Bank of Canada Act doesn't need tweaking

By William B.P. Robson and Jeremy Kronick
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Senator Diane Bellemare has launched an inquiry into revising the Bank of Canada Act to add full employment to the bank's mandate. Senator Bellemare's inquiry appears to reflect a view that the bank's current framework – expressed in periodic agreements with the Parliament of Canada – of pursuing 2-per-cent inflation is deficient, and that requiring the bank to pursue an explicit goal related to jobs would improve it.

An alternative take on the situation is that the current framework is a sensible and highly successful way for the bank to pursue its existing mandate – which is in the Bank of Canada Act and already refers, among other goals, to mitigating fluctuations in employment and promoting the economic and financial welfare of Canada.

Because inflation in Canada has been low and stable for almost 25 years, it is worth recalling that inflation during the 25 years before that was higher and less stable. Economists generally do not like high, unstable inflation, and most non-economists like it even less; it makes simple things such as everyday buying and selling complicated and can make nonsense of longer-term decisions such as those regarding mortgages and retirement. Unhappiness with inflation inspired a change to inflation targeting in the early 1990s. The Bank of Canada's mandate did not change – the agreements with Parliament on inflation control made explicit that preserving the purchasing power of money was the surest route to accomplishing its goals related to employment and welfare more generally.

Inflation targeting has been a success. The bank's target has been to keep annual increases in the Consumer Price Index in a range of 1 to 3 per cent (midpoint 2 per cent) since 1995. In the 280 months since then, inflation has been within that range for 219 of those months – 78 per cent of the time. Both inflation and real activity (gross domestic product) have been less volatile since then. And, to speak directly to Senator Bellemare's concern, the unemployment rate – its peaks, its troughs and its averages – has been lower.

Not all is well in the world. Senator Bellemare's call for an inquiry cites, among other challenges, climate change, protectionism and income inequality. Low returns on savings are another major concern for many Canadians. But to the extent that Canadian policy makers can address these issues, unelected central bankers are not the right people for the job. Changes in environmental regulations, trade policy, taxes and spending are the responsibility of policy makers who run on platforms addressing these kinds of concerns.

In the current environment, it is hard not to see this initiative as part of a more general populist threat to central bank independence. One need only look south of the border to see how this plays out. U.S. President Donald Trump has repeatedly argued for keeping rates low, and he has berated the Fed for hiking rates despite signs over the past year of an economy at the peak of the cycle. The reason? Low rates keep the economy booming even at the risk of overheating and inflating asset prices – and we know the damage this can cause. The Bank of Canada's governing council, as an independent body with an inflation-targeting mandate, can look out longer term and determine the appropriate action over the course of a full business cycle.

Unhappiness with central bankers around the world is in many ways a result of two simultaneous events: the failure of fiscal policy makers to provide coherent strategies since the

financial crisis, forcing central banks centre stage, and the inability of monetary policy on its own to stimulate the type of economic rebound we are used to seeing after recessions. Central bankers have no control over the former, but they can – with no threat to their independence or the goal of low and stable inflation – raise their game with respect to the latter.

Perhaps annual changes are too short a horizon for inflation targets. Going to a longer period – 24 months, say – would give the bank scope to let the economy run hotter for a period without causing a confidence-damaging overshoot of its target. Tactically, the bank could probably be more energetic in fostering faster money growth when the economy is slowing.

Tweaks like these do not require any changes to the Bank of Canada's mandate – which, to repeat, already refers to employment and Canada's economic and financial welfare. Reopening the Bank of Canada Act, especially when central banks are under attack as the U.S. Federal Reserve currently is, risks undermining the larger framework that has been such a success over the past quarter-century. A thorough inquiry in the Senate would likely conclude – indeed, should conclude – that targeting low and stable inflation has been a major success for Canadians.

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