Letter Addressed to Honourable Bill Morneau, Federal Minister of Finance of the Government of Canada, by Canadian Economists in Support of a Multi-Goal Mandate for the Bank of Canada

We wish to encourage the Canadian Government and, more specifically, the federal Minister of Finance, the honourable Bill Morneau, to instruct the Bank of Canada to pursue policies more consistent with its official broad mandate as stipulated in the preamble to the *Bank of Canada Act*:

" … 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." http://laws-lois.justice.gc.ca/eng/acts/B-2/page-1.html

The current official mandate of a 2 per cent inflation target is the outcome of a specific monetary policy framework put in place since 1991 when the Bank of Canada and the federal Minister of Finance of the then Progressive Conservative Government of former Prime Minister Brian Mulroney agreed on an inflation-targeting regime to conduct Canadian monetary policy. Through a decision of the Cabinet, the Canadian Government renews every five years this specific inflation target agreement with the Bank, with the most recent being in 2016 for the 2016-2021 period. Because this inflation-targeting regime has been in place for over a quarter century, we believe it is time to assess the current framework and open the discussion to the possibility of a broader mandate, which is more consistent with the spirit and intent of the original *Bank of Canada Act*.

In its current narrow policy framework, the Bank monitors and is supposed to act exclusively on the performance of the actual monthly inflation rate when the latter deviates from its annual target of 2 per cent inflation rate. Admittedly, the Bank takes decisions on the appropriate target overnight interest rate also by monitoring the evolution of the unemployment rate (or the "output gap", as defined by the Bank of Canada), but this is only for pre-emptive purposes, as a tool for controlling future inflation, on the basis of some hybrid Phillips Curve relation. There is strong indication, however, that the Phillips Curve is a relatively flat trade-off relation when observing evidence over the last decade or more. For instance, we have witnessed some very wide fluctuations in the unemployment rate since the global financial crisis of 2008, despite relatively small changes in the inflation rate. This suggests that, in addition to demand-side factors, there are other important determinants of the inflation rate over which the central bank has little control. In addition, there is a growing amount of empirical research that indicates that deflationary pressures on the economy triggered by actions of central banks to restrain inflation can be detrimental to the economy, not only in the short term, but also in the long term: output and employment on average never recover the trend levels that were previously forecasted. A side effect of this research is to question the validity of the output gap measures used by central banks to justify their pre-emptive strikes against inflation.

Recognizing the sharp decline in the Bank's target overnight interest rate despite the small changes in the inflation rate over the last decade, it would appear that both former Governor Mark Carney and current Governor Stephen Poloz have actually shown a high degree of pragmatism since the global financial crisis of 2008. This would suggest that, in practice, the Bank has pursued a policy that has shown great concern also with the level of employment and output, not as a predictor of future inflation, but primarily because high unemployment is detrimental to the welfare of Canadians who find themselves in such a socially unacceptable labour-market state. The same applies for the concern of the Bank with the high household debt ratios of Canadians, which may well be another reason why Governor Poloz has been reluctant to raise interest rates more quickly in recent years, despite the nearly continuous fall in the unemployment rate. Such decisions taken by the Bank have not directly been a response to changes in the inflation rate. They go beyond the Bank's official single-goal commitment of solely achieving its 2 percent inflation target. The Bank's behaviour seems, in fact, to be much more consistent with a broader multi-goal mandate that should be entrenched officially in any future government decision guiding monetary policy.

Also, strong, shared and sustainable growth and full and productive employment are among the goals of the United Nations that were adopted in 2015 in its 2030 Agenda to promote sustainable development, and full employment remains a goal for the US Federal Reserve under the Humphry-Hawkins Full Employment Act. We believe that such goals should be part of a broader vision of the Bank of Canada's strategy to improve the well-being of all Canadians.

That is why we are proposing that the *Bank of Canada Act* be amended to move the preamble text into the *Act* itself and thus become section 1 of the *Act*. We also propose to add the notion of full and productive employment as defined in Goal 8 of the United Nations 2030 Agenda. This article could read as follows: ***Article 1: The mandate of the Bank of Canada is 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 as well as full and productive employment.***

We also propose to add a new article to the *Act* pertaining to the framework of monetary policy. It could read as follows: ***Article 2: In the name of the principle of transparency and to ensure the conformity of the framework of monetary policy with the mandate of the Bank of Canada set out in Article 1 of the*** **Act*****, twelve months before the renewal of its (five-year) framework for the conduct of monetary policy, the government and the Bank of Canada table for the consideration of the Parliament of Canada (the House of Commons and the Senate) an evaluation of the monetary policy framework for previous years, including the effects of this policy on economic growth, inflation, employment and income distribution at the national and regional levels. This report also includes a presentation of the proposed new five-year framework for the conduct of monetary policy.***

We believe that this expanded mandate would be more consistent with the spirit of the original *Act*. It would also make monetary policy more transparent and understandable to all Canadians who know very well that such a policy can have an impact not only on the rate of inflation but also on economic growth, the level of employment and unemployment rate, as well as on the distribution of income and wealth of Canadians.

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