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Governing the Canadian Economy: Ideas and Politics

Neil Bradford

CANADIAN POLITICS

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GOVERNING THE CANADIAN ECONOMY: IDEAS AND POLITICS

Neil Bradford

In 1998, Finance Minister Paul Martin rose in Parliament to announce a "new era" in Canadian public finance and economic management. For the first time in nearly 50 years, the federal government reported that its books were balanced and that Canadians could look forward to future "fiscal dividends." The boundaries of macro-economic policy discussion, long confined by the imperative of restraint, suddenly shifted to include the prospect of new public spending. Indeed, talk of a post-deficit era in federal budgeting has reopened fundamental debate about Ottawa's proper role and responsibilities in relation to the economy, society, and the provinces.

For citizens and governments alike, much is at stake in the struggle to redefine Canadian macro-economic policy. Decisions about expenditure, taxation, and the money supply directly affect the public issues that people care most about in their daily lives: the availability of jobs, the stability of prices, the cost of borrowing, and the amount of disposable income. Moreover, Ottawa's "spending and cutting" choices reverberate across the country's critical political faultlines, shaping conceptions of social citizenship, national identity, and federal–provincial relations. Simply put, macro-economic policy is central to modern governance. In complexity and breadth, it is truly a policy field "unlike the others."

This chapter analyzes the dynamics of federal budgeting, tracing developments from the dawn of modern macro-economic policy in the Great Depression of the 1930s to the present day. The historical narrative is structured by the concept of the governing policy paradigm, an analytical device that captures the crucial interplay over time between ideas and politics in macro-economic policy. This field is both politically charged and technically complex. Governments rely on the advice of professional economists, who devise sophisticated models to understand the economy and forecast its direction. As such, governing macro-economic paradigms are coherent policy doctrines that acquire for a time substantial influence in the expert community, the political system, and departments of state.

We will see that Canadian macro-economic policy has been governed by two such paradigms. Keynesian economic theory organized federal policy for nearly three decades after World War II, and neoliberalism assumed a similar dominance in the 1980s and 1990s. Today Canada approaches another macro-economic crossroads, with the prevailing neoliberal paradigm under stress in both technical and political contexts. No clear alternative has yet crystallized to underpin either a reformulated expert consensus or political realignment. The chapter closes with consideration of the emerging lines of conflict over the best macro-economic route into the next millennium.

BASIC DEFINITIONS AND KEY CONCEPTS

Macro-economic policy manages the "whole" economy through *fiscal policies* of aggregate spending and taxing and *monetary policies* for setting the money supply, interest rates, and the value of the dollar. Since the "Keynesian revolution" of the 1930s and 1940s, four basic objectives have been central to this process: economic growth, full employment, price stability, and balance-of-payments equilibrium. Controversy arises as governments set priorities among these objectives and give particular meanings to each. For example, basic judgments must be made about whether low unemployment or low inflation will be the key goal. Similarly, governments may redefine full employment to be when the unemployment rate is lower than 6 percent. Choices are also made about whether economic growth will be tempered by concerns about ecological sustainability, regional balance, or income distribution.

THE BUDGET

Government thinking in these matters is elaborated in the annual budget statement read by the Finance minister in Parliament. It details the government's expenditure and revenue plans, announces new programs or tax changes, and forecasts the budgetary deficit or surplus. Through budgets, governments communicate to the private sector and the public their economic priorities, ranking of macro-economic objectives and official

definitions of optimal growth, employment, inflation, and trade balance. Internally, the budget is the key "framework document" for governing. Its allocations establish parameters and expectations around program initiatives for a host of state departments and their constituencies.

Four principal sets of actors influence federal budget making and therefore Canadian macro-economic policy: the Department of Finance, the Bank of Canada, international financial markets, and provincial governments. In fiscal policy, the federal Cabinet, empowered constitutionally to introduce money bills into Parliament and equipped with general spending and revenue-raising capacity, is formally the central actor. More precisely, the Department of Finance dominates Ottawa's taxing and spending decisions. In monetary policy, the Bank of Canada is the major player, regulating the interest rate for borrowing money and the total amount of currency in circulation. While appointed by and accountable to the federal minister of Finance, the Bank's governor operates with substantial independence. (Finance ministers are generally unwilling to risk the turbulence in financial markets that could flow from public disputes between fiscal and monetary authorities.)

The next important player in macro-economic policy is the international financial community, on which national governments increasingly depend for their borrowing. The power of these markets is indirect but significant. Monitoring the macro-economic choices of governments, they impose penalties in the form of credit rating downgrades or even national "currency runs" for what they deem irresponsible fiscal or monetary behaviour. The final principal actors in federal macro-economic decision making, equally subject to the scrutiny of international money markets, are provincial governments. They are independent fiscal authorities responsible for about one-half of the total budget for the aggregate Canadian public sector. While control over the main fiscal, monetary, and exchange rate instruments is concentrated at the federal level, macro-economic policy is characterized by extensive interdependence. Federal decisions about the use of its spending power in areas of provincial jurisdiction, or equally, about offloading strategies for its deficit reduction, have large consequences for provincial budget making.

Secondary players influencing federal macro-economic policy include opposition political parties, organized interests and social movements, the media, and policy experts outside the state. In particular, business representatives command influence as corporate investment decisions condition the efficacy of spending and taxing instruments. Moreover, they often align themselves with international financial markets in linking "irresponsible" macro-economic policy to threats of domestic capital flight. While other organizations—for example, those representing workers or the poor—do not enjoy the power of business, they may, by mobilizing their constituencies, gain representation in bureaucratic agencies that pressure the Department of Finance for specific expenditures. Finally, outside policy experts such as academics in universities or researchers in private-sector think tanks or financial institutions can shape choices by generating new and different analytical perspectives on macro-economic objectives. Injected into public debates and official deliberations, these frameworks can shift perceptions of feasible policy options or priorities.

IDEAS AND POLITICS: GOVERNING PARADIGMS

The substantial role of experts in shaping macro-economic policy underscores the importance of ideas in policy fields that are highly technical and that rely on theories and data generated by social scientific research.[1] In macro-economic policy, these ideas take the form of well-developed policy paradigms that interpret past performance and project future trends. They define for governments the broad goals behind policy and the problems that must be solved to attain these goals. As such, policy paradigms address both "philosophical" matters about the legitimate role of the state in the economy and "technical" concerns about causal relationships among objectives and the likely effectiveness of potential instruments. Macro-economic paradigms thus contain fundamental judgments about whether government intervention is needed to correct any alleged market shortcomings. They establish conceptual parameters for the annual budgeting process that, in turn, define programmatic possibilities in formally distinct policy fields including health, welfare, education, and technology.

Policy paradigms can be said to be *governing* when their public philosophies and technical models channel thought and behaviour in two key contexts: expert ideas and sociopolitical interests. In the former, social scientists coalesce behind certain theoretical suppositions and devote scholarly resources to applying this knowledge to society's problems. Disciplinary "mainstreams" (like those in economics) evolve socialization processes for professional recruitment and advancement that reinforce the intellectual power of the dominant paradigm. In the case of the political system, a similar dynamic can be observed as the influence of a policy paradigm spreads across institutional settings. Political parties invent symbols and rhetoric appropriate to the paradigm's definition of the public interest and the economic role of government. Societal actors make peace

with the paradigm—some on terms to their own liking—others coming only reluctantly to an accommodation. Civil servants develop new data sets, operating procedures, and administrative capacities to implement programs consistent with the paradigm. Finally, international financial markets incorporate new criteria for judging the performance of domestic governments.

In sum, when a governing paradigm is embedded in state and society there is a *match between the technical and political dimensions of public policy*. Controversy may persist but it will be confined to debates about the particulars of putting into practice widely accepted goals. Policy adjustments are incremental and political conflict is bounded by larger agreement. However, history reveals that such periods of consensus and accommodation are punctuated by episodes of breakdown, as "anomalies" emerge that cannot be managed, even understood, within the existing paradigm. At these critical junctures, intellectual debate and political struggle are especially intense. Research communities revisit first principles and causal theories. Partisan alignments and social alliances come apart. From this upheaval, a new governing paradigm reconnecting ideas, politics, and administration may emerge.

CANADA'S KEYNESIAN REVOLUTION: FROM THE 1940s TO THE 1970S

KEYNESIAN IDEAS

When the Great Depression savaged Canada in the 1930s, the federal government had virtually no recognizable macro-economic policy. Guided by the nostrum of "sound finance," Conservative and Liberal cabinets had by tradition set a relatively limited role for the state in the economy. Unemployment, bankruptcy, foreclosure, and poverty were all understood to be individual and private matters, with families, churches, charities, and municipalities being the primary lines of defence. This narrow conception of the state's responsibilities reflected the prevailing laissez-faire philosophy of the period. As well, there was no analytical framework to inform an expanded government role. Public finance was more akin to accounting than economic management with its priority to ensure an annual balance between expenditures and revenues. Not yet considered was the state's potential role in maintaining not simply short-term, sound finance, but also, over the longer term, a sound economy.

The Depression provided the intellectual–political context for the Keynesian breakthrough in the second half of the 1930s. Keynesian economic theory proved "revolutionary" in a number of respects, but most obviously it provided a theoretical critique of economic orthodoxy about the self-correcting market. The capitalist economy, Keynes and his followers argued, was inherently subject to wild fluctuations rooted in the vagaries of business and consumer confidence. Even when interest rates were very low, private investment and expenditure could stagnate, leaving the economy in equilibrium at high levels of unemployment. The key problem was the lack of aggregate demand for goods and services, and this was not something natural or unalterable. For Keynesians, aggregate demand became a variable that was subject to conscious manipulation by governments through fiscal policy. Maintaining stability in investment and employment required adjusting expenditures over the full business cycle of boom and bust—stimulating demand through deficit financing in hard times and cooling inflationary pressures by running surpluses during booms.

Keynes saw public finance as no mere bookkeeping exercise. Reconceptualizing the economy as a field of strategic action where economists could offer their new knowledge to the "positive state," he enabled politicians to take responsibility for growth and employment. Conceived at the height of the Great Depression and emphasizing an active role for government, Keynesian macro-economics privileged the employment objective over price stability and fiscal policy over monetary policy. Demand management, supported by low interest rates, encouraged private investment while reducing debt repayment charges. With this technical reconstruction in place, Keynesian theory's full political import came into focus. New policy tools were invented to address the major economic problem of the day—unemployment—and, further, governments were tutored on the details of their operation. Keynesian ideas mapped political ground beyond the polarized extremes of laissez-faire and centralized planning. Politicians could now take pragmatic but purposeful policy action to correct market failures.

Canada's Keynesian revolution was notable both because the policy transformations came late in comparison with breakthroughs in many other countries and because it was not driven by visionary politicians taking bold action in the face of the economic crisis. While workers and farmers devastated by the Great Depression created new parties to protest the economic orthodoxy, these new movements stalled electorally and remained marginal to official policy debates. In the end, senior civil servants pushed and pulled a reluctant federal Cabinet toward macroeconomic experimentation. Only the emergency of financing the Second World War moved Canadian policymakers to apply the economic innovations that the policy experts had produced in the 1930s through their work

on various public inquiries, most importantly the National Employment Commission and the Royal Commission on Dominion–Provincial Relations (the Rowell-Sirois Commission).[2]

Emerging through techno-bureaucratic processes rather than in the public light of ideological competition between political parties, Canadian Keynesian theory proved more circumscribed and tentative than that evolving in countries where explicit political commitments were made to full employment, public investment in economic infrastructure, and labour force development. Such grand ideas were dismissed by the technocrats behind Canada's Keynesian paradigm as "impractical and illusory schemes for which there was neither the know-how nor a demonstrated need."[3] In place of structural reforms to capitalism, it was believed that government policy experts could stabilize the environment for private investment and restore confidence in the future. It followed that the institutional changes required to implement Canada's form of Keynesian theory were comparatively limited. Arrangements to centralize fiscal capacity within the federation were linked to renovation of Ottawa's administrative and statistical expertise in priming the pump of an essentially sound economy and then fine-tuning its operation. Canada's Keynesian countercyclical instruments of choice were corporate tax cuts and automatic social stabilizers such as unemployment insurance payments, which compensated for market fluctuations but limited government intervention.

Thus, in the early postwar years, economic experts moving between the departments of government and academia formalized the relationship between the "smart state" and Keynesian doctrine. National income analysis was anchored in economic models and forecasting techniques of increasing sophistication, expressing the shared expectations of public- and private-sector decision makers about the economy and public policy. The paradigm was housed in key bureaucratic locales such as the Finance and Reconstruction departments, and the Bank of Canada. Related support came from the Dominion Bureau of Statistics, which gathered the necessary data, and other federal line departments in health, welfare, and employment policy, which administered specific stabilization programs in partnership with the provinces. Further buttressing the domestic consensus were new international agreements and institutions mandated by national governments to stabilize and regulate financial and trade flows across borders such as the General Agreement on Tariffs and Trade (GATT). Officials from Canada's Department of External Affairs also played a significant role in creating the facilitative international context for national implementation of Keynesian policy.

KEYNESIAN POLITICS

Canada's technical consensus eventually found its match in a political accommodation that encompassed party and interest-group systems and intergovernmental relations. In fact, the bureaucratic form of Keynesian theory proved well-suited to the dynamics of Canada's party system. "Brokerage politics," pioneered by the Mackenzie King Liberals, emphasized political caution, policy vagueness, and balancing of multiple, often competing interests. Pressured by the leftist Co-operative Commonwealth Federation (CCF), the government found it useful in the late 1930s to defer the challenges of economic policy innovation to nonpartisan experts, and, in the mid-1940s, to refashion a partisan identity around the discourse of managerial efficiency and technocratic problem solving generated by Canada's Keynesians. As the Liberals made these shifts, the Conservatives also adjusted to the new paradigm: they embraced the positive state, added Progressive to their name, and chose John Bracken, a strong advocate of Keynesian theory, as leader. By 1945, both governing brokerage parties had created new space for their progressive factions: social Liberals and red Tories. Even the CCF moderated its earlier calls for the replacement of capitalism and embraced a form of "social Keynesianism" that questioned only specific aspects of the governing paradigm. Indeed, the depth and breadth of the Keynesian accommodation in the postwar federal party system led some observers to question its implications for democratic debate and policy accountability.[4]

Within the institutions of federalism, Ottawa linked its Keynesian fiscal and social measures to a new "centralism" constructed around the twin pillars of national standards and regional equalization. While Quebec remained at best a limited partner to the accommodation, the other provinces accepted the new paradigm and acknowledged Ottawa's leadership role. Keynesian economic theory supplied the terms for cooperative federalism expressed in official-level negotiation of fiscal arrangements for social programs and coordinated budgeting to counter business cycles. Meanwhile, regional conflicts among first ministers were muted as debate shifted to provincial claims on an expanding economic pie.

After the war, business, labour, and agricultural interests, like political parties, remained "policy takers," deferring to experts in matters of macro-economic management. Both labour and agriculture had reasons to contest the limited form of Canadian Keynesian theory but lacked the national organizational capacity, not to mention the political clout, to advance alternatives. Consequently, they reacted to bureaucratic

initiatives and accepted expert judgments about feasible options. Gaining political legitimacy and certain rights within the overall Keynesian philosophy, workers and farmers turned their attention to securing further protections through collective bargaining, agricultural marketing, and price support programs. For business, the Keynesian accommodation was smoothed by the technocratic emphasis on arm's-length government fine-tuning of private investment and capital formation. Moreover, business representatives were offered an ongoing voice in shaping the terms of Keynesian practice, as information about their investment intentions became critical in budget decisions and forecasts.

For the first three decades of the postwar period, Keynesian theory was a governing macro-economic paradigm in Canada, underpinning both a robust technical consensus and a broad political accommodation. In these years, the economy achieved success across all four objectives: high employment, price stability, economic growth, and international balance. Ironically, however, as many observers have noted, federal budgeting in these years exhibited no consistent Keynesian counter-cyclical pattern in the face of mild economic cycles.[5] In fact, by the 1950s, the chief Keynesian goal of high employment came to be seen to depend more on international demand than domestic economic management. Continental integration through natural resource exporting and foreign direct investment became the effective national economic strategy. And in the 1960s, concerns were increasingly raised about problems of a non-Keynesian sort: high foreign ownership, inadequately skilled workers, regional underdevelopment, and lagging productivity and technological innovation. By the early 1970s, these new concerns intersected with old problems thought to be banished by Keynesian fine-tuning: rising inflation *and* unemployment.

BREAKDOWN: THE 1970S

In the 1970s, economic conditions suddenly changed for the worse in ways that confounded the Keynesian paradigm. Increased internationalization of investment raised the spectre of "deindustrialization" as transnational corporations rationalized production globally. Stagflation—the combination of high inflation and high unemployment—defied the most basic Keynesian tradeoff between price stability and jobs. Deepening the confusion was the dissolution of the postwar international financial regime premised on fixed exchange rates to create space for domestic Keynesianism. The onset of floating currencies imposed powerful constraints on government fiscal activism.

Bewildered by these pressures, the federal government groped for direction. Initially following an expansionary course featuring large corporate tax cuts to entice productivity-enhancing investment, the government soon changed to a deflationary focus. In 1975, it imposed mandatory wage and price controls, without the support of either business or labour, following an election campaign that promised the opposite. The Bank of Canada began to restrain the growth of the money supply, suggesting a commitment to low inflation over other macro-economic objectives such as job creation. Meanwhile, within the bureaucracy, planning began on a longer-run national industrial strategy to solve Canada's productivity and innovation problems. Rather than concentrating on deflation and restraint, this strategy contemplated new government-directed spending and a regulatory regime to transform the branch-plant, commodity-dependent economy.[6]

Canadian macro-economic policy in the 1970s has been aptly characterized as " 'ad hocism' practiced with a vengeance." [7] Inflation more than tripled in the first half of the decade, while unemployment doubled in the second half. Large federal expenditures on tax incentives and cuts, combined with increased pressure on automatic stabilizers caused by deteriorating economic conditions, created another problem: persistent, growing annual budget deficits. Further, the severity of the deficit difficulties for the Department of Finance was exacerbated by the Bank of Canada's success in combating inflation and defending the value of the Canadian dollar through higher interest rates. In short, Keynesian instruments were either failing or working at cross-purposes.

The governing paradigm was in crisis. Policy experts pursued numerous, and often mutually exclusive, "post-Keynesian" lines of thought: monetarism, corporatist productivity bargaining, nationalist mega-projects, continental integration, and social welfare reform. The collapse of the existing technical consensus was paralleled by new political mobilization against the old Keynesian accommodation. In the party system, social Liberals and red Tories found themselves on the defensive as new factions sponsored business-based conceptions of the public good that celebrated free markets, not smart states. Within federalism, the provinces increasingly contested Ottawa's macro-economic dominance in both its fiscal and social policy dimensions: province-building premiers asserted new claims for control over regional economic development and joined Quebec in resisting the imposition of federal social priorities, especially when federal contributions to shared-cost programs began to decline. In society, latent class conflict resurfaced. Business and labour fought Ottawa and each other over wage and price controls, and each elaborated divergent post-Keynesian macro-economic paradigms. Labour advanced an interventionist and nationalist full-employment strategy premised on greater worker voice in productivity—enhancing public investments in technology and workplace reorganization. Business went on the offensive with a market-based, inflation-fighting, continentalist restructuring thrust valuing, above all else, corporate flexibility.

If the 1970s were years of inconclusive macro-economic experimentation, the 1980s would be the decade of paradigm shift. Neoliberal ideas became a new orthodoxy among economists and a critical ingredient in the major realignment of sociopolitical forces in the party, state, and intergovernmental systems.

CANADA'S NEOLIBERAL RESTORATION: FROM THE 1980S TO THE 1990S

NEOLIBERAL IDEAS

As with Keynesian philosophy a generation earlier, the creation of the neoliberal governing paradigm was anchored in theoretical reconstruction by professional economists, notably Milton Friedman from the University of Chicago. Deep-seated assumptions about accountability for the economy's performance were overturned. Governments, not markets, were prone to failure; individuals were responsible for their own labour market circumstances and well-being. Left alone, the private economy supplied the incentives and disciplines for optimizing behaviour by workers, firms, and communities. The great risk was intervention by state managers who not only lacked the knowledge for corrective action but were motivated to compound, over the long run, any short-term dislocations generated by free markets. Keynesian theory institutionalized all manner of inefficiency: "rent-seeking" behaviour by interest groups securing special benefits and expenditures; workers and companies insulated from new realities and therefore avoiding adjustments; and politicians and bureaucrats seeking to advance their own careers through various kinds of "pork barrelling." Neoliberalism thus unveiled a new public philosophy whose goal was to substitute impersonal market rules for government discretion based on Keynesian expertise.

This philosophical critique was given concrete macro-economic meaning through the interrelated policy doctrines of monetarism and the non-accelerating inflationary rate of unemployment (NAIRU). The NAIRU disputed the assumed tradeoff between employment and inflation that had been central to Keynesian theory. The NAIRU stated that there was no necessary relationship between higher inflation and lower unemployment because of the way Keynesian social policy structured the choices of workers. Expansionary demand management measures that traded short-term inflation for longer-term employment were undermined as individuals responded to changing work and pay incentives. Seeing their real earnings diminished by inflation, the argument ran, rational workers would either press for higher wages or quit to take advantage of social benefits. The result would be not simply higher inflation but higher unemployment; domestic workers either priced themselves above the global competition or voluntarily left their jobs.

The NAIRU's implications for social policy were evident: all assistance and support should be recast through "active" labour market strategy to force worker adjustment to market dictates. Structural reforms to remove impediments to change included rolling back minimum wages, trade union rights, unemployment insurance, and welfare benefits. Savings realized from deep cuts in Keynesian stabilization programs could be diverted to skills upgrading or labour mobility. Ideally, such adjustment responsibilities would be privatized: worker training was a management prerogative exercised in relation to market signals, or a matter of individual choice as workers invested in their own human capital.

Neoliberal theory typically set the NAIRU in the range of 8 percent, a level unthinkably high for Keynesians, and set a target of zero inflation for monetary policy, incomprehensibly low from a Keynesian perspective, in which monetary policy was in the service of counter-cyclical fiscal activism. Neoliberals sought to return Canadian unemployment to its "natural" level, where workers would neither demand higher wages nor substitute social programs for paid work. Consequently, neoliberalism recast unemployment as a necessary component in macro-economic strategy to eliminate inflation. The break with Keynesian theory was complete: price stability became the overriding objective, monetary policy the principal instrument, and central banks with independence from politicians the governing authority.

This neoliberal technical consensus was expressed in a variety of expert policy forums in the 1980s. Think tanks and research institutes such as the Economic Council of Canada, the C.D. Howe Institute, and the Fraser Institute all offered their own specialized contributions to the emerging paradigm. Business leaders, in a marked departure from the postwar pattern of deference to bureaucratic expertise, created an umbrella organization, the Business Council on National Issues (BCNI) and gave it the resources to disseminate sophisticated neoliberal policy analysis and advice.

The Royal Commission on the Economic Union and Development Prospects in Canada (the Macdonald Commission) was a galvanizing process for neoliberal economic ideas and business interests. Issued in the midst of protracted economic problems and policy confusion, the Commission's 1985 report fully endorsed the economists' theoretical case for the inherent superiority of markets to other modes of resource allocation such as corporatist negotiation or statist planning. It devised an integrated neoliberal policy package advocating continental free trade, "natural" unemployment rates, and social welfare retrenchment. The commission delivered a full-blown statement of a new economic paradigm in a fashion reminiscent of the pathbreaking contributions to Canadian Keynesian theory made by the Rowell-Sirois Commission of the 1930s. Advocates of industrial strategies, defenders of Keynesian ideas, and critics of the NAIRU found no space in the report's description of Canada's "new reality." By the mid-1980s, dissenters from the neoliberal technical consensus were marginalized.

NEOLIBERAL POLITICS

In the wake of the Macdonald Commission report, the neoliberal technical consensus was matched by a new political accommodation as the paradigm gathered support in the state, party, and interest-group systems. Among parties, support for neoliberalism was signalled by changes in the leadership of both the Progressive Conservatives and the Liberals. Conservative Brian Mulroney and Liberal John Turner each arrived with strong ties to the business community and proclaimed their general opposition to the post-Keynesian interventionism and nationalism that had informed the final Trudeau government of the early 1980s. The Mulroney government was elected with a massive majority in 1984 but stumbled badly in its first year without apparent economic or social policy direction. In 1985, despite the Mulroney's campaign statements against welfare retrenchment and continental free trade, the government suddenly embraced just such a neoliberal "adjustment agenda."

This structural reform package was reinforced by macro-economic policy. Expenditure restraint achieved through cuts in unemployment insurance, social assistance, and provincial transfers became near-permanent features of Mulroney government budgets. The Conservative Finance minister also backed the unprecedented commitment made by the Bank of Canada to the goal of zero inflation. Indeed, in its constitutional proposals of the early 1990s, the government proposed making price stability the sole objective of the Bank and federal monetary policy. One consequence of the pursuit of this extreme anti-inflationary goal was to greatly increase the costs of public debt servicing. In practice, the Finance Department's fiscal restraint was undermined by the Bank's monetary restraint. Interest payments on the debt consumed a growing proportion of federal revenues, amounting to nearly one-third of every expenditure dollar when the Conservatives left office in 1993. The annual budget deficit was $42 billion, or 6 percent of gross domestic product. Interestingly, another consequence of this effective disjunction between fiscal and monetary policy was to buttress political support for neoliberalism. The mistaken perception that deficits and debt problems were caused by excessive and rising social spending hardened into received wisdom, reinforcing calls in the media and among politicians and business interests for more cuts.

In relation to all this, the Liberals repositioned themselves to compete for the same economic policy space as the Conservatives and the emerging Reform Party. Moreover, the New Democratic Party fell into line, at least in the critical "free trade" election of 1988, when it opted to avoid economic policy discussion altogether and campaign in classic brokerage fashion on the basis of an appealing leader and a myriad of specific promises to social movement constituencies. By the time of the 1993 election, neoliberalism defined the political terms for a governing macro-economic consensus. Conservative Kim Campbell told the voters as much when she declared that governments, regardless of partisan stripe, could do nothing to reduce unemployment.

While the Liberals campaigned on a "Red Book" offering a Keynesian-style alternative to Campbell's unvarnished neoliberalism, the Chrétien government's post-election conversion to deficit and debt reduction confirmed the paradigm's power. Retaining the goods and services tax, cutting unemployment insurance and federal transfer payments, the Liberals made continuity not change the hallmark of their macro-economics. Between 1993 and 1998, total federal program spending as a percentage of the economy declined by 3.9 percent, falling to 12.7 percent, its lowest point since 1949–50.[8] During the years of Conservative government, the Bank of Canada took the lead and the Department of Finance moved in step. Under the Liberals, the Department of Finance and Paul Martin moved centre-stage with unprecedented spending cuts, supported by central agencies orchestrating equally sweeping program and expenditure management reviews to shrink the role and size of the federal public sector. The process culminated in the 1995 budget, which in the depth and breadth of its cuts and downsizing led more than one observer to announce the "end of Canada as we know it."[9]

In intergovernmental relations, a new accommodation, albeit one marked by considerable controversy, reversed the centralism of Canadian Keynesian theory, Guided by the NAIRU and monetarism, the federal government's use of its spending power in areas of provincial jurisdiction for national purposes declined precipitously. Decentralization and provincialism captured the political and fiscal dynamics of Canadian federalism reframed by Ottawa's neoliberal macro-economic paradigm. In the means used to offload their deficit problems, there were, nonetheless, important differences between the Conservative and Liberal governments. The Conservatives proceeded incrementally through expenditure freezes, benefit de-indexation, and regressive tax burden shifts. They were criticized for this "stealth" approach to change that carried huge implications for the country's identity and the workings of the federation.

By contrast, the Liberals in their 1995 budget addressed matters openly, and all at once, through fundamental institutional change in federal–provincial relations. The Canadian Health and Social Transfer created a new fiscal regime for social policy that reduced the flow of federal dollars by about $6 billion while providing greater discretion to the provinces in allocation. In this case, critics argued that the Liberals had used macro-economic decisions to effect a major constitutional restructuring of the postwar federal social bargain. Regardless of the preferred implementation style, it was clear that the neoliberal paradigm in its intergovernmental guise spoke persuasively to the economic and national unity agendas of both the Mulroney and Chrétien governments. Ottawa could reduce its deficit while offering more autonomy to the provinces.

Meanwhile, the business community, through the research and mobilization of the BCNI, actively supported the paradigm. Under its leadership, regional and sectoral tensions within Canadian business over macro-economic policy were replaced by a unity of purpose defined by neoliberal restraint and liberalization. The BCNI found ample space for its ideas in influential policy development locales such as the Macdonald Commission, think tanks, and the media. At the same time, the socio-political accommodation never included representatives of workers or the social movements comprising the "popular sector." These groups contested neoliberal claims about natural rates of unemployment or incentive-distorting social programs even as federal governing parties and many premiers embraced them. Yet this social coalition remained on the defensive with its constituencies reeling from the combined impact of neoliberal policies and wrenching economic restructuring that stripped away resources for political mobilization.

The new Canadian domestic consensus and accommodation found its international counterpart. Continental free trade, floating exchange rates, and financial deregulation were all seen by neoliberal advocates to further discipline domestic states and societies to conform to market imperatives. In fact, the global policy constraint argument followed a logic similar to the domestic policy constraint case based on the NAIRU. Expansionary fiscal policy would lead international money traders to sell national currencies, effectively forcing the government to raise interest rates to defend the currency's value, with deleterious impacts on domestic investment and employment. As with the NAIRU, Keynesian policymakers would only worsen the very problems they originally set about to correct.

In sum, it is apparent that in the 1980s and early 1990s a new governing macro-economic paradigm was embedded in the Canadian state and society. While the technical consensus behind neoliberal ideas redefined the mainstream of the economics profession away from Keynesian philosophy, the political accommodation remained more tenuous. Challenges persisted along a number of policy dimensions. Were federal deficits actually traceable to overly generous social expenditures? Did redistributive or stabilizing social programs really produce inefficient labour markets? Would expansionary fiscal policy inevitably worsen unemployment? Would federal retrenchment not lead to a patchwork "social Canada" distinguished by interprovincial discrepancies in standards and services? Finally, what are the obligations and capacities of national governments in helping citizens adjust to, or perhaps even challenge, economic globalization? In the late 1990s, these questions have become the subject of renewed macro-economic debate.

2000 AND BEYOND: A NEW GOVERNING PARADIGM?

Only four years after the landmark 1995 federal budget, there is evidence to suggest a fraying of both technical and political support for the neoliberal paradigm. The late 1990s witnessed two significant developments. First, the fiscal circumstances of the federal government, and most provinces, have dramatically improved. Decades of growing public deficits have suddenly been replaced by budgetary surpluses as the combination of economic growth, expenditure cuts, public-sector downsizing, tax increases, and lower interest rates expand government revenues. The issue of spending choice suddenly has been injected into macro-economic debate alongside the restraint imperative.

The second significant development relates to growing awareness of the social consequences of neoliberal macro-economics. A particular pattern of success and failure is taking shape that reopens fundamental questions about the role and responsibility of government in countering market outcomes. Neoliberalism has done much to wrestle inflation and the deficit to the ground. But the victories have hardly been cost-free: unemployment has remained at near double digit levels for more than two decades; social polarization has intensified in the face of growing earnings inequality and employment insurance and welfare cutbacks; as well, concern grows in all provinces about the quality of the health care and postsecondary education systems.

TECHNICAL CHALLENGES TO NEOLIBERALISM

Not surprisingly, the neoliberal record, assessed in the context of the fiscal dividend, has stirred controversy in both technical and political circles. Among experts, neoliberalism has been subject to searching critique by professional economists who cannot be dismissed as part of the discipline's radical fringe. For example, Pierre Fortin, former president of the Canadian Economics Association, demonstrated that macro-economic policy adherence to the NAIRU and monetarism were the key causal factors behind Canada's recession of the early 1990s, the worst since the 1930s.[10] Among Fortin's conclusions: maintaining the unemployment rate above the NAIRU did not reduce inflation, and neither did reducing inflation or cutting unemployment insurance benefits increase employment.

Along similar lines, Paul Krugman, an award-winning American economist, singled out Canada in a cross-national study of the negative employment and growth effects of an unwavering commitment by monetary authorities to zero inflation.[11] Lars Osberg and Gideon Rosenbluth, each also serving as presidents of the Canadian Economics Association, have illuminated the social impacts, indeed the contradictions, of neoliberalism.[12] Their research has clarified two issues of particular macro-economic significance. They have shown that the primary source of federal deficits resided not in excessive social spending but in revenue shortfalls related to corporate tax cuts and in debt-servicing charges caused by high interest rates. Further, they describe how policy deference to a NAIRU in the range of 8 percent undermines the effectiveness of education and training programs that neoliberalism recognizes as the only legitimate form of social expenditure. Simply put, displaced workers need expansive fiscal policy, first, to fund their skills upgrading and, second, to make new jobs available. Neoliberal deflation meets neither need. As Osberg summarizes: "The continued implementation of a macro-economic policy that focuses on zero inflation and deficit reduction implies continuous high unemployment rates ... [and] dooms long-run structural adjustment policies, like retraining, to failure."[13]

Similarly, key aspects of the neoliberal paradigm have engendered controversy among policymakers.[14] For example, in 1995, disputes emerged between officials at the Bank of Canada and Department of Finance and Liberal Cabinet ministers on how to measure the NAIRU, and indeed, the figure at which it should be set. Officials proposed a NAIRU in the range of 9 percent, a figure flatly rejected by then minister of State for International Financial Institutions, Douglas Peters, himself a professional economist, who then set the target figure at 6 percent. In the midst of this internal dispute between his junior minister and his officials, Finance Minister Paul Martin publicly declared that he was not guided in his budgetary decisions by any such theoretical concept of natural unemployment. Fuelling further controversy over the NAIRU were two departmental reports that became public showing the overall costs of Canada's high "natural" unemployment rate to be between $45 billion and $77 billion. By 1996, even Deputy Finance Minister David Dodge conceded that the zero-inflation commitment made in the 1980s may have been excessive and that in hindsight a more moderate or balanced macro-economic policy was perhaps warranted.[15]

The rethinking of Canadian neoliberalism was underscored in some degree by macro-economic developments in the United States. It was duly noted that when the U.S. unemployment rate dropped well below the NAIRU by the mid-1990s, not only did inflation not result but unemployment continued to fall. It was also observed that across this expansionary period, U.S. monetary authorities did not raise interest rates. By the late 1990s, a number of leading U.S. economists concluded that the NAIRU was theoretically vacuous, and its policy application reflected bad macroeconomic advice.[16] Finally, and most recently, the spread of the so-called Asian economic flu driven by massive short-term international currency speculation has led to growing interest in a new global framework to provide a greater measure of domestic policy discretion while limiting the effects of external shocks. Different from neoliberalism, this framework would use supranational regulation to restrain global capital flows.

POLITICAL CHALLENGES TO NEOLIBERALISM

These technical disputes have now been fully matched by political controversy over macro-economic policy. The contested terrain has been the federal budget surplus. Beyond questions of its size and projected growth over time, the surplus has triggered heated debate among socio-political actors. Business, labour, social movements, and the provinces all make their own cases that the surplus should be spent on them. Labour and social movements formed a "social reinvestment alliance" calling for new spending to respond to the human consequences of neoliberalism, with an initial priority placed on restoring unemployment insurance benefits and eligibility. Such claims carry considerable moral force as program cuts, disproportionately affecting this constituency, contributed most to the elimination of the federal deficit. However, business and international financial interests have identified much different fiscal policy priorities. On the one hand, they emphasized across-the-board tax relief, including significant payroll tax reductions, which they asserted would induce new private investment while halting the so-called brain drain of specialized professionals to the United States. On the other hand, some corporate spokespersons have rejected any form of stimulative expenditures, calling instead for application of all surpluses to debt reduction. Unified in its opposition to new social spending, the business community still appears somewhat divided over the specifics of federal post-deficit budget policy.

For their part, the provinces have spoken with one voice in demanding restoration of the $6 billion federal social transfer cut announced in the 1995 budget. They have been equally adamant that the "fiscal payback" take the form of transfers not new federal programs (like Ottawa's plans for a Millennium Scholarship Fund). More generally, it can be said that the premiers are seeking an intergovernmental fiscal-social regime that departs from both of postwar Canada's governing macro-economic paradigms. They want the federal government to abandon its deflationary, restraint-focused neoliberalism and to do so in a manner that will grant far more provincial control over new spending than that countenanced by Keynesian thinking.

Faced with this growing political conflict, the Liberal government, re-elected with a reduced majority in 1997, has proceeded cautiously. Relying heavily on opinion polling and focus group testing, the government crafted a budgetary strategy that sought some balance among the three competing macro-economic claims: one-half of the surplus for new social spending and tax cuts, and the other half for debt repayment.[17] In part, this strategy reflected Cabinet's desire to manage the Liberal Party's internal tensions over this issue. Moving from the "politics of scarcity" to the "politics of the fiscal dividend" rekindles debate among social and business Liberals about the party's future direction. Do budgetary surpluses permit the Liberals to reclaim their tradition of "progressive centralism" involving active use of the federal spending power, defining national standards, and delivering benefits to students, the poor, seniors, and so forth? Or do they confirm the wisdom of the party's recent cutting, clearing the path for consolidation of a more fiscally conservative partisan identity?

At the same time, the government's macro-economic balancing act and opinion tracking also speaks to a larger vacuum in the realm of governing ideas. The sudden fraying of the neoliberal technical consensus and political accommodation has left the government without an "overarching vision" or a "new public finance philosophy."[18] Indeed, Finance Minister Martin in his October 1998 Economic and Fiscal Update abruptly cast aside the government's balancing act in dispensing the surplus. Instead, he dismissed the representations from all spending constituencies by declaring that global turbulence, which had reduced the value of the Canadian dollar by more than 10 percent between March and October 1998, made it necessary to channel the entire $3.5 billion 1997–98 fiscal surplus to debt repayment. The Finance minister changed the government's post-deficit script to follow what John McCallum, chief economist of the Royal Bank, called a budgetary policy of "surpluses by stealth."[19] That is, the government greatly understated the size of the surplus and overstated the constraints on new expenditures. Whether this represents temporary tacking in response to exceptional circumstances or indicates a more enduring federal budgetary course is not yet clear.

MACRO-ECONOMIC POLICY AT THE CROSSROADS

More clear is that Canadian macro-economic policy stands at another historic crossroads. Simply put, neither Keynesian economic theory nor neoliberalism delivered the productive investments required to prevent growing unemployment, social inequality, and pronounced vulnerability to international economic forces. Thus far, only a few general parameters have been set around a new governing paradigm: no deficit financing along the lines proscribed by Keynesian thinking and a more relaxed monetary policy than that permitted by neoliberalism to encourage investment in technology, skills, and health. Beyond this, there is much creative work to be done in the worlds of both ideas and politics. The central challenge is to develop a macro-economic policy paradigm that will provide for economic innovation *and* social cohesion, that indeed will recognize their interdependence. Economic and social well-being cannot be traded off one against the other. A growing body of cross-national data indicates that more equal and inclusive societies are also more productive economies; devoting fewer resources to illness, incarceration, illiteracy, and idleness, these societies are better able to make rapid and efficient adjustments to industrial change and economic shocks.[20]

Within these broad outlines, the terms of future expert debate and political conflict in Canadian macro-economic policy are now crystallizing. One perspective argues that innovative economies depend for their dynamism on what is called "social capital," referring to "a social structure that facilitates, through trust and shared norms, coordination and cooperation among individuals, institutions, and enterprises".[21] Formation of social capital, it has been argued, should be a cornerstone of macro-economic policy because it is a key "determinant of growth" in the knowledge economy. From this vantage point, three budgetary priorities present themselves. First, demand stimulus is needed to provide jobs for workers, particularly those in training programs or seeking first employment. Second, there must be reinvestment in health, education, and social assistance to close the widening gap between the rich and poor and to help ensure an equitable sharing of the economy's productivity gains between corporate profits and worker wages. Finally, institutional supports are required to facilitate social partnerships or associational networks that generate leading-edge technical and organizational knowledge and enable learning across sectors—business, finance, education, and voluntary associations. Rooted in the Keynesian public philosophy of market failure, this new perspective looks beyond bureaucratic expertise for corrective action to the web of social relations and civic cooperation.

Other observers take issue with much of the social capital approach to economic policy.[22] They agree that long-term investments are needed in new social and technological infrastructures, but insist that these are private rather than public or collective responsibilities. Individuals in free markets will maximize their own human capital through educational choice. Competitive firms, guaranteed intellectual property rights, and low tax rates will create knowledge-based assets. Social partnerships engender not trust conducive to productivity, but special privileges inhibiting innovation. From this perspective, government's role is to extend the reach of market incentives and disciplines. The philosophical debt to neoliberalism is evident. Macro-economic policy is seen only as providing the framework for securing private returns to investment.

Into the next millennium, these different perspectives on economic innovation and social cohesion will coalesce new alignments of ideas and interests in the Canadian political system. The skirmishes in the late 1990s over the meaning and use of federal budget surpluses are only the opening round in what promises to be a lengthy struggle to design and embed a new macro-economic paradigm. The battle has been joined to remake the match between ideas and politics in governing the Canadian economy.

NOTES

1. For insightful discussions of policy paradigms, see Peter A. Hall, "Policy Paradigms, Experts, and the State: The Case of Macro-economic Policy in Britain," in Stephen Brooks and Alain-G. Gagnon, eds., *Social Scientists, Policy, and the State* (New York: Praeger, 1990), pp. 53–79; and Margaret Weir, *Politics and Jobs: The Boundaries of Employment Policy in the United States* (Princeton: Princeton University Press, 1992).

2. Neil Bradford, *Commissioning Ideas: Canadian National Policy Innovation in Comparative Perspective* (Toronto: Oxford University Press, 1998), chap. 2.

3. W.A. Mackintosh, "The White Paper on Employment and Income in Its 1945 Setting," in S.F. Kaliski, ed., *Canadian Economic Policy Since the War* (Ottawa: Carleton University Press, 1965), p. 19.

4. Eugene Forsey, "Parliament Is Endangered by Mr. King's Principle," *Saturday Night* (October 9, 1948): 10.

5. Robert Campbell, *Grand Illusions: The Politics of the Keynesian Experience in Canada, 1945–1975* (Peterborough, ON: Broadview Press, 1987); David A. Wolfe, "The Rise and Demise of the Keynesian Era in Canada: Economic Policy, 1930–82," in M. Cross and G. Kealey, eds., *Modern Canada: Readings in Canadian Social History* (Toronto: McClelland and Stewart, 1984).

6. Glen Williams, *Not For Export: The International Competitiveness of Canadian Manufacturing*, 3rd ed. (Toronto: McClelland and Stewart, 1994), chap. 6.

7. G. Bruce Doern and Richard Phidd, *Canadian Public Policy: Ideas, Structure, Process* (Toronto: Methuen, 1983), p. 409.

8. Department of Finance, "Government Announces First Budget Surplus in 28 Years" (October 14, 1998).

9. Former Ontario premier Bob Rae and former federal deputy minister Arthur Kroeger each used this expression to describe the impacts of the 1995 budget.

10. Pierre Fortin, "Lessons from the Canadian Slump of the 1990s," in Tom Kent, ed., *In Pursuit of the Public Good: Essays in Honour of Allan J. MacEachen* (Montreal/Kingston: McGill-Queen's University Press, 1997), pp. 92–119.

11. Paul Krugman, "Stable Prices and Fast Growth: Just Say No," *The Economist* (August 31, 1996): 19–22.

12. Lars Osberg, "Social Policy, Macro Policy and the Debt," and Gideon Rosenbluth, "The Debt and Canada's Social Programs," in L. Osberg and P. Fortin, eds., *Unnecessary Debts* (Toronto: Lorimer, 1996).

13. L. Osberg, "Social Policy, Macro Policy and the Debt," p. 127.

14. Linda McQuaig, *The Cult of Impotence: Selling the Myth of Powerlessness in the Global Economy* (Toronto: Viking, 1998), pp. 82–98.

15. See David Dodge, quoted in Tom Kent, "Debating the Public Good, with Afterthoughts," in Tom Kent, ed., *In Pursuit of the Public Good: Essays in Honour of Allan J. MacEachen* (Montreal/Kingston: McGill-Queen's University Press, 1996), p. 170.

16. James Galbraith, *Created Unequal: The Crisis in American Pay* (New York: The Free Press, 1998), pp. 171–82.

17. Leslie A. Pal, "Balancing Act: The Post Deficit Mandate," in L. Pal, ed., *How Ottawa Spends 1998–99* (Ottawa: Carleton University Press, 1998), pp. 1–10.

18. Michael J. Prince, "New Mandate, New Money, New Politics: Federal Budgeting in the Post-Deficit Era," in L. Pal, ed., *How Ottawa Spends 1998–99*, p. 48.

19. "Martin Surplus Much Too Tiny, Economists Feel," *London Free Press* (October, 17, 1998).

20. Jane Jenson, *Mapping Social Cohesion: The State of Canadian Research* (Ottawa: Canadian Policy Research Networks, 1998).

21. T. Kent, "Debating the Public Good, with Afterthoughts," in T. Kent, ed., *In Pursuit of the Public Good*, p. 163. For the links between economic performance and social capital, see Lars Osberg, "Sustainable Social Development," in Richard Allen and Gideon Rosenbluth, eds., *False Promises: The Failure of Conservative Economics* (Vancouver: New Star Books, 1992).

22. See, for example, the innovation strategies proposed in Richard Lipsey, "Economic Growth, Technological Change, and Canadian Economic Policy," C.D. Howe Institute, Benefactors Lecture, 1996; and Thomas Courchene, "Proposals for a New National Policy," in T. Kent, ed., *In Pursuit of the Public Good*, pp. 65–92.

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