

# Revisiting Deficit Hysteria

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Tim Lewis, *In the Long Run We Are All Dead: The Canadian Turn to Fiscal Restraint* (Vancouver: UBC Press 2003)

Janice Mackinnon, *Minding the Public Purse: The Fiscal Crisis, Political Trade-offs and Canada's Future* (Montréal and Kingston: McGill-Queen's University Press 2003)

THE LATEST ECONOMIC NEWS (May 2004) from the United States, Japan, and Asia is positive. Of all the G7 countries only Canada remains obsessed with balanced budgets and avoiding deficits. In Japan unemployment has now fallen to 4.7 per cent from 5.4 per cent a year ago and growth is a robust 5.6 per cent. The United States is running a deficit that is almost 5 per cent of its GDP, which the Democrats deplore and the *New York Times* dislikes. But an economic recovery is taking root. Growth is 4.2 per cent and unemployment has dropped to 5.6 per cent from 6 per cent a year ago. The Chinese and Indian economies are experiencing booms with growth rates in excess of 9 per cent in China and over 10 per cent in India. Canada with its zealous policy of balanced or surplus budgets has growth of 1.6 per cent and unemployment of 7.3 per cent.

In Europe, with overall unemployment at 8.8 per cent, the European Union continues to denounce countries like France and Germany that have run deficits that exceed 3 per cent of the GDP or 60 per cent of the debt-to-GDP ratio on the grounds that they are violating the stability pact that governs the common currency and the very monetarist European central bank. But unemployment is 9.8 per cent in France and 10.5 per cent in Germany. The one major European country that so far has refused to join the stability pact and the common currency, Great Britain, has an

unemployment rate that is the lowest in the European Union, 4.7 per cent, and is running a significant deficit.<sup>1</sup>

So what gives here? By all accounts the Keynesian era is dead and gone. Yet countries approximating a Keynes-style course are doing well. Those still mired in monetarist dogma of balanced books and strict controls over inflation are doing less well.

I am not surprised as I have been arguing for years that Keynes and his ideas, particularly when adjusted for contemporary circumstances, are still far superior as a guide to policy than those of Milton Friedman and the monetarists. Even more to the point they are far superior to those of Hayek and his followers like James Buchanan, Gordon Tullock, and Robert Barro, who are major critics of deficit finance, and the band of fiscal conservatives associated with the contemporary neo-classical mainstream like Benjamin Friedman.<sup>2</sup>

Here in Canada we continue to be under the unfortunate spell of fiscal conservatives like David Dodge at the central bank, a believer in both balanced budgets and fighting inflation as opposed to targeting lower unemployment and low inflation. In the United States, on the other hand, George Bush has appointed Alan Greenspan to a fifth term as Governor of the US Federal Reserve because Greenspan has kept rates at historic lows and tolerated Bush's fiscally stimulative deficits as the correct course of action against sluggish growth and elevated unemployment.

In Canada up until quite recently our central banking establishment has continued to warn of the risk of inflation when even world-wide there is little evidence that inflation is our problem outside of the cartelized petroleum industry. Exactly how interest rate rises cure the impact of an oil cartel in an economically efficient way is beyond me. Instead, such increases simply convert the shock of higher oil prices into an even more damaging recession. Part of this perverse orthodoxy has been the return of the dogma of sound finance, that is an aversion to deficits at all costs.

Recently we have been treated to two very interesting books on the subject of Keynes and deficits. One is by a professor turned politician, the other by a promising young academic who has devoted his PhD research to the issue of the eclipse of

<sup>1</sup>All data from *New York Times*, 18 May 2004, *The Economist*, and the OECD.

<sup>2</sup>For a sample of the work of Friedman, Barro, and Tullock, see James Rock, ed., *Debt and the Twin Deficits Debate* (Mountainview 1991). For more Keynesian perspectives see Robert Eisner, *How Real is the Federal Deficit* (New York 1986); Francis Cavanaugh, *The Truth About the National Debt: Five Myths and One Reality* (Boston 1996); Pierre Fortin & Lars Osberg, *Unnecessary Debts* (Toronto 1996); Harold Chorney, *The Deficit and Debt Management: An Alternative to Monetarism* (Ottawa 1989); Harold Chorney, "The Deficit: Hysteria and the Current Crisis," in Harold Chorney and Phillip Hansen, eds., *Toward a Humanist Political Economy* (Montréal 1992); and Harold Chorney, *The Deficit Papers* (Montréal 2001).

**Keynesianism.** Since my work is discussed in one of these books and targeted indirectly in the other, let me be up-front about my interest in the matter. By all means buy both books if you can and make up your own mind. The academic book by Tim Lewis, *In the Long Run We are All Dead: The Canadian Turn to Fiscal Restraint*, is by far the more impressive and useful but the politician's tale by former Saskatchewan Finance Minister Janice Mackinnon, *Minding the Public Purse: The Fiscal Crisis, Political Trade-offs and Canada's Future*, is not without interest for revealing how shallow the thinking is among our leading decision-takers, even ostensibly well-intentioned social democrats with PhDs.

Even more appalling than the shallowness is an unwillingness to go beyond the second-hand and frankly second-rate understanding of the doctrine they were rejecting when Saskatchewan, to the delight of the bond raters and the fiscal conservatives in the financial press in Canada, embraced as holy water the doctrine of balancing the books as social democratic gospel on the disturbing but probably accurate assertion that this is what Tommy Douglas, the Baptist preacher turned politician and premier, preached during his long career as Premier of Saskatchewan.

Before I get into a detailed discussion of these works let me try to explain why deficit finance is viewed rather differently by Keynesian economists like myself. In the good old days when John Maynard Keynes and his colleagues, Michal Kalecki, Joan Robinson, and Robert Bryce, a student of Keynes who served with distinction as our deputy Finance Minister, shaped policy and public opinion, these ideas were widely understood. Deficits that were planned and in the World War II years reached as high as 21 per cent of the GDP were accepted because they provided the necessary stimulus to aggregate demand to push economies out of recession and depression. By the way, a 21 per cent deficit to GDP would be of the order of \$200 billion dollars today. Imagine the improvements in our society we could bring about armed with a budget boost of that magnitude.

It is in many ways a matter of simple algebra to demonstrate the virtues of deficit spending when one is in recession or has unmet investment needs in infrastructure or human capital. Let me explain. For those who find algebra difficult to follow I will explain the argument in words as I go along. What I am going to show are the macro-economic equations that demonstrate the efficacy of deficits for the success of capitalism where success is measured by profits and wages.

Let  $R_{(tr)}$  = profits after taxes and at interest rate  $r_i$

$W_{(tr)}$  = wages after taxes and at interest rate  $r_i$

$T$  = taxes

$C(W_{tr})$  = consumption of workers after taxes, at wages  $W$  and rate of interest  $r_i$

$C(K_{tr})$  = consumption of capitalists after taxes at profits  $R$  and rate of interest  $r_i$

$I_{(tr)}$  = investment at tax level  $T$  and rate of interest  $r_i$

$X$  = exports

$M$  = imports

$S$  = savings

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$r_i$  = rate of interest which is  $< \Delta \text{GDP}$  i.e. Less than the growth rate in the G.D.P.

Then  $W_{(tri)} - C_{(wtri)} = \text{Savings financed from workers that is, } S_{(w)} \text{ (a)}$

$R_{(tri)} - C_{(ktri)} = \text{savings financed from capitalists, that is } S_{(k)} \text{ (b)}$

And therefore  $S_{(w)} + S_{(k)} + D_n \text{ (} D_n = \text{Depreciation)} = I$

The assumption is that  $D_n$  is accounted for before profits and is automatically invested in restoring plant, machinery, and human capital, and that  $R_{(tri)}$  = retained earnings  $Re + d + D_n$  where  $d$  = dividends and  $Re$  are profits reinvested in the firm after being retained as earnings and not distributed as dividends.

Further, let us assume that  $r_i$  is less than the growth rate in the GDP in order that the debt to GDP ratio does not rise.

Then :

$$R_{(tri)} + W_{(tri)} + T = C_{(wtri)} + C_{(ktri)} + G + (X-M) + I_{(tri)} \text{ (1)}$$

That is, profits plus wages plus taxes which are income flows equal consumption by workers plus consumption by capitalists plus government expenditures plus exports - imports plus investment which, except for exports, are expenditure flows. Note that subtracting  $T$  for taxes from both sides of this equation then leaves us with

$$R_{(tri)} + W_{(tri)} = C_{(wtri)} + C_{(ktri)} + (G-T) + (X-M) + I_{(tri)}. \text{ (2)}$$

Note that  $G-T$  is a measure of the public sector deficit. What equation two states is that the larger the deficit the larger the combination of wages and profits. This will hold true so long as expectations are not dominated by the financial press's dogma about deficits. These dogmatic notions may well exist in some circles like the bond market but are just as likely in a stochastic sense to be cancelled by Keynesian expectations among a larger portion of the population. Hence Ricardian-Barro equivalence that equates deficits to future taxes will not hold. The precise division between wages and profits will be the outcome of various factors including the rate of unemployment, the rate of unionization, the legal environment, and underlying social values.

Further note that  $-(C_{(wtri)} - W_{(tri)}) = S_{(w)}$  (c) Therefore

$$R_{(tri)} = C_{(wtri)} - W_{(tri)} + C_{(ktri)} + (G-T) + I_{(tri)} + (X-M) \text{ (3)}$$

And  $R_{(tri)} = (I_{(tri)} - S_{(w)}) + C_{(ktri)} + (G-T) + (X-M)$  (4) because of (c) above and through straightforward substitution of  $-S_{(w)}$  for  $C_{(wtri)} - W_{(tri)}$ .

What these macroeconomic equations show is that contrary to all the conventional wisdom that dominates the financial press and the politicians these days, deficits stimulate both profits and wages and therefore economic growth. The only question is whether the central bank can keep interest rates below the growth rate in the economy for any significant length of time despite the judgement of the finan-

cial market with respect to the position of long-term rates. The answer is remarkably clear as we have seen the US Federal Reserve and the Bank of Canada do precisely this over the past few years.

Despite all the claims to the contrary, the Fed and the Bank of Canada have the absolute power to set short-term rates at whatever level they desire if conditions are less than robust and there is a continuum between short term, medium term, and long-term rates. The experience ever since 11 September 2001 demonstrates this fact.

Furthermore, deficits during World War II reached over 20 per cent of GDP and the level of debt to GDP climbed to over 130 per cent in Canada and the United States and over 200 per cent in the United Kingdom without any harm being done to these economies. In fact quite the opposite occurred. Not only is high indebtedness in a modern developed country less than the problem imagined but deficits can accomplish important positive outcomes in the health and social sectors. The investments they facilitate can boost economic growth and general prosperity. It is not hard to recognize this when one sees the direct results of eliminating deficits and building surpluses through cutbacks in key social programs, health care, and education. Most Canadians, myself included, have directly experienced the awful consequences of these policies and the harm they cause to ourselves, our families, and loved ones.

In fact, investments in these areas are more correctly viewed as investments in human capital that need to be amortized over the life of the investment which is typically decades long. In this case the deficits that were engendered during the 1970s and 1980s and early 1990s would have largely disappeared.

Now that I have set the stage which clearly shows where I am coming from and why I argue as I do let me discuss in some detail the two works under consideration. First the far more interesting work by Timothy Lewis. Lewis begins by arguing against the notion that the return to sound finance and rejection of Keynesian thinking was based on a lack of technical understanding of Keynesianism. In his view it is perfectly plausible for otherwise intelligent sophisticated people to reject Keynes and deficits. As he puts it, the “subjectivist school” — and here he lumps my writing in with the journalist popularizer Linda McQuaig and the progressive think-tank, the Canadian Centre for Policy Alternatives — suggest that the fiscal conservatives suffer from a certain interest or ideological bias that poisons their understanding of the issues involved and ignores the legitimate concerns and actions of market traders and bond holders. He also argues rather bizarrely that the subjectivists neglect to ground their ideas in history. How any reader of my work *The Deficit and Debt Management: An Alternative to Monetarism* could argue this is very puzzling since a big chunk of that monograph is historical, a history that Lewis himself later cites in his work.

Lewis is wrong to conflate my work with McQuaig. McQuaig was and is a good journalist who, when looking for the story about deficits and debt reduction,

took me and a number of others out to dinner to pick our brains about the issue and construct the very good book *Shooting the Hippo* that she wrote on the subject. As good as it is, however, McQuaig is not a technically trained economist, and sometimes gets things wrong or at the very least overly simplifies arguments so they become easier targets for critics.

Secondly, unlike most of the other excellent people at the Centre for Policy Alternatives, I am not a huge critic of free trade who solely stakes out my position on the left. In fact, for much of the past decade, I have been a member of the Liberal Party as opposed to the NDP and I take special care not to be dogmatic about any issue including deficits. Nevertheless, on the subject of public finance, I have done my homework and I know the full breadth of the debate, its past history, and its current circumstances. My training and personal preference are to make the case on technical grounds.

On these grounds, as I have tried to show above, I find it impossible to accept the much weaker argument that advocates surplus budgets as the key to our economic well-being in circumstances of slow growth and high unemployment.

Lewis may, however, have a valid point as he explores the importance of the sea change in policy preference that occurred over the past 25 years in governing circles in his assertion that ideas only count when they have political backing. He also argues, I think correctly, following Polanyi, that ideas become embedded within social relations.<sup>(36)</sup> The durability of Keynesian thinking resulted from its becoming part of embedded liberalism that has now largely but not completely withered and died. He explores, in valuable detail, how anti-Keynesian neo-liberal and neo-conservative ideas came to dominate the agendas of governments throughout the western world.

I have an alternative explanation to Lewis's of how this happened which I have taught my students the past two decades. Allow me to share it briefly with you. The Keynes approach, in my view, was displaced because of a combination of the circumstances surrounding the OPEC price shock of the early 1970s and the fact that the kind of policies that passed for Keynesianism were inaccurate representations of Keynes's original doctrine. Instead of a model of Keynes's economics that incorporated his core arguments, a very distorted model was taught to students. Keynes' original work had stressed the role of uncertainty. This included a curvilinear aggregate supply and demand curve as opposed to linear ones, and the notion of prices rising well before full employment and therefore the simultaneous existence of inflation and unemployment, and a labour market that did not clear not just because of rigidities but because of uncertainty and mismatches in savings and investment intentions which required in certain circumstances negative interest rates to bring about equilibrium at full employment. But the economics profession in the decades that followed Keynes — and I was a new recruit to this profession in the early 1960s — was taught a neo-classical Samuelson- and Hicks-inspired model of Keynes that was based on a very serious distortion of the original work that ignored or distorted

the key core principles and reduced his model to a variant of neo-classical general equilibrium.

Joan Robinson, one of Keynes's closest younger colleagues, pointed this out in the late 1940s and continued to point it out during the 1950s and 1960s. But she was ignored as were Shackle, Kalecki, Austin Robinson, and R.F. Kahn, all close Cambridge colleagues of Keynes. The very core arguments of Keynes that were elaborated in the *General Theory* in the chapter on prices and his chapters on uncertainty and the aggregate supply curve were simply brushed aside in a 1939 article that Paul Samuelson wrote and in his later textbook. The classical Keynesian cross diagram with the 45-degree aggregate supply line which Samuelson introduced in 1939 is nowhere to be found in Keynes unless you stop reading the chapter on prices and the role of the quantity of money at the halfway mark, ignoring the rest of the chapter which clearly repudiates this approach as unrealistic. Even as strong a monetarist as Alan Meltzer who has advised President Bush admitted this in his own work on Keynes written in the 1980s.

As Joan Robinson often pointed out Keynes was simply reabsorbed into neo-classical orthodoxy with the non-ergodic side that post-Keynesians like Sidney Weintraub and Paul Davidson along with Joan Robinson and Keynes himself saw as critical simply being swept under the carpet. Thus a very much weakened American model of the original Keynes became widely taught and was an easy target of the conservative neoclassicals and the monetarists when the phenomenon of stagflation appeared after the OPEC price shock.<sup>3</sup>

Once one disaggregates the economy into its constituent components and accepts that the economy is heterogeneous rather than homogeneous, it becomes clear that inflation can begin in certain sectors at much lower rates of capacity utilization. A cartel-controlled sector like petroleum can undergo inflation even when there is considerable slack in the system overall. Similarly a heavily unionized sector where the shareholders and managers are unwilling to accept a reduction in their income share in response to a wage boost can experience price rises even when there is overall slack but customers are still available for the output despite the price rise.

Any proper reading of Keynes needs to include not only the *General Theory* but the *Treatise on Money* and the articles in the *Quarterly Journal* and elsewhere that elaborate the argument.<sup>4</sup>

Once we recognize the disastrous distortions that occurred, which even Sir John Hicks, the inventor of the IS-LM apparatus that all neo-classicals are trained with, admitted toward the end of his long life and career, it becomes much easier to

<sup>3</sup>For the roots of this argument see John Maynard Keynes, *The General Theory of Employment, Interest and Money* (New York 1991), 292-98.

<sup>4</sup>See his "The General Theory of Employment," reprinted in *The Collected Writings of John Maynard Keynes* (London 1971), Vol. 14, 109-123; and "The Ex Ante Theory of the Rate of Interest," *Quarterly Journal of Economics* (1937), reprinted in *Collected Writings*, Vol. 14, 215-223.

understand what happened. It's a great pity that an analyst of Lewis's calibre did not have exposure to these arguments while he was researching his PhD. For if he had, his work would be much stronger. Instead of discussing these kinds of questions in depth Lewis briefly mentions incomes policies in the context of post-Keynesian approaches and goes no further.

Lewis does, however, get some of the story correct when he notes briefly the dilemma faced by Bob Rae, Floyd Laughren, and other senior New Democrats when they debated what to do about the budget deficit that Rae's Ontario government faced in 1991 as it planned its first budget. The mistake he makes is to accept the argument that, after François Mitterand's failed experiment with Keynesian reflation, Rae had no other options. In the first place the Mitterand experiment failed because France, unlike Britain, refused to exit the exchange-rate mechanism. In the case of Ontario there was another option for the Rae Government but it refused to exercise it.

I know something of the behind-the-scenes debate that took place because I, along with a number of other economists, was brought to Toronto in 1991 to debate these questions in front of Rae, Laughren, and Frances Lankin, along with their political staffs and civil servants.

What was striking about that meeting was the right-wing ferocity of some of the bank economists who were at the table to represent the other side of the spectrum. There were nine economists, five Keynesians and four bank economists, although one of them, Doug Peters, was trained in the post-Keynesian tradition. Not only were the bank economists opposed to any sort of Keynesian strategy, but two of them even urged major cuts to medicare as the solution to the problem.

This helps put the 2004 budget of the current Liberal Government of Ontario in perspective. Premier McGuinty has resisted cutting medicare but not resisted increasing taxes to pay for it while seeking to balance the budget over the longer term. Undoubtedly he came under similar pressure to Rae.

The NDP in 1991 was not in a good position given the depth of the recession underway, the implacable anti-inflationary obsession of the central bank then still under the leadership of the zealous zero inflation policies of John Crow and the implacable opposition of the financial press. I recall Mike McCracken telling Premier Rae "if you are going to get hung, better to be hung for a pound rather than a penny" as he supported my call for a full-throttle Keynesian budget.

But in the end the Rae government opted for a moderate one billion dollar stimulative addition to the deficit that would have occurred anyway.<sup>5</sup> This still took considerable courage, but it was not enough to do much good. They got assaulted by the media and because their heart was not completely in the Keynesian strategy to begin with they did not do a good job of defending themselves.

<sup>5</sup>Floyd Laughren, Ontario Budget, 29 April 1991.



In effect, they got hung for a penny. It did not help that papers like *The Globe and Mail* refused to print letters written in defense of their position. I know because I wrote one that, like many others since, they refused to print.

Bob Rae has since defended his actions and criticized the advice of people like myself.<sup>6</sup> His arguments are worth reading and debating but frankly he still does not understand the thrust of the Keynes argument.

Where we went wrong in our advice was underestimating the severity of the recession and the damage that bad monetary policy would impose upon the province. But his mistake was to repudiate the policies on the grounds they were ineffective rather than explain to the public how these other federal institutions and players were sabotaging the policies and call for reform of the Bank of Canada and the stranglehold the Governor had on policy. It is one thing to impose bad policy because of the lack of power to do otherwise, and use the circumstances to explain the problem to people and educate the public about it. It is another to argue that bad policy is somehow good policy.

As one former federal deputy Finance Minister put it to me over coffee and rich desserts a couple of years later in Toronto, as we advised the leader of a political party on economic policy, I was wrong to believe that the federal government and the Department of Finance controlled the central bank. To their credit Paul Martin and Jean Chrétien reasserted some control over the Bank when they refused to reappoint John Crow as Governor. Unfortunately they did not go far enough, likely because they feared the financial markets and the IMF.

Lewis wisely explores Pierre Fortin's argument that an inappropriate monetary policy characterized by an obsession with inflation made the recession of the early 1990s much worse than it needed to be.(134) He uses this argument to develop the notion that the rightward shift in politics both at the elite level in the 1980s and the mass level in the 1990s explains most of what went wrong during the 1990s and finally overcame whatever residual Keynesian thinking remained within policy circles.

Lewis, while not insightful on the economic theory debates that underlay the shift from Keynes to monetarism, is quite good on the political nature of these sorts of battles. His discussion of the Mulroney and Chrétien/Martin regimes and the gradual emergence of anti-deficit dogma as the bedrock of Paul Martin's approach to governing is highly illuminating. He quite correctly argues that the earlier regimes under Prime Minister Trudeau, despite the conversion of the Bank of Canada to monetarist doctrine in 1975, still were wedded to a variant of Keynesian policy, albeit a bastardized version. Government's commitment to keeping unemployment from rising too much evaporated by the time of the Mulroney era and was not revived when Chrétien came to power despite the false promises he made during the election campaign that defeated the Tories in 1993.

<sup>6</sup>Bob Rae, *From Protest to Power* (Toronto 1996).

The doctrine of low unemployment as a bedrock principle of Canadian politics was ancient history by 1993. Lewis argues, again convincingly, that Finance officials had already abandoned the Keynes doctrine and had embraced the NAIRU (non-accelerating inflation rate of unemployment) by 1982-3. In fact, in the world of economics, this shift was already occurring at places like the LSE in the late 1960s and early 1970s where much of the groundwork for Thatcher's revolution was already being laid. Of course, my own argument is that the groundwork dates back even earlier to the unfortunate distorted way in which Keynes's theory had been popularized.

Tragically, Canada has suffered from elevated unemployment beyond what could have been accomplished ever since these sea changes in doctrinal adherence and policy regime were instituted. Of course, this rise in unemployment is no different in much of the G7 where almost identical policy shifts took place. The only notable exception has been Japan.

Those of us who have observed how these "tectonic" shifts in policy (Lewis's word) played themselves out within the confines of the Liberal party and thereby paved the way for the overthrow of Chrétien by Martin will find much usable analysis in Lewis's account. As Lewis puts it, despite their overall lack of enthusiasm for neo-Liberal views in comparison with the Mulroney Tories or even now in comparison with their new Conservative foes under the leadership of Stephen Harper, "the Liberals nonetheless walked neoliberal and talked neo-liberal." (168) Both the Liberal party and the New Democrats, and the Parti Québécois for that matter, reacted to the pressure of neo-conservatism by absorbing and ultimately advancing and defending these reactionary new policies. (190)

One may hope now that this strategy is long in the tooth and discredited by the damage it has promoted. Furthermore, the ultra-conservative regime of George Bush has shown how Keynesian strategies still work, albeit from a military Keynesian point of view. Hence the time is well overdue for a pendulum swing in policy. If Republicans can dismiss deficits as of no consequence, surely social democrats and genuine liberals can assert the same argument. What an ironic shift to see the Democrats take on the mantle of fiscal conservatism while Republicans become advocates of Keynesian stimulus. Unfortunately, the Canadian Liberals, Conservatives, and the NDP all remain wedded to the notion of balanced budgets come what may.

In fact, however, Lewis closes his work with the admission that perhaps Keynes is not totally eclipsed after all and that scope remains for Keynes-style policies to reassert themselves. But this reassertion will be a modest one involving running smaller surpluses or even no surpluses in exchange for reinvesting in health care or social policy. This is a welcome admission from him and certainly one that Janice Mackinnon would never make.

Mackinnon's work is largely an account of her own certainty that the Saskatchewan government, of which she was a central figure, was correct to do everything in

its power to discredit any sort of social democratic commitment to Keynesian full-employment policy. Mackinnon boldly announces her neo-conservative credentials at the outset of her work. Not only did she oppose deficits and swallow whole the propaganda of the bond raters and financial markets, but she was also opposed to crown corporations, regulation, and big government, all of which she claims harmed Saskatchewan. An amazing credo for someone who believes she is a social democrat and who taught History before she became a politician. In her work, she attacks Allan Blakeney, one of the better premiers of Saskatchewan, and refers derisively to Mulroney "caving in to an irate senior" over deindexation of seniors' pensions. (6-7)

Mackinnon must be one of the only politicians in the country who believed it was good politics to stick it to seniors in order to balance the books. Whatever his faults, Mulroney was absolutely sensible and frankly adhered to a higher ethical standard than Mackinnon when he quickly retreated before the wrath of seniors. Tommy Douglas would probably roll in his grave at Mackinnon's macho and decidedly unsocial democratic attitude to the plight of low-income pensioners.

Significantly, Mackinnon is an admirer of Paul Martin for his attack on deficits. (155) Not surprisingly, Martin also unsuccessfully tried to reduce pension benefits for seniors in one of his budgets. Fortunately the measure was later withdrawn. How representative Mackinnon is of the NDP remains an open question. Mackinnon's book is a self-congratulatory account of her term as Finance Minister and her neo-conservative-inspired attack on the deficit problem in Saskatchewan. At no point in this 316-page work does she explore or even ask whether there might be another way to finance Saskatchewan's debt outside of Wall Street. What role might the Bank of Canada play in financing or helping to manage finance at least partly the debt of our provinces? And even more to the point is investment in education and health care a current or capital expenditure? For if it is at least partly the latter, which I believe it is, it ought not to be treated in the current expenditure way that it is treated in the provincial or federal accounts. If this were done, then many of these deficits would evaporate or be much reduced. None of these important questions merit Mackinnon's attention.

Instead, she is fascinated by the blackmail power exercised by Moody's and the bondrating agencies and the Mexican debt crisis as if Saskatchewan were remotely like Mexico. I also have spoken to Vincent Truglia of Moody's Sovereign Debt Unit. He assured me as he did Linda McQuaig that they do not consider their ratings the last word on economic performance. They are often surprised at the way in which Canadian politicians, bankers, and other interested parties urge them to downgrade ratings in order to promote neo-con policy. A downgrade does cost money in the form of an additional premium in interest rates required to sell the debt. But compare that cost, which is in the millions of dollars, to the much higher cost that health care cuts, cutbacks in education, or higher unemployment impose.

Mackinnon reveals her adherence to the “bond raters rule” school when she discusses the Mexican peso crisis in 1994 as having been a lucky development for Paul Martin insofar as it sufficiently scared Canadians to permit Martin to carry out draconian cuts in his 1995 budget. (209) Martin during the 2004 election campaign, defended his draconian budget cuts in 1995, which severely damaged our health care system, on the specious grounds that they helped us avoid the fate of Argentina.

This is, of course, verbal overkill. Canada is and was in no way comparable to Argentina with its corrupt governments, military dictatorships, Peronist movements, heavy foreign-owned debt, ingrained habits of tax avoidance, and a rigid currency board that caused the Argentinian peso to be wildly overvalued in comparison to the currency of its principal trading partners.

Mackinnon also reveals her Western Reformer-Alliance inclinations in celebrating what she wrongly takes to be the federal Liberals’ abandonment of Trudeau’s commitment to bilingualism in the 1995 budget by offering Quebec more economic power rather than greater acceptance of the French fact in Canada. She does, however, rightly complain about federal downloading of responsibilities without equivalent funds. (215)

Mackinnon concludes her book with a neo-conservative critique of the Romanow report as offering an unworkable solution to Canada’s health care crisis which she is unwilling to solve by reverting to either Keynesian measures or simple restoration of the necessary federal funds cut out of the system in 1995. (249) What I observed in Bob Rae’s government was that the neo-conservatives were quick to attack our health care system if the threat of deficits pushed them to it. This neo-conservative approach has clearly affected its share of leading New Democrats. Mackinnon laments Martin’s temporary departure from politics in the book and undoubtedly celebrated his return as party leader and Prime Minister.

Mackinnon’s neo-conservative attitudes of course raise an important question which I and many others asked during the 1990s. If the NDP are only willing to promote social programs, investment in health and education, in good times when unemployment is low, what is the point of having such a party in addition to the Liberals who normally did exactly the same thing in good times? It is in fact a costly dilution of progressive voices that may strengthen right-wing parties that openly seek to worsen things in both good and bad times for ordinary people. Far better to work for a party committed to these principles with a long tradition of holding federal power and struggle within that party with the same reactionary disavowal of intelligent Keynesian doctrine. This was the conclusion I reached living and working in Quebec. But I can understand people reaching other conclusions.

It is my argument that the battle over fiscal policy but not the war was lost because the economic logic brought to bear was intellectually inferior. But, against a reinvigorated Keynes doctrine and in the light of all the damage we have witnessed over the past 25 years, other results are now possible.

In my own research on the texts of the immediate post-Keynes era, I have only found one major text that accurately represented Keynes's theory. This was A.W. Stonier and Douglas Hague's *A Textbook of Economic Theory* which first appeared in 1953 and was widely used in Britain. I was taught from this text in my intermediate course in micro and some macro theory taught by Prof. Fu Sen Chen at the University of Manitoba in the early 1960s. It was also a text widely used in Great Britain before the Samuelson and later Lipsey texts dominated the field. The virtue of Stonier and Hague is quite clear in their discussion of aggregate supply and aggregate demand. They accurately and faithfully introduce students to the concepts and show the role that expectations and uncertainty play in the construction of these curves. Of course, reading Keynes's *General Theory* and his own writings that both precede and follow this work is the best way of understanding what he was driving at. But it must be admitted that Keynes's work is not very accessible to introductory or even intermediate-level students. It was intended, as Keynes himself pointed out, for his fellow economists, that is those advanced enough in the field to be considered professional economists or at least graduate students.

What a pity more students of the subject were not properly instructed so they could have avoided the error of the 45-degree phantom aggregate supply curve that Samuelson unfortunately introduced into economics and claimed to be Keynesian. Anyone trained in the Stonier, Hague interpretation of Keynes and aware of the Keynes argument in the chapter on prices in the *General Theory* and his arguments in the *Treatise* would understand that stagflation was not at odds with Keynes's argument because of the possibility of simultaneous inflation and unemployment already being anticipated by Keynes in the 1930s. In fact, this aspect of the argument was also correctly diagnosed by the American economist Charles Schultze writing for the Joint Economic Committee of the US Congress and their investigation into inflation in 1959. Later, the influential economist, Arthur Okun, also explored these kinds of approaches in his work.

In the modern era the most influential group of economists to put this case outside of Okun and Schultze have been the post-Keynesians who took their inspiration from Robinson, Kalecki, and Keynes himself. Modern expositors of this sort of argument included Paul Davidson, Sidney Weintraub, and in Canada economists like the late Jack Weldon, A. Asimakopoulous at McGill, and John Hotson at the University of Waterloo. Arthur Donner, Doug Peters, and the late Clarence Barber to some extent also understood much if not all of this analysis. Unfortunately, when Doug Peters was in the first Cabinet of Jean Chrétien, he lost the battle to David Dodge and his followers who were wedded to the strict orthodox neo-classical and even monetarist point of view. It was Dodge's very conservative and anti-Keynesian point of view that carried the day. Another major Keynesian voice has been Mike McCracken, a former finance official, CIA economist, and influential econometrics consultant who some time ago told me he considered almost the entire

senior bureaucracy in Finance and at the Bank of Canada committed to anti-Keynesian doctrine.

There were other Keynesians here and there across the country. But unfortunately there was very little connection between what they taught and the economists who came to dominate the Department of Finance after the Bryce era ended and the Bank of Canada once Gerald Boeey succeeded Louis Rasminsky as Governor. In the case of Bryce a careful reading of his text that summarized the basic argument of the *General Theory* reveals that he had an excellent understanding of Keynes' argument and the role of uncertainty. It is less clear whether he had absorbed Keynes's theory of inflation. Laurie Tarshis, who had been an early convert to Keynes's economics and taught for years at Stanford and in his final years at York, was also clearly aware of these arguments.

Canada is a small country and its intellectual elite who have access to the powerful institutions that run the country is drawn from a small circle of insiders. Outsiders, whether ethnically or religiously marginal, are simply not included. This was in fact the experience of the brilliant economist Abba Lerner whose work on functional finance codifies a system for using planned deficits in the stabilization of the economy. Lerner was a favourite student of Keynes.<sup>7</sup> Keynes accepted Lerner's version of functional finance but was politically cautious about embracing it publicly. In a letter to his follower James Meade he wrote, "Lerner's argument is impeccable but heaven help anyone who tries to put it across to the plain man at this stage of the evolution of our ideas."<sup>8</sup>

Lerner had sought a position with the Canadian Department of Finance during the war but not even his friend Robert Bryce could bring it off because, as Bryce himself noted, Lerner "was of the Hebrew faith" and certain other Finance officials foolishly considered Lerner's ideas to border on "social credit." Had our elites been more open to ethnic, religious, and ideological diversity I am convinced our economic policies would have been less dogmatically anti-Keynesian even when the monetarist counter-revolution was underway.

These works by Tim Lewis and Janice Mackinnon and the earlier ones by Bob Rae, Pierre Fortin, Lars Osberg, and others are part of an ongoing debate that needs to be revisited. So long as so much damage is being done to our social and economic fabric by the dogmatic application of conservative fiscal and monetary policy and reactionary sound finance, there will be a pressing need to rediscover the humanist principles of Keynes's policy. The moral necessity for doing so is simply inescapable.

<sup>7</sup>See the article by David Colander on the conversation between Keynes and Lerner at the US Federal Reserve in Washington during the war. David Colander, "Was Keynes a Keynesian or a Lernerian?," *Journal of Economic Literature*, 22 (December 1984), 1572-1575.

<sup>8</sup>Keynes to Meade, April 1943, in Colander, "Was Keynes," 1573.  
(<http://cepa.newschoil.ed/het/profile/lerner/htm>)