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BANK OF CANADA ACT

INQUIRY—DEBATE ADJOURNED

Speech by:

The Honourable Diane Bellemare

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THE SENATE

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[*Translation*]

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INQUIRY—DEBATE ADJOURNED

Hon. Diane Bellemare (Legislative Deputy to the Government Representative in the Senate): Honourable senators, this evening I wish to ask the following question: Do we need to broaden the mandate of the Bank of Canada to pursue the objective of full and productive employment, as is the case in the United States, Australia and just recently New Zealand? This question may seem odd at first, but let me explain why I'm raising it and why I want to convince you that it is important.

I will first explain the context for this inquiry and then briefly talk about the fundamental reasons for broadening the Bank of Canada's mandate.

[*English*]

Let me begin with the contextual reasons for this inquiry. Some of you may know that the Bank of Canada Act received Royal Assent July 3, 1934, and has not yet been substantially revised to account for the major changes in the economy over more than 85 years when 30 per cent of the labour force was working in the agricultural sector.

[*Translation*]

Furthermore, no section of the act specifies the Bank of Canada's mandate. The act primarily includes provisions on management, as well as a preamble that explains why the central bank was created. The preamble states the following:

> WHEREAS it is desirable to establish a central bank in Canada to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of Canada;
>
> THEREFORE, His Majesty, by and with the advice and consent of the Senate and House of Commons of Canada, enacts [the Bank of Canada Act]

[*English*]

This preamble is very large in scope but has not the power of law. In the rest of the law, it's managerial issues that are taken care of.

[*Translation*]

In the beginning, the Bank of Canada was focused on protecting the external value of the Canadian dollar, protecting the financial security of our institutions, promoting growth and carrying out the objectives set out in the preamble. Over time, and especially in the 1970s, monetary policy became focused on price stability.

Some of you will no doubt remember the aggressive monetarist strategy to fight inflation adopted between 1976 and 1990, which kept interest rates extremely high. At the time, it was not uncommon to see mortgage rates of 20 per cent. What is more, the unemployment rate in Canada was about 10 per cent and the youth unemployment rate was almost 20 per cent in the 1980s.

During the 1990s, although the Bank of Canada Act remained unchanged, price stability became the Bank of Canada's official mandate. Since 1991, the bank has been signing five-year agreements with the Government of Canada that set out an inflation target to guide monetary policy. The most recent agreement signed in 2016 will have to be renewed in 2021. Under this agreement, the bank conducts its activities in a way to target the annual rate of inflation at two per cent, the midpoint of a one to three per cent target range. In practice, the Bank of Canada uses the key interest rate to stimulate or slow economic activity in order to achieve an average rate of inflation of two per cent. As you know, the bank announces its key interest rate on a set date, eight times a year.

That being said, I repeat that the act does not mention the primary objective of the monetary policy or the five-year agreement between the Bank of Canada and the government, nor does it specify transparency obligations that would explain how and why the central bank fixes the key interest rate.

Things are very different in other countries.

[*English*]

Since 1977, the United States Federal Reserve Act specifies:

> Section 2A. Monetary policy objectives
>
> The Board of Governors of the Federal Reserve System and the Federal Open Market Committee shall maintain long run growth of the monetary and credit aggregates commensurate with the economy's long run potential to increase production, so as to promote effectively the goals of maximum employment, stable prices, and moderate long-term interest rates.

[*Translation*]

U.S. monetary policy pursues what economists call a dual mandate. It promotes stable prices on the one hand and full or maximum employment on the other.

Australia's Reserve Bank Act stipulates that the central bank must pursue a dual objective: full employment and price stability. Recently, in late 2018, the mandate of New Zealand's central bank was revised to include maximum employment.

These countries have also incorporated transparency obligations into their legislation.

It was in this legislative context that, in May 2018, at the behest of Professor Mario Seccareccia, more than 60 Canadian economists sent a letter to the Minister of Finance, Bill Morneau, asking him to amend the Canada Bank Act in order to broaden its mandate to pursue full and productive employment. These economists also asked the Minister of Finance to add a provision in the act imposing transparency obligations on the bank. The letter was signed by Ph.D.s in economics from every Canadian province, mostly eminent professors and researchers. I don't have the time to name all of them but I'd like to point out that those who signed the letter included Pierre Fortin, who we know very well in Quebec, Mathieu Dufour, also from Quebec, Andrew Sharpe, John Smithin and Brenda Spotton Visano, from Ontario, and many others from all the provinces. I mention these experts because they all sought to reach out to the Minister of Finance and others.

That is the context for this inquiry. Now, what about the substance of the issue?

[*English*]

First, colleagues, the mandate of the Bank of Canada is not a theoretical question. The conduct of monetary policy affects the wallets of every Canadian, those in debt or those with a mortgage, as well as those who are saving for retirement or living on a fixed income. For example, a homeowner with a mortgage of $280,000 would see his or her monthly payments increase by about $150 following a rate increase of one percentage point.

[*Translation*]

Monetary policy also influences our overall economic prosperity and our collective wealth. Indeed, an abrupt increase in the key interest rate can slow the economy and cause job losses. Some research done in 2010 by Kimberley Beaton, a former researcher at the Bank of Canada, found that a one percentage point increase in the unemployment rate comes with a 2.6 per cent decline in the GDP. In 2018, that percentage was equal to $57.8 billion. That's a lot of money lost, and lost forever.

[*English*]

The second reason is inflation is not the problem it used to be 40 years ago when it was considered by central banks to be the number one enemy.

[*Translation*]

Indeed, there are no longer accelerating price increases. Price increases tend to be in the one per cent to three per cent range, which is the preferred range. In the first quarter of 2019, for example, the inflation rate measured by the consumer price index was 1.7 per cent, so under two per cent.

In short, more and more economists believe that the economic reality of the past few years suggests that inflation dynamics are quite different today than they were in the past. Salary inflation no longer poses the same threat it did in the 1970s and 1980s. These days, a country can maintain very low unemployment rates without inflation increasing or accelerating.

On January 4, 2019, through the Internet, I was able to watch some of the debates and sessions held in Atlanta as part of the annual meeting of the American Economic Association. Two former presidents of the U.S. Federal Reserve, Janet Yellen and Ben Bernanke, and the current president, Jerome H. Powell, indicated that the correlation between the unemployment rate, salary increases and price increases is much weaker today than was once believed. In other words, the tradeoff between inflation and full employment is no longer seen as a problem, as it was between 1975 and 1990.

[*English*]

The third reason why we should consider a change in the mandate is Canada, like most countries, is now facing new risks, and monetary policy can help face those risks.

[*Translation*]

What are these new risks that the monetary policy must consider?

First, as we are now seeing, climate change and the will to reduce greenhouse gas emissions will force people to change their consumption patterns and potentially create unprecedented population movements that will require major investments. According to Mark Carney, former Governor of the Bank of Canada and current Governor of the Bank of England, climate change also threatens the stability of the financial system and requires massive private sector investments.

Technological changes and the advent of artificial intelligence will have a considerable impact on the labour market. According to various studies, including the Royal Bank's "Humans Wanted" study, over the next 10 years, the advent of artificial intelligence will redefine the configuration of tasks of almost 50 per cent of jobs, which means one job in two. The workforce will have to adapt to these changes. Individuals and businesses will have to make massive investments in skills development.

The aging population will increase public spending and create labour shortages. That is another risk factor that calls for setting a target for growth. The rise of protectionism and the ensuing tariff wars might also make it tremendously challenging for businesses to remain competitive.

Increased income inequality is another risk factor that is clearly a social scourge. As Professor Seccareccia demonstrated, monetary policy can contribute to containing or exacerbating these inequalities. From 1976 to 2008, labour shares of the national income continued to decline, while real interest rates surpassed productivity growth.

Many of these risks and uncertainties can lead to instability and higher prices. A monetary policy that only seeks to stabilize prices by raising the key interest rate as soon as the consumer price index increases beyond the target is liable to slow down the economy. When the economy slows down, businesses invest less, which prevents Canada from being able to adapt and cope with all the challenges it is facing.

[*English*]

In our present time, monetary policy that exclusively targets inflation is not enough.

[*Translation*]

That is why the Reserve Bank of New Zealand, for example, decided to broaden its monetary policy's mandate to include the pursuit of maximum employment. Since monetary policy is a powerful tool and inflation is no longer the number one enemy, why not specify that the policy seeks to achieve economic prosperity, and particularly full, sustainable employment?

In reality, since 2008, the monetary policy in Canada, New Zealand and other parts of the world has already been seeking to support job growth. Why not make it official?

The Bank of Canada's current balanced and responsible approach certainly deserves to be enshrined in law and in the agreement that the bank has with the government.

That is one of the reasons why the mandate of the Reserve Bank of New Zealand was reviewed. In a recent speech, Dr. John McDermott, the assistant governor of the Reserve Bank of New Zealand, explained the reason for the dual mandate as follows:

[*English*]

> And what of the move to a 'dual mandate'? The Bank has always had regard to developments in the labour market, and this has been encouraged by our increasingly flexible approach. We have a long history of meeting with businesses and organisations across the country, and we regularly assess the available labour market data and are committed to discussing labour market developments. So my current sense is that, to a large extent, the changes are a way of ensuring that the flexibility in our approach endures.

[*Translation*]

A dual mandate would reassure Canadians. They could have more confidence in the investments they need to make to adapt to the changes and risks we now face. This would perhaps require closer collaboration between monetary policy and fiscal policy, but it's worth it.

In conclusion, dear colleagues, as you can see, the question I asked at the beginning of this speech is certainly worth examining. The Standing Senate Committee on Banking and Commerce could certainly start a discussion with all interested parties on this very important topic.

Thank you for your attention.