

**Searching for Keynes:
With Application to Canada, 1870-2000**

by

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Abstract

This paper has two themes. In the first instance, we are concerned with uncovering the impact of intellectual thought on the practice of economic policy - specifically, the influence of Keynesianism on fiscal policy. Keynes' idea that national governments can stabilize aggregate economic activity, presented in his *General Theory of Employment, Interest and Money* (1936), is one of the most important innovations in economic policy thinking of the last century. It is clear that this argument has influenced both macroeconomic theory and popular opinion about what governments can and should do with respect to the business cycle. However, the extent to which Keynesian thinking has actually influenced the course of public policy remains an open question.

Since Keynesian stabilization concerns the transitory components of public policy, a “search for Keynes” requires that policy actions be separated into permanent and transitory components. There is little research on the challenging problem of modelling 'trend' and 'cycle' in the public sector, and this aspect of the paper constitutes a second theme, one that is of interest in its own right.

We look for evidence of attempts at Keynesian stabilization in the fiscal policy actions of the government of Canada after 1945, using consistent budgetary data for 1870 - 2000 constructed by Irwin Gillespie (1991) and updated by the authors. (The long time series is required in order to construct a counterfactual showing what we would observe ‘after Keynes’ if Keynesianism had not in fact been attempted.) Our decomposition of fiscal policy into permanent and transitory components is based on an intertemporal, probabilistic voting model in which all policies are considered part of an evolving political equilibrium.

While the methodology we develop can be used to decompose the evolution of public policy over time in any competitive political system, the Canadian case is of particular interest for a number of reasons: the *White Paper on Employment and Income* in 1945 signalled the acceptance of Keynesianism in senior policy circles, and one of Keynes’ students, Robert Bryce, who dates the first Keynesian budget from 1939, played an important role for many years in the Department of Finance.

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