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CANADIAN CENTRE for POLICY ALTERNATIVES MANITOBA OFFICE

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Keynes and the 2009 Provincial Budget

Budget day always presents an opportunity to contemplate the state of society, and this year in particular has most of us pondering the current economic mess we are in. How did this crisis happen? How and when will we move back to more stable times? This year's provincial budget takes some positive steps in keeping with Keynesian reform policies, so now would be a good time to review Keynes' ideas and see how the budget measures up.

Over the past several months there has been a remarkable resurgence of interest in the theories of the famous English economist, John Maynard Keynes. This interest in Keynesian economics is hardly surprising giving the spectacular failure of free-market theory as manifested in today's world-wide recession. The "invisible hand" wrecked such havoc in the financial sector as to make even the most fanatical free-market supporter wonder what neo-liberal theory had to say about reality. Surprisingly little, it seems.

Another famous economist, Kenneth Galbraith, said that it was rarely ideas that changed the "conventional wisdom", but the march of events. Events have certainly caused this about-face towards Keynesianism: policy advisors and politicians simply do not know what else to do. There are no tools in the neo-liberal toolbox to deal with a recession of the magnitude we are facing, and the fact that it was free-market theory that caused the crisis in the first place deflates any recommendations coming from that camp. So as we revisit Keynes' ideas the questions we need to be asking are, what are the tools we need to maintain Manitoba's relatively strong position in the Canadian economy, and how do we use them?

Keynes gave us both monetary and fiscal policies. Monetary policy is a federal-government tool that manipulates the interest rate and money supply. Fiscal policy refers to government spending and taxation. Keynes talks about "counter-cyclical" strategies to stimulate the economy when it contracts, and slow it down when it overheats. Simply put, both federal and provincial governments should spend strategically (running a deficit if needed) and lower taxes and in a recession and, once the economy recovers, slow spending and raise taxes to counteract inflationary pressures and pay down the debt.

We have certainly heard a lot from around the world about stimulus spending, and the provincial budget does have that. While it is difficult to determine an exact amount, there appears to be a provincial commitment for new rent-geared-to-income housing of around $24 million and a continued commitment to capital funding for

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renovation of existing public housing. We are also pleased to see the introduction of an interesting program, called Rebound, to provide new training and employment opportunities for the unemployed. However, the province still has not taken a comprehensive approach toward poverty reduction which would incorporate firm targets and timelines.

Many provinces have recently introduced poverty-reduction strategies designed to drive down poverty rates. CCPA Mb. has recommended a similar strategy that includes significant improvements in social assistance rates and pegs future adjustments to the rate of inflation. We also recommended increasing access to education and training for excluded groups. This improvement could be done through extending income supports for social assistance recipients pursuing education beyond the current two-year limit and establishing a scholarship program designed to encourage high-risk youth to complete secondary education. The new Rebound program mentioned above may move in this direction (we don't know the details yet), but it needs to be a part of a comprehensive poverty-reduction strategy.

The 2009 provincial budget also includes \$31.7M in tax cuts, something you would expect to see with a contracting economy. The problem is that this government has been using the tax-cut tool every year for the past ten years, even when the economy was strong. Cumulative tax cuts have shaved \$1B dollars from provincial revenues; this trend is not sustainable.

Shrinking revenues for a government that has to conform to balanced-budget legislation can only mean shrinking spending. Manitoba has serious social problems that raise health and crime costs and prevent many from participating in our economy; it makes sense to intervene with at-risk groups before they develop long-term problems. And it makes even more sense to engage in this kind of strategic spending during a recession.

Counter-recessionary fiscal stimulus should direct money so as to provide the quickest and biggest impact on aggregate spending. This government knows that the most effective way to provide a direct stimulus is through increases in benefits to the unemployed and transfer payments to the poor, simply because they spend everything they get in local economies. US economist Mark Zandi estimates that a one-dollar increase in stimulus spending results in a GDP increase of \$1.59 – information that is cited in the budget papers.

One may make an argument for lowering taxes in recessionary times (although the stimulus effect is less than when money is spent), but the other side of the coin is raising taxes again when the recession is over. Unfortunately, 30 years of neoliberal ideology has tried to convince the public that all taxation is bad, making it politically difficult to raise taxes when necessary. In fact, although Manitoba can lower taxes effortlessly, it cannot raise taxes without running a provincial referendum to seek public approval. With taxes set at permanently rock-bottom rates, the government will eventually have to cut social programs to balance the books.

We recommend that the province take another, closer look at Keynes' ideas: tax cuts should never be a permanent feature of a progressive, forward-thinking society. Eventually there will not be enough money for the important initiatives so needed in our province; initiatives that would allow us to ride out the current crisis and emerge even stronger.

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