector’s desire to net-save. It’s a zero-sum game.
Forstater derives 15 lessons from Lerner's principles of functional finance, and argues that a public-service employment programme could be implemented to ensure full employment. "There is no excuse for involuntary unemployment in today's world", Forstater concludes, "joblessness means only that we have not learned our lessons well". Nell argues that conventional thought about monetary relations was once relevant to understand the working of a craft economy, then "[a]s technology developed, production and employment took on new forms, and came to require different kinds of financing". He argues that monetary theory and policy have failed to adjust to these developments. Nell concludes by supporting an employer of last resort (ELR) programme that acts as an automatic countercyclical stabilizing device for the economy.

John Smithin develops an interesting macroeconomic growth model, focusing on the relationship between the real rate of interest, the rate of profit, the wage rate in the context of endogenous money, and Nell's theory of transformational growth. He shows that an easy-money policy could boost both wages and profits, provided that the rate of productivity growth keeps pace with the resulting increase in labour bargaining power. Part four concludes with the report of a roundtable discussion, in which Heilbroner, Musgrave, Eisner, Nell, Colander, Smithin, Duesenberry, and Forstater address ways and means of countering today's call for balanced budgets and surpluses.

Part five explores full employment theory and policy under the principles of functional finance. Per Gunnar Berglund addresses Lynn Turgeon's question about the need for taxing people when we have functional finance. Berglund develops a simple model for a closed economy and argues that taxes should be levied in order to keep the interest rate at a level lower than that of GDP growth. Only when the rate of interest is allowed to exceed the GDP growth rate, will the government debt be a burden on the private sector. Ingrid Rima advocates a "systems approach" to functional finance and labour markets, as opposed to the traditional analytical distinction between micro and macro. Rima sees three major subsystems in the economy: the production subsystem, the anthropogenic subsystem, and the monetary-financial subsystem. She then considers the ELR programme and explores several policy alternatives including tax cuts, wage subsidies, and trade policy.

William Mitchell presents the Job Guarantee (JG) programme as a tool to ensure full employment and price stability simultaneously. He convincingly shows that the JG programme is superior to the NAIRU approach. After exploring the case for introducing a JG programme into a NAIRU economy, then maintaining full employment under inflationary pressure, Mitchell introduces the concept of NAIBER (non-accelerating-inflation-buffer employment ratio) as an automatic control mechanism for inflation. The JG programme can eliminate wage-price pressures by "chocking" (squeezing) aggregate demand and introducing a slack in the non-buffer stock labour sector. He concludes that unemployment is due to small budget deficit, and that there are no logical (financial or political) reasons for objecting to the validity and viability of a JG programme.

The concluding part of the book carries forward the discussion about the ELR programme. Nell shows that the ELR is far superior to an unemployment insurance programme both at the financial and the social level. He also shows the benefits of the ELR programme in supporting the value of the currency, setting a
floor to money wages, and giving a new dynamic to the labour market. The book closes with the transcript of an open discussion between conference speakers and participants.

Reinventing functional finance is a must read for all scholars interested in public finance and full employment policy. Policy-makers (and their economic advisers) are encouraged to read it and to consider going back to the basic insights that Abba Lerner and others brought to light six decades ago. This is an insightful, fresh, and well-overdue look at functional finance and its policy implications. The challenging task ahead is to take the principles of functional finance back to the policy arena.

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Recent books


This is the third annual report in this series. As the title suggests, Benchmarking working Europe monitors a range of labour market indicators in order to assess the performances of both individual countries and of the European Union as a whole. Separate chapters are devoted to employment; income distribution and social exclusion; working time; social protection and social infrastructure; lifelong learning and the knowledge society; working environment and occupational health and safety; worker participation, information and consultation; and – for the first time in this 2003 edition – European social dialogue and implementation.

This year’s report finds that working conditions and quality of employment in Europe have failed to improve as expected, in spite of an overall improvement of the labour market situation in the period covered. Other major findings include inequality in access to life-long learning opportunities and, more generally, “a considerable degree of labour market discrimination suffered by older and younger workers, women and persons with few skills”. With the current economic slowdown in Europe, the report also reflects the European Trade Union Confederation’s concern over the prospect of “a further significant increase in unemployment” in 2003, especially in the light of the ambitious goals set at the Lisbon Summit of the European Council in 2000 and the stated political intention to create “more and better jobs”.

M. A. L.
