BANK OF CANADA

Opening statement by
John W. Crow
Governor of the Bank of Canada
before the House Standing Committee on Finance
16 January 1992

I appreciate appearing before you as you complete hearings on those constitutional proposals of the federal government that have a bearing on the Bank of Canada.

I thought it might be helpful if I were to kick off this session with some comments on a number of the issues that have figured prominently in the testimony you have heard. My comments will focus on three areas: first, matters relating to Bank of Canada mandate and accountability; then issues related to governance and accountability; and finally, some brief remarks on the question of regional representation.

Mandate and accountability

In its November 19 submission to this Subcommittee the Bank emphasized the value of being as clear and realistic as possible as to the monetary policy purpose of the institution. This is why we have supported the proposal to make achieving and preserving price stability the primary mandate for policy.

You also know that there are views that such a mandate is too narrow — that it leaves out various other goals for monetary policy.

In response, let me begin by agreeing that there are more economic goals than price stability that people, including people at the Bank of Canada, can and should care about. However, that is not itself a good reason for believing that monetary policy can best achieve them by aiming its policies at all of them directly. For this to be an effective approach, it needs to be shown how the Bank of Canada, with the single tool, monetary policy, that it has to work with, can pursue in a direct way several underlying goals. There is no basis for believing that such a multiple approach, implying that monetary policy can focus on a number of different targets at the same time, is effective.

However, there is good reason to believe that the best way for monetary policy to contribute in a sustained way to good general economic performance — probably quite well captured in the goals of high employment and rising living standards — is by focusing on price stability. In other words, managing monetary expansion in a way that is consistent with money retaining its integrity for the economy is valuable as a means of achieving Canada's broad economic goals — through the unique contribution that monetary policy can make.

Price stability is a means to an end because we have a monetary economy — an economy in which the institution of money plays an absolutely vital role for progress. The danger in not pursuing monetary stability is more serious than simply a financial problem of a progressive loss of trust in money and high interest rates. This is because lost confidence in money in turn means that the economy in general will not function as well as it can, and that therefore economic objectives such as sustained high employment and rising living standards will become more difficult to achieve as well. The most likely end result of inflationary monetary policies, as we have seen so many times around the world, is not inflationary prosperity but some form of stagflation.

Because expectations and market behaviour do take time to change, when talking about underlying goals for monetary policy we are necessarily referring to the medium and longer term — a matter of years rather than months. So while it is crucial to be clear about the goal, it is also desirable to establish a process in achieving that goal that takes account of the time factor. This is why the federal government proposals contemplate a mechanism for agreement between the Bank and the Government on the pace for getting to, or in the event of major inflationary shocks for returning to, price stability. Essentially, the purpose would be to establish a path that was sufficiently gradual for expectations and market behaviour to adapt reasonably well, but not so slow that the assurance of a trustworthy money becomes a dead letter and the whole exercise self defeating.

Furthermore, given the inevitable fluctuations in prices and the important lags from monetary policy actions to inflation, we should expect "price stability" itself to represent the average situation over possibly several quarters or a couple of years, rather than a month-to-month or even quarter-to-quarter standard of performance.

Let me also add here that there is no inherent conflict between the Bank's proper concern for the effective operation of financial markets and the underlying goal of price stability, as for example the Bank of Canada's actions around the stock market fall of October 1987 demonstrated. Neither does any such conflict arise from the Bank's responsibilities as lender of last resort.

As regards the Bank's status as a public policy institution, it is quite striking that in the presentations and discussions in this Subcommittee, there appeared to be relatively wide support for some degree of central bank "independence." This was so even among those advocating a monetary policy mandate aimed at having the Bank target in some fashion a range of economic goals, rather than having it focus on and contribute through price stability.

However, I believe that it is important to be clear on the point that the justification for an independent central bank, with the accountability that this entails, must stem from the belief that there is a proven need for an institution that concerns itself centrally with ensuring that the value of money is maintained. And if the importance of having a care for the value of money is indeed at the heart of the Bank's independent position within public policy, and therefore of its accountability as well, it is surely constructive to establish this clearly in the Bank's mandate. There does not seem to be any useful economic policy purpose in obscuring this principle. Indeed, obscurity on this matter makes the task of achieving monetary stability more difficult.

To summarize, whatever objectives are set for monetary policy should be ones that the Bank of Canada can realistically be expected to achieve with the policy instruments available to it, and over an appropriate time horizon. To proceed otherwise cannot be helpful for good economic policy, for a good understanding of monetary policy, or for serious institutional accountability.

Governance and accountability

This Subcommittee has had the chance to review the role of the Board of the Bank. Let me reemphasize in that regard that there is a whole series of links between three entities — the outside directors, the Minister and the Department of Finance, and the Bank's management. The communications go in both directions along all three sides of this triangle. In particular, the Committee will be aware that the Bank's outside directors perform an oversight role for the corporation across the entire range of its activities. Proposals to replace outside directors with, for example, some sort of full-time monetary council for the Bank pose issues as to how the oversight function that directors now fulfil is to be satisfied.

Another issue here would be the relationship of the Bank with the federal government, in particular the Minister of Finance, if such a monetary council arrangement were ever envisaged for the Bank. A corporate rearrangement of this kind might well entail a reappraisal of the current consultation-directive provisions in the Bank of Canada Act, since those accountability provisions at present highlight the specific responsibility of the Governor in monetary policy dealings with the Minister of Finance.

Regional representation

Since there can be no question of regional monetary policies, the issue of regional representation appears to be other than simply economic. Some witnesses have in this context invoked "political legitimacy" as something that is lacking for the Bank. This is not an issue on which the Bank's management feels competent to volunteer views.

However, and to conclude, I wish to reiterate that establishing as carefully and as clearly as possible the monetary policy and other purposes that the Bank of Canada is to serve provides the surest basis for deciding whether or how its institutional framework can be improved.