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Chair

Mr. James Rajotte

Standing Committee on Finance

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● (1100)

[*English*]

The Chair (Mr. James Rajotte (Edmonton—Leduc, CPC)): I call the meeting to order. This is the 29th meeting of the Standing Committee on Finance.

I want to thank all our guests for coming in today.

Pursuant to Standing Order 108(2), we're very pleased to have five presenters here for our study of the inflation-targeting framework of the Bank of Canada.

From Bentley University, we have a professor of economics, Mr. Scott Sumner, by video conference.

Mr. Scott Sumner (Professor of Economics, Bentley University): Thank you for inviting me.

The Chair: We will endeavour to fix a technical problem.

We also have a professor from the Department of Economics at the University of Ottawa, Mr. Mario....

Professor Mario Seccareccia (Department of Economics, University of Ottawa, As an Individual): Seccareccia.

The Chair: Thank you very much.

From the Canadian Auto Workers Union, we have Mr. Jim Stanford, economist. Thank you for being with us.

From McGill University we have David Dodge, chair in monetary policy, C.D. Howe Institute, and associate professor of economics Mr. Christopher Ragan. And from TD Bank Financial Group, we have Mr. Craig Alexander, the senior vice-president and chief economist.

I'm going to start with Mr. Seccareccia and your presentation. You can take between five and seven minutes for your opening presentation. That will leave us a lot of time for members' questions.

Prof. Mario Seccareccia: I'll do my best.

Thank you, Mr. Chair, for inviting me here. I'm quite privileged and honoured to be among my fellow economists, especially here.

I read through the background information, the report that was circulated on the net, regarding the renewal of inflation targeting by the Bank of Canada. From the beginning, from that first page, they refer to the benefits of the inflation targeting regime we've had since 1991. They assert, basically, that it has delivered on a number of things pertaining to what is fundamental here, which is that we now have a low, stable, and predictable inflation rate, which we didn't have earlier.

Now, what were these benefits? One, they argue, is that we have had a lower and predictable inflation environment here, which has made it possible for consumers to manage their finances with greater certainty about the future power of their savings and income. Second, interest rates have also been lower, in both nominal and real terms, across a wide range of maturities, as a result of this inflation targeting. Third, we have had lower and stable inflation, which has helped to encourage more stable economic growth and lower and less variable unemployment.

If you look at these, I would argue that these sorts of benefits are not as tangible as they suggest they are. Let's start with the first one. For one thing, it is clear to me that the inflation rate, yes, has been more stable. But we've also witnessed during this whole era a decline in the savings rate, which practically went to zero in Canada, and associated with that, growing household indebtedness.

In the balance-sheet kind of recession we're facing right now, what households can in fact look towards is merely stability in the real burden of their debt, not stability in their savings. They don't have as much as they had when we first began with this regime. So one question is simply whether this regime has actually delivered on that.

Even more importantly, if we look at what actually went on over the last few years, especially with pension funds and all of that, they've gone through some very serious haircuts. Surely when we talk about stability of savings, we're trying to figure out what is exactly in the mind of the Bank of Canada.

Second, if we look at these lower real interest rates, the really sharp decline actually occurred during two periods. We didn't really go through a recession in Canada, but we did in the United States, in the 2000-2001 period, when we witnessed a fairly significant drop in interest rates. Obviously, during the last financial crisis here, in 2008-2009, we again saw a really deep drop in interest rates, both nominal and real. Hence, in fact one could argue that real interest rates fell much less, initially, let's say, because of the inflation targeting. While interest rates did fall eventually, we've really patterned ourselves along the lines of what has been going on continentally and even in the world economy at large, rather than just as a result of somehow, because we've had inflation targeting, these interest rates fell dramatically as a result of it over the last 20 years.

Third, with regard to the issue of actually encouraging economic growth, once again, I think it depends on which period, precisely, one is talking about. While we did have more growth, let's say, prior to the financial crisis, I would argue that with inflation targeting, the Bank of Canada did not as willingly try to combat unemployment as it would have if unemployment were actually, let's say, a variable in their reaction function.

Moreover, contrary to why inflation targeting was in fact actually sold to Canadians originally, I'm old enough to remember the 1980s and early 1990s, when they were discussing why we should have inflation targeting. If you go back to John Crow, for instance, at that time there was the idea of having some sort of zero inflation target. The reason given was essentially that it would enhance productivity growth, that it would enhance efficiency in the economy and would increase productivity growth. Well, if you look at the actual pattern of productivity growth in this country over the last 20 years, it has been dismal. It has been very bad.

● (1105)

Once again, if you look at what they actually say at the Bank of Canada, they don't talk about productivity growth, even though that used to be their sort of *cheval de bataille*, as we say in French, at a time when they were actually putting forth inflation targeting.

In that regard, I would argue that the Bank of Canada has always argued that it cannot really impact on real variables, such as unemployment and the growth rate over time, at least not in the long term. Hence, it is ironic, in a sense, that it is now claiming that its policy has generated more employment and growth of output, when it has continually argued that its policy could not affect these real variables in the first place.

We're kind of seeing how it's been able to put forward and change its discourse over the last while. I would argue, basically, that what we should be doing is going back to a broader approach to dealing with how we should set interest rates in this country. We should not tie ourselves to one single goal. Rather, we should consider some other variable in the economy, such as unemployment or real growth in the economy. We should consider at least those as important so that we do not make the mistake of doing things that may actually be counterproductive, especially when we look at the uncertainty in the world environment today and when we're probably going to be facing higher rather than lower unemployment in the short term.

Thank you.

The Chair: Thank you very much for your presentation.

Mr. Sumner, can you hear me?

Mr. Scott Sumner: Yes, I can. Can you hear me?

The Chair: Yes, we can.

If we could have your presentation now, we'd appreciate that very much. Thank you for being with us today.

Mr. Scott Sumner: Thank you for inviting me.

Let me say, first, that I think inflation targeting did improve things quite a bit, especially in Canada, but I think the current recession shows there are some flaws in inflation targeting and that we can do better. I have to admit, though, that probably right now the biggest advantages would be in the U.S. and Great Britain, but perhaps in the future in Canada as well, and even now it would benefit somewhat.

It seems to me that nominal GDP targeting is the logical next step in the process of improving our control of the macroeconomy. It would be more expansionary during recessions than inflation targeting. It would be more contractionary during booms than inflation targeting. It would tend to smooth out the business cycle somewhat. And very importantly, you could still maintain the same long-run average rate of inflation. So if the real GDP growth in Canada were 2.5% per year, on average, you could set a 4.5% nominal GDP target and still hit the same long-term inflation trend. It's really long-term inflation that matters in terms of the welfare effects of inflation.

Over the short-term business cycle, you could argue that what matters most is stabilizing employment, and for that, nominal GDP targeting does better. It especially does better in addressing disequilibrium in the labour market, so a sharp rise in oil prices with inflation targeting might require some contraction, which could hurt the manufacturing sector of the economy and increase unemployment there.

With nominal GDP targeting you have more flexibility dealing with things like supply shocks. It's also a better tool for dealing with liquidity traps. When interest rates hit zero, it can be difficult for a central bank using conventional techniques to stimulate the economy. Generally during that sort of period, nominal GDP has fallen much more sharply than inflation, so it gives you a much more aggressive nominal growth target. It allows the central bank to be much more aggressive in setting expectations, and that can be a valuable tool in escaping a liquidity trap.

We can see recently in Great Britain one strong advantage over nominal GDP. There are some rumours that it's an informal target of the Bank of England, and right now inflation in Britain is well above the official 2% target, yet almost everyone in Great Britain thinks that the economy is still depressed, and if anything, needs more stimulus. In fact, the fiscal austerity is quite controversial in Great Britain for that reason. So with nominal GDP targeting, because not all GDP growth is currently below 5% in Britain, that would allow the Bank of England to be expansionary, which is what people think is needed right now.

Another advantage of nominal GDP is that it's a simple, single target. Admittedly, there are versions of inflation targeting that are flexible, that deal with real shocks, to some extent, but that leads to a lot of ambiguity in monetary policy setting, and in some cases it allows the central banks to hide behind a very vague mandate. Admittedly, that's more of a problem in the United States right now than in Canada, but it becomes a problem if inflation targeting seems to be giving the wrong signals.

It's also easier to communicate to the public what you're doing. One recent example from the United States is that in mid-2010 our inflation rate had fallen well below the Federal Reserve's implicit goal of about 2% and the Federal Reserve announced that quantitative easing was going to be done to boost the inflation rate. But that turned out to be a very difficult sell politically because most people assume that a higher cost of living is something that hurts them. And most people don't understand macroeconomics well enough to understand how inflation can actually provide macro-stability in certain situations.

In contrast, if you are targeting nominal GDP, the Federal Reserve could have announced that they're not trying to boost Americans' cost of living, they're trying to boost Americans' incomes, because those have been depressed by the recession. Not all GDP is essentially national income. It makes it easier to communicate to the public what you are actually trying to do in a macro-stabilization sense.

So I think it has both technical advantages and political advantages, particularly in unusual circumstances like liquidity traps or supply shocks, where inflation targeting might not do as well.

Thank you.

● (1110)

The Chair: Thank you very much for your presentation.

We'll now hear from Mr. Stanford, please.

Dr. James Stanford (Economist, Canadian Auto Workers Union): Thank you, sir, and committee members. I am very grateful for the invitation to participate in this discussion.

I see that the government announced last week that the target is going to be extended for five years. I'm not sure how we'll fit into that decision process, but I think these issues of inflation targeting and monetary policy are among the most important economic issues facing the country, and I'm very honoured to participate in this discussion.

In my judgment, the economic and financial events of the last three or four years should lead us to fundamentally question both the theory and the practice of inflation targeting. The theory of inflation targeting goes as follows. There's assumed to be some kind of automatic tendency for the real economy to settle at some kind of a full employment equilibrium position, often defined as a NAIRU, non-accelerating inflation rate of unemployment. Monetary policy is seen to have no long-run impact on that real equilibrium. The best thing monetary policy can do, the theory goes, is to promote stability in prices and therefore greater certainty and better judgments by the participants in that real economy.

That underlying faith in the self-adjusting character of the real economy was never, I would say, justified. After the events of the last three or four years and especially facing a horizon of several years of difficult times to come, that underlying faith seems downright bizarre. Clearly, private markets are not necessarily efficient. The market economies do not automatically adjust to recreate full employment. They can become stuck for long periods of time in positions that are suboptimal, underutilized, and socially damaging.

While the inflation targeting regime in Canada is clearly temporally associated with lower inflation and more stable inflation, as the Bank of Canada's backgrounder makes clear, its success depends on the impact of inflation stability on the real economy. I will also point out that the disinflation and the lower and more stable inflation rates that were observed in Canada are also observed in many countries that did not adopt inflation targeting.

At any rate, the ultimate end goal of economic activity is not low and stable inflation. The ultimate end goal is maximum employment, productivity, and output. Has inflation targeting boosted these goals or not? The data contained in the Bank of Canada's background document, their own data, suggests that's not at all clear. Their table 1 shows that average real GDP growth has in fact been slower under inflation targeting than under the previous regime. The average official unemployment rate has hardly changed. Real long-run interest rates have not fallen at all. The table doesn't note it, but productivity growth in Canada has slowed notably under this regime. So the real economic benefits of low and stable inflation are hard to find, but I think we've become more aware in the last couple of years of some of the costs of getting to and maintaining a near-zero inflation target.

Very low inflation rates make it hard to facilitate relative price adjustments, including adjustments in the relative price of labour. Those relative price adjustments may require nominal price reductions, which are always difficult.

Very low inflation rates impose a binding floor to the operation of monetary policy, because interest rates can't fall below zero. Therefore in a 2% target world, real interest rates cannot fall below negative two. But in moments of crisis, you may want your real interest rates to be much lower than that.

Very low inflation rates increase the risk of deflation, because there's not much of a cushion before you tip over into negative inflation, which can cause all kinds of dangerous and explosive results on debt burdens and spending decisions.

Very low inflation enhances the real burden of debts on consumers and governments, and reduces real tax burdens, neither of which are desirable in the current context.

In light of these issues, there's a view among a growing number of economists that the optimal level of inflation is not 2% and it should be possibly higher, perhaps 4% or 5%.

My own conclusion is different. I find a flaw in the fundamental logic of inflation targeting. There are times when proactive monetary policy is necessary to be targeting particularly employment growth, increasing output, and helping the economy out of recession or even depression. An inflation target unnecessarily ties the hands of monetary policy in doing that.

I recognize fully that the practice of monetary policy in recent years at the Bank of Canada has been more flexible than the inflation target alone would make it look. I applaud that flexibility, which has been important in the current crisis. To some extent, I think we're maintaining a polite fiction, that the Bank of Canada is concerned with one thing and one thing only, namely inflation. In practice, they've been concerned about many things, and they've behaved accordingly.

● (1115)

Why don't we just acknowledge that the Bank of Canada faces a difficult but essential task of balancing different goals? The pre-eminent goal should be the maximization of output and employment to foster long-term sustainable productivity growth. That goal has to be pursued within the constraints of other issues, such as sustainable inflation, sustainable external balances for the country, and sustainable social and environmental performance.

The ultimate goal is real output and employment. The Bank of Canada should be given a diverse and flexible mandate that allows that pre-eminence to be respected.

Thank you.

The Chair: Thank you very much, Mr. Stanford.

We'll go to Mr. Ragan now, please.

Professor Christopher Ragan (Associate Professor of Economics, McGill University, David Dodge Chair in Monetary Policy, C.D. Howe Institute, As an Individual): Thank you for inviting me.

Canada's monetary policy is very important to Canadians' living standards, and I'm very happy to be discussing details—sometimes contentious details—with my peers.

I should begin by clarifying my affiliation. I notice that Mario was listed as representing himself, but I am listed as representing McGill University. That's probably because I incorrectly filled out the form. So though I would be delighted to be asked to write McGill University's official view on inflation and monetary policy, I feel that they will never ask me to do that, so I should claim to be speaking only for myself.

The Chair: Perfect.

Prof. Christopher Ragan: In case it's not clear from my comments, let me try to make it clear at the outset that most of what I say will disagree largely with not everything that Jim and Mario have said but with elements of what Jim and Mario have said and with only a little bit of what Scott has said.

I think it's important at the outset when thinking about monetary policy to recognize the modest impact that central banks can actually have on the economy over a sustained period. In fact, I think the disagreements that I have with Jim and Mario and possibly with Craig will come down to that point: what kind of effect can the central bank have on the economy over short periods of time, and what kind of effect can it have and on what variables over long periods of time?

I believe that Canada's inflation targeting framework has been a great success. The system began in 1991, as you know. The inflation target has been at 2% since 1995, and since that time inflation has been lower and more stable than it was in the previous 30 years. I think that stability of inflation is good for the stability of the economy. I think it is good for planning. A very important part of inflation targeting is the extent to which it helps to anchor the expectations of inflation—the expectations of households, of firms, of participants in financial markets—in response to shocks of various kinds. And of course our economy is subject to shocks of various kinds.

As you all know, the bank and the government recently announced their new agreement for five more years, which will leave the status quo largely unchanged, and, all things considered, I think that was actually a good decision. So let me be here today as a defender of the status quo, although there were some alternatives the bank and the government considered, which could have been chosen.

Targeting nominal GDP, as Scott said, is one alternative. As Scott explained, a perceived advantage of targeting nominal GDP is that it gives the bank—or any central bank, but the Bank of Canada in this case—more flexibility in being able to take its eye off of inflation and be concerned a little bit more about real GDP growth in the short run.

In my view, the problem is that makes the bank officially indifferent, if you like, to various combinations of real GDP growth and inflation. The sum of those two is nominal GDP growth. So if it is going to put more emphasis on real GDP growth in the short run, by definition it must put less emphasis on inflation. The result of that, I think, is almost certainly that inflation will be a little bit more volatile over the business cycle.

The danger with that is that it may dislodge those well-entrenched, well-anchored expectations. I am concerned about that possibility, given that it takes a long time for monetary policy to develop the credibility necessary to actually establish and anchor those expectations.

Scott also said that you could have the same long-run trend of inflation in a world of nominal GDP targeting, and that's true under some conditions. Canada, more so than the United States, is faced with an aging population. They have aging there as well, but their demographics are a little bit better than ours, and we will have a declining rate of real GDP growth over the next 15 years, due simply to the aging of the population and the withdrawal of retired Canadians from the workforce. Other things being equal, that reality will reduce the rate of GDP growth.

If we were targeting nominal GDP from now to the future, in a world where real GDP growth on trend would decline, there would be a trend to increase in inflation. I see no reason why we should be sanguine about an increase in the costs that come from that inflation.

Another option is targeting full employment. Mario talked about how in the past the bank did not work hard enough to combat the unemployment rate, and Jim talked about how the bank might pay more attention to variables other than just inflation. So, at least on the surface, targeting full employment is an attractive option.

The problem is the concept of full employment is very slippery. You can look all you want at the data published any place by Statistics Canada and you will not see a measure of full employment. Why? Because it is not something that is directly measurable. It is a concept that is very useful and that economists use to organize their thinking about the operations of the economy, but it is not something observable in the data. You can only use our models to back out an estimate of full employment, but the models of course are contentious.

● (1120)

Mario's preferred model will almost certainly be different from Jim's, mine, and Craig's. That means if we're going to disagree about the models, we will disagree about the estimate of full employment that comes from those models. Then if you have a target for the central bank around which there is disagreement on the measurement of the variable, what basis is that for actually targeting monetary policy?

The Chair: You have about one minute left.

Prof. Christopher Ragan: Another point on the full employment targeting comes back to my point about the modesty of monetary policy. There has been a growing recognition over the years that central banks have a very difficult time influencing real variables in a systematic way over the long run. The central bank's balance sheet, which is its only instrument, is fundamentally a nominal variable. It is about dollars. It is not actually about real things like productivity or employment. So it is difficult for the central bank to be able to systematically and in a sustained way influence real variables. It's much better for it to focus on the control of inflation.

I'd also make a point about the flexibility of central bank policy. Jim alluded to this, and I think he's quite right. There is flexibility in the current system, but it is what the bank and economists call constrained discretion. If that term intrigues you at all, we can come back to discuss that in the questions.

Thank you very much.

● (1125)

The Chair: Thank you very much for your presentation.

We'll now hear from Mr. Alexander, please.

Mr. Craig Alexander (Senior Vice-President and Chief Economist, TD Bank Financial Group): Thank you.

It's a real pleasure to have an opportunity to chat with you about this terribly important subject.

The goal of monetary policy is ultimately the management and supply of money and the level of interest rates in a manner that supports economic growth and the highest possible standard of living. That's what we want to do. From the point of view of highest possible standard of living, this also means that you really want to have as close to full employment as you can.

I would argue that the central mandate of the Bank of Canada already encompasses a multi-dimensional approach to the ideal environment they are hoping to achieve. We need to understand that they are only one part of the bigger economic system, and they have limited impacts.

As to how to achieve this goal, there are various options. Let's be honest: all the options have pros and cons, and no one approach is perfect. So what's the mandate that we've had and what's the mandate that's just been renewed? Since 1991 the Bank of Canada has been targeting inflation. Since the end of 1993, it's been the 2% midpoint target of the 1% to 3% range.

Economic theory tells us that in the short run monetary policy can have a big impact on the economy. We can see the effect of lowering interest rates in early 2009 and the impact this had on the housing market in Canada, helping to boost domestic demand and mitigate the recession.

Over the very long run, the impact of monetary policy is primarily on the level of prices. If you're going to create a low and stable inflation environment over the long run, over several business cycles, you should see evidence that it will lead to the economy growing at around its long-term trend, with lower and more stable unemployment.

What's the evidence? Well, over the last two decades we've seen inflation average almost exactly 2%, so the Bank of Canada has to be commended for hitting their target almost perfectly over a two-decade period.

Then you look at economic growth. Economic growth has been 3%. Most economic estimates would say that 3% through the 1990s was probably the potential rate of growth, the long-term trend in the rate of growth. Right now I think the trend rate of growth in Canada has slowed, so we'll be lucky if we actually get 3% on a sustained basis going forward. That's not a reflection of monetary policy; that's a reflection of demographics and productivity. The Bank of Canada does not have control over productivity. They can help encourage investment by having interest rates lower. They can lead the horse to water, but they can't make it drink.

We've seen that we have had periods of low unemployment in Canada. We reached a point where unemployment was at a three-decade level. In fact, it was creating problems for parts of the economy. The reason we had higher unemployment in recent years had to do with an external shock to the Canadian economy. It had nothing to do with the domestic economy, and that's what domestic economic policy can affect.

I would argue that the existing mandate has served the country very well. Could we change the target? Yes, we could lower it. If we lowered it, you'd start running into challenges of measurement. When you start getting down to around 1%, people start to worry about deflation, so maybe 1% is a little too low. If you raise it, I'm not sure why you'd want to reduce the purchasing power of people's money over the long haul at a faster rate. So 2% seems like a very reasonable target.

The next question is, would an alternative model serve us better? The last model has been doing a good job. Should we adopt something different? I think it's a very reasonable and healthy thing to have the mandate renewed periodically and to have discussions like this about what the appropriate mandate should be. When I think about all the other options and the current target, I'm reminded of the quote by Winston Churchill that democracy is the worst political system except all the rest.

Regarding the inflation-targeting environment, I think there are lots of other options. You can have a lot of complaints about the 2% target, but it's probably the best among all the other options. We could target full employment, except that we don't actually know where full employment is. Estimates are somewhere between 6% and 8%. And I don't think it's useful to have a target that you can't pinpoint.

● (1130)

I would contend that actually the unemployment rate is in the decision-making function of the Bank of Canada, because when it is setting monetary policy it does consider a large number of other variables. One of the core variables it looks at is the amount of slack in the economy and the output gap, and that is largely a function of what's happening in the labour markets. The Bank of Canada does implicitly build unemployment into its thinking about where monetary policy should be headed without its being the explicit target of the inflation rate.

Regarding nominal GDP targeting, I've got to be honest that I actually think there's a compelling argument for the U.S. Federal Reserve to have a nominal GDP target. I don't actually think it's appropriate for Canada. I think the main issue here is that the U.S. economy is currently in a liquidity trap, where low interest rates are not going to propel stronger economic growth or above-trend economic growth, but this is an exceptional situation. I'm not convinced you should actually adopt an exceptional policy that's appropriate for another country as the business-as-usual target for Canadian monetary policy.

I think there are a lot of reasons that nominal GDP targeting would be effective in the United States. I'm not sure that we should adopt it here, for many of the reasons Chris outlined, because at the end of the day, I don't think we are indifferent between targeting 4.5% nominal GDP growth and 4.5% inflation and zero real growth.... I'm not indifferent between that and 0% inflation and 4.5% real economic growth. So it's a functional challenge.

I think there is a lot of merit to price-level targeting, and this something the Bank of Canada is very enamoured with. My main problem with it is a communication issue, and that is that if you end up with inflation at 1% for an extended period of time, you probably should run 3% over a period of time to get you back to 2%. The problem is that when you get to 3%, if it's sustained for a length of time, you're going to get the media and markets worrying that 3% isn't the peak, and it could lead to un-anchor inflation expectations.

Lastly, in terms of dual mandates, I think if you have one target it's a very simple way of characterizing what the bank is doing. If you have dual targets, I think you take your eye off the ball, and that runs the risk of creating an inflation problem.

The Chair: Thank you very much, Mr. Alexander.

We're going to begin members' questions with Mr. Julian.

I'll just remind members and witnesses that members have a very short time, about five minutes, for each round of questions. If we can be very brief in our questions and responses, it will assist members in their deliberations here.

Mr. Julian, please.

Mr. Peter Julian (Burnaby—New Westminster, NDP): Thank you, Mr. Chair.

Thanks to our witnesses. You've given us a lot of food for thought.

I'd like to start with you, Mr. Stanford. I have three questions.

First off, as you know, the job figures for October were very sobering. More than 72,000 full-time jobs were lost in the Canadian economy. You referenced how the Bank of Canada has been acting and I think Mr. Ragan's phrase was “restrained discretion”. I'm wondering how you feel about the renewal of the inflation-targeting agreement between the Bank of Canada and the federal government, whether you think that's a mistake or that within that restrained discretion there is some room for monetary policy addressing what is becoming a bit of a joblessness crisis in our country.

Second, you pointed out in your presentation that we've had the same stable inflation rate as countries that don't do inflation targeting. Are there other countries that have maintained a stable inflation rate and have done a better job on employment targeting with monetary policy?

My third question to you is around the definition of full employment that both Mr. Ragan and Mr. Alexander raised as something difficult to define. I would like to have your reaction on that.

● (1135)

Dr. James Stanford: Thank you, sir.

In terms of the job numbers, this month's numbers were very worrisome. Whether that's a one-month blip—there is a bit of month-to-month movement in these things—or the sign of something worse is not yet clear. But we have never in recent history had a jobs number like that without being in a recession. So that gives me serious concern.

I think the Bank of Canada has been ambitious, flexible, and aggressive in its response to the crisis. But I do think that its hands have been unduly tied by at least needing to give nominal—and I guess that's a mixed adjective in this setting—or at least a token gesture that it still is guided by the inflation target, which clearly wouldn't make sense. Core inflation is rising in Canada right now, driven by commodity prices, and that's one of the problems with inflation targeting. The labour market is not the only source of inflation.

So in this regard, I don't think the quick renewal of the mandate for another five years helps. But I am going to recognize the Bank of Canada's creativity and flexibility and hope it continues to exert that way.

There are many countries that do not have formal inflation targets where inflation followed a similar path to Canada, and there are many countries that have performed better than Canada in labour market terms. Some of the Asian developed economies and some of the European developed economies have had consistently lower unemployment rates. Whether that's due to different monetary policy.... I suspect it reflects a whole mixture of economic policy institutions.

In terms of the challenges in defining full employment, I'll certainly acknowledge that. I will say there are many challenges in defining inflation as well but that hasn't stopped inflation targeting from picking one of them and zeroing in with razor-like focus to the detriment of other objectives that monetary policy could follow.

In terms of measuring inflation, there are very important empirical and theoretical issues about consumer prices versus GDP deflators. Do you measure all items, or do you just look at core items? The major failing of the focus of inflation targeting on the CPI has been the failure to recognize asset price inflation and the dangers of asset price inflation. When you see a totally unsustainable bubble in asset prices, whether that's housing in the U.S. or dot-com stocks in an earlier era, that never enters into the monetary policy-makers frame when you have a uni-dimensional focus on CPI inflation, even though it clearly reflected credit conditions. You couldn't have an asset bubble without enormous growth of credit conditions, which is a monetary variable, even though monetary policy could play a role —a difficult role, but a role—-in trying to prevent those types of problems from arising.

Measurement difficulties are inherent whatever goals are chosen, and we'll just have to do our best to sort them out. But measurement difficulties have been a factor in inflation targeting as well.

The Chair: You have 30 seconds.

Mr. Peter Julian: Okay.

Just quickly to Mr. Seccareccia, you said that with the uncertainties we're living with now we need to consider other variables, like employment. Are you saying particularly now, given the difficulties, that we need a different mandate, a different type of agreement?

Prof. Mario Seccareccia: Jim already mentioned in his presentation that the Bank of Canada has been a little more flexible than simply the inflation target in a reality. If you look at what they did, for instance, in April 2009 all the way to June 2010, where they pegged the overnight rate at the lowest possible level and left it there, that would suggest that maybe they were very concerned about the crisis at that time and acted appropriately, I would say, in this case, just as the Federal Reserve is doing right now. So in fact, even though they don't have that as an actual mandate in their function and they only look at the inflation rate, in reality they do look at others.

To suggest also that somehow we cannot define full employment or any sort of high level of employment is absurd, not only because we also have a problem with inflation, but the central bank has been concerned with the NAIRU over the last 20 years, you could argue, or with potential GDP growth. That is a similar problem.

The Chair: Thank you.

Thank you, Mr. Julian.

We'll go to Ms. McLeod, please.

Mrs. Cathy McLeod (Kamloops—Thompson—Cariboo, CPC): Thank you.

I really appreciate the expertise that we have at the table here today, and certainly from the testimony we've heard, it doesn't seem like this is an easy subject to actually wade one's way through.

I would like to first of all give Mr. Ragan a chance to talk a little bit further about your “constrained discretion” comments.

● (1140)

Prof. Christopher Ragan: Thank you. This will relate to comments that Jim and Mario just made.

You will notice, if you've read the Bank of Canada's background agreement, that they talk about the flexible inflation-targeting framework. While that word may have been used less in the past years than it is used now, in that document the concept of flexibility has always been an important part of inflation targeting. It's completely consistent, in my view, with Mario's description of the conditional commitment that was given in April 2009 by the Bank of Canada.

In my view, the flexibility is equal to these words, “constrained discretion”. The constraint is the bank has a very clear objective to try to keep inflation low and stable and close to 2%. We sometimes talk about 2% as the midpoint of a 1% to 3% band. Sometimes less emphasis is placed on the band, but the target is clearly 2%. The discretionary part is the bank has latitude. Following a shock of various magnitudes, various sources, the bank uses its discretion, or, if you like, its judgment, to choose the route back towards that target.

One of the things that's always been true about inflation targeting is that there's a recognition that central banks' actions can't influence inflation immediately. Their actions today to influence, for example, the target for the overnight rate influence employment over a future interval of three or four quarters and inflation over six or eight quarters in the future. So what you'd expect in a system of constrained discretion is that when negative or positive shocks of various kinds hit the economy, as was true in 2008-09, the bank would have the flexibility to lower rates. In this case they issued a conditional commitment, but it's a conditional commitment that they would keep rates low, conditional on the performance of inflation. If inflation started to pick up, then they reserved the right to raise rates, as they did eventually.

What you'd expect in that system is if they were both constrained by the target but had the ability to use their discretion, you'd expect inflation to average at the target, as it has, but you'd expect inflation to deviate from the target over the business cycle in response to various shocks, which it has. I think this constrained discretion is an important part of understanding Canada's inflation-targeting system.

The bank does care about real GDP; it does care about unemployment. The bank publishes its estimate of the output gap, which is the difference between real GDP and full employment GDP. And it views its goal as keeping inflation on target by keeping output close to potential, and that's why it builds that into its operations, if you like.

Mrs. Cathy McLeod: I know there were some arguments for different focuses, measurements, but given the fact that for the next five years we have gone in terms of the 2%, is the 2% an appropriate target, an appropriate rate? Is 1% to 3% an appropriate range? I know there are arguments for and against other measures, but I believe Mr. Alexander indicated support for that target and range.

Are there any other comments?

The Chair: Mr. Alexander, do you want to...?

Mr. Craig Alexander: I covered it in my remarks. I think 2% is the right target.

The Chair: Who would you like to answer this?

Mrs. Cathy McLeod: Anyone can jump in on this.

Dr. James Stanford: If I were to follow an inflation-targeting system, which I indicated I think is not adequate, I would suggest the target should be higher in light of some of the economic evidence from the last couple of years about the problem of the zero-bound, where interest rates can't go below zero, even at times when you need more stimulus. Within the realm of inflation targeting, I think there's an argument for a higher target.

The Chair: Okay, there is time for a couple more brief comments.

Prof. Mario Seccareccia: I think we need a broader band or range, as indeed Jim was also suggesting, but also we should include another variable in there. If you take the U.S. case, it's governed essentially by the Humphrey-Hawkins Full Employment Act of 1978, and they're still committed to those basic principles that guide the governor of the Federal Reserve as well, which includes unemployment there. That's the point I was trying to make earlier, which is that we should have both a broader band for the inflation rate as well as some sort of concern about where we should reach in terms of some employment targets.

● (1145)

The Chair: Mr. Ragan, briefly, please.

Prof. Christopher Ragan: I would be in favour of maintaining the inflation targeting system. I think 2% is a reasonable target. I certainly would not suggest increasing the target. I see no genuine or likely benefit from increasing the target. I would consider reducing the target, although I think there's a legitimate debate about whether the benefits from lowering the target to 1.5% or 1% would outweigh the costs. I think that's a legitimate debate. I think the case is much weaker for raising the rate.

The Chair: Thank you very much.

We'll go to Mr. Brison, please.

Hon. Scott Brison (Kings—Hants, Lib.): Thank you, Mr. Chair.

And thanks to each of you for your input today. It's very helpful to us.

Dr. Sumner, you're familiar with Nick Rowe's blog. Mr. Rowe sits on the C.D. Howe Monetary Council. On his blog recently, Rowe compared CPI and nominal GDP trend lines for the Canadian economy, and since 2008. What effect do you expect that nominal GDP targeting would have had on Canadian unemployment levels compared to status quo inflation control targeting?

Mr. Scott Sumner: I have that right in front of me. It looks to me like even with inflation targeting, Canada might have been able to do a bit more, but certainly with nominal GDP targeting the Bank of Canada would have been significantly more aggressive in the last three years and unemployment would probably be somewhat lower today.

As I said before, it's not a miracle worker. I think the advantages are probably greater right now for the U.S. and Britain, but I think even for Canada, looking at this data—I also looked at some labour market data on wages and so on—it looks to me like a little bit more expansionary monetary policy would have been beneficial over the last three years.

Hon. Scott Brison: The Bank of England has been missing its inflation targets and is also experiencing weak economic growth at the same time. What would be the potential advantages for nominal GDP targeting and inflation control targeting, the pros and cons of each, in the context of the U.K. experience? Generally, how would nominal GDP targeting compare with alternatives during a period of stagflation, where we have high unemployment and high inflation at the same time?

Mr. Scott Sumner: That's a good question. In the case of Britain, I think there's a fairly general understanding that Britain needs more stimulus right now. The economy is very weak and the problem the Bank of England has is there's a desire to provide it but it feels very uncomfortable with the fact that it would be violating the inflation mandate. So it's sort of dancing around the issue a little bit but it's not moving as aggressively as it would like, in my view, because of the inflation mandate.

In terms of stagflation, monetary policy can't really solve long-term real growth problems, but I think what it can do is provide better performance when there's a temporary supply shock or productivity issue. In the case of long-term growth, just to react a little to what Chris and David said, there is a problem if there are demographic changes. One way of addressing that is to use nominal GDP per capita or even for the working age population. That's more likely to give you better results, because what really matters is nominal output per worker or potential worker in the economy, which you want to keep as stable as possible.

When there's a sort of supply problem, if you have inflation targeting, you're forcing all the adjustment on wages, and wages don't tend to be very flexible, so you tend to get fluctuations in employment. With nominal GDP targeting you allow some variation in inflation, which helps provide equilibrium in the labour market. It's going to provide a little bit better performance in terms of jobs, again without changing your long-term rate of inflation.

Now, given all the discussion revolving around the recession, people tend to think of nominal GDP targeting as being more expansionary than inflation targeting or perhaps allowing inflation to get out of control in some sense, but I think that's very misleading. In the long run, you're going to get the same inflation rate. It's also true that during boom periods, such as the American housing boom, you probably have a little tighter monetary policy. So the long-term inflation rate won't differ, and I would argue it's really the long-term inflation rate that you want anchored, not the year-to-year variation.

● (1150)

Hon. Scott Brison: In August, Canada had 0.3% growth in our GDP, but that was largely due to the 2.8% growth in energy. Canada has a commodity-based economy, or it does in parts of our regions of our country. Alberta and Saskatchewan as provinces benefit significantly from growth in commodity prices, but that drives inflation numbers, and at the same time it crowds out jobs in other parts of the country and in manufacturing. In light of that two-tier economy, that bifurcated Canadian economy we have because of commodity issues, does nominal GDP as a target potentially become more attractive to at least consider?

The Chair: Just a brief response, Mr. Sumner, please.

Mr. Scott Sumner: I think it does. It would provide a better cushion for the manufacturing parts of Canada, Ontario and so on. I also will just briefly add that Canada was a little bit lucky by the high commodity prices in the last few years. Normally during worldwide recessions, commodities would do much worse, so I think that part of Canada's superior performance to America and Britain was based on the luck of having high commodity prices during a sluggish period for the developed world economy.

The Chair: Okay, thank you.

We'll go to Mr. Hoback.

Mr. Scott Sumner: It might not happen again.

Mr. Randy Hoback (Prince Albert, CPC): Thank you, Chair.

Thank you, gentlemen, for being here this morning.

This is an interesting debate, and it's one that I find really interesting for the country of Canada, because the country of Canada has so many different sectors and regions to it. That's where I get to my first question, and maybe, Mr. Ragan, I'll go to you.

When you see different parts of the country, some experiencing a boom and other parts experiencing a recession, how do you account for that as you look at a model for setting monetary policy for the country as a whole?

Prof. Christopher Ragan: Thank you. That's an excellent question, and a perennial one in Canada.

We have many sectors. We have many regions. The sectors often line up with the regions, so very often the issue arises as to whether it's desirable to have a flexible exchange rate, for example, which is an important part of Canada's monetary policy system.

This relates to the last comment that Scott made. The problem—and perhaps I can steal a phrase and say that it's just an inconvenient truth—is that we have different sectors of the economy, different regions of the economy, and they are subject to very different shocks. The best examples would be if you want to think about the west or maybe now the west and the east being exposed to world commodity prices, energy prices in particular, and producers and exporters of energy, whereas central Canada is largely a user of energy. Well, when world energy prices rise, that is going to tend to be very good for those energy-producing regions and sectors, and it's going to be bad for those sectors and regions in the economy that are net users.

That's just a fact of life. But then the question is what kind of monetary policy do you want? The current system has an inflation targeting system where we allow the exchange rate to rise and fall in response to those shocks, and we certainly have seen those adjustments in the past. Unless you're going to have multiple currency areas across Canada, and I don't think anybody is seriously suggesting that, politically or economically, then you have to deal with the fact that we are a single-currency union.

I didn't think this discussion was going to get to Europe, but it could get there very quickly.

We accept the fact that we are a single-currency union with regions with very different shocks and we deal with it. We do deal with it. That doesn't mean that there is not pain and adjustment that happens in response to these shocks, but it's one thing to recognize those shocks and it's quite another to believe that monetary policy can do something about it.

As long as we are going to have a single-currency area called Canada, the Bank of Canada needs to have a single monetary policy for Canada as a whole. So it tends to look at, and tends to be driven by, national averages as opposed to regional developments. I believe that's appropriate.

Mr. Randy Hoback: When we look at the way Canada has performed in the last *x* number of years, the last three or four years, and we look at the model we've been using and basing our decisions on going through the 2008 crisis and moving forward, has anything structurally changed that would make you say we should change it?

Maybe I'll go to Mr. Alexander, and Mr. Ragan after that.

● (1155)

Mr. Craig Alexander: I think the Bank of Canada has managed monetary policy remarkably well through the financial crisis of 2008 and the economic recovery. They aggressively eased monetary policy as the financial shock hit. They took interest rates down to unheard-of levels that no economist five years in advance would ever had anticipated you would have rates decline to. It did some very out-of-the-box thinking about how to respond to the environment.

The introduction of the conditional commitment was a good example of something that hadn't been tried before and that actually, I think, showed its benefits. I think it's one of the reasons why the federal reserve has chosen to follow the same path in terms of trying to anchor interest rate expectations, at a level even lower than they otherwise would have, to provide support to the economy.

I think the decision to take interest rates off the zero per cent floor was sound. I'll be honest; I actually think zero per cent interest rates might even be creating some of the problems in the United States, because your financial system doesn't actually operate properly when there is zero per cent interest. When you have an interest-bearing chequing account, you actually have to have some interest on it or else it stops being an interest-bearing account. It's probably contributing to the problem with the circulation of money.

You know, you can always look with perfect hindsight and raise questions, but with the information they had at the time, I think they've done a remarkably good job.

The Chair: We're over time, Mr. Ragan, but you can add something just briefly.

Prof. Christopher Ragan: I have two quick comments to add to Craig's.

Number one, I think the last few years show the value of the flexibility of an inflation-targeting system. With the inflation expectations very well anchored, it liberated, if you like, the Bank of Canada to be very aggressive in its policy response. It was very aggressive, and it could be very aggressive in terms of cutting rates and doing other creative things secure in the knowledge that expectations wouldn't be dislodged.

The second thing is that in the last three or four years, I wouldn't call it a structural change, but financial stability, of course, has become an issue that central banks are thinking more about now than they were eight years ago. That's entirely appropriate and consistent with the inflation-targeting system. The flexibility, or the constrained discretion, allows the bank to think about that.

The Chair: Colleagues, I want to try to get everyone in. If we can shorten our questions up a bit, I would appreciate that.

Monsieur Mai.

Mr. Hoang Mai (Brossard—La Prairie, NDP): Thank you, Mr. Chair.

To Mr. Seccareccia, you spoke about the full employment target. I think I understand the arguments regarding having one single inflation targeting, that it brings more confidence, more stability.

Can you explain to us what would be your model, or what would be your specific targeting, that would be specific enough for people to really focus on in terms of trying to understand where the Bank of Canada is heading?

Prof. Mario Seccareccia: It's not that the Bank of Canada doesn't have an implicit target of unemployment, it does implicitly, because it believes in some notion that there's a kind of NAIRU out there, a non-accelerating inflationary rate of unemployment. So what it wants to do is keep that economy within a certain band, which has prevented unemployment in Canada from going below 6%, basically, if you look at the last 20 years. In that regard, there's an implicit one there.

What I'm saying is that we should be able to have it explicitly, and it should be something lower than that NAIRU—that's my concern. And we should allow that band for the inflation targeting to be wider, to allow for the possibility of getting that unemployment rate lower, if indeed we do have a NAIRU there.

My belief is that if you look at the actual work and research done —I'm sure some would support me on this—there's no NAIRU here that is a constant. It varies with the unemployment rate. That's why it becomes a bigger problem. You have a central bank that believes there's something out there that exists that will prevent inflation from actually going up, which is an unemployment rate of around 6% or 7%. But, then, there are those who are saying that this NAIRU is not some constant. Hence, if you look at that work, it would suggest they have a problem even with the implicit one, as I said, that they do not officially talk about but that is there.

Now, with regard to what should be an unemployment target, I'm old enough to remember back in 1965, when they set up the old Economic Council of Canada. They came out with some very precise figures as to what should be the full employment in Canada. Indeed, in 1966 we had reached an unemployment rate in Canada of around 3.5% or less, if I remember correctly. We know that we've had unemployment rates that are far lower than the 6%, 7%, or 8% range that we've been living with over the last 20 years. My point is simply that what should be on the radar screen of the central bank should be a concern about whether that unemployment rate should be a lot lower here than what they think it should be because of the inflationary pressures argument along the lines of the NAIRU.

What should it be exactly? As I said, I could go back to the old Economic Council one of 3.5%, but it surely should be less than that 6%.

● (1200)

Mr. Hoang Mai: Mr. Stanford, could we hear your view on that too?

Dr. James Stanford: I think Mario's response has brought out a key problem in the way that the Bank of Canada looks at unemployment today. They certainly are aware of unemployment. They care about unemployment, and the level of unemployment influences their actions, as I think all of us have agreed. But in an inflation-targeting system it influences their actions in a very particular and peculiar way.

The bank has a judgment on what it views as the potential output of our economy. It doesn't actually have an explicit NAIRU estimate, but there is a NAIRU estimate embedded in its judgment of what the potential output is. The bank also has a theory that the dominant cause of inflation will be any time actual output exceeds what it judges to be the potential output, that is, the form of demand-driven or labour-market-driven inflation that the bank is most concerned with. They also understand that monetary policy acts four to eight quarters down the road. This is how the bank operationalizes its inflation target. It has a judgment of potential output down the road and then it tries to steer demand to a level that's not in excess of that level of potential output, to prevent the inflation that it expects would arise if you exceeded that output.

The problem is that this can easily become a self-fulfilling prophecy because labour markets, expectations, real capital capacity in our economy will adjust if everyone understands what the bank is doing. Then their assumed level of the NAIRU actually becomes the actual level of the NAIRU for the simple reason that we don't have the capacity or the ability to move beyond that.

If the bank were explicitly governed by at least a twin mandate of reasonable inflation and job growth, then it could test the waters a bit more to try to see where exactly inflation would pick up, because they would be trying to capture the benefits of the upside on the employment.

The Chair: Thank you, Mr. Mai.

We'll go to Mr. Adler, please.

Mr. Mark Adler (York Centre, CPC): Thank you, Chair.

Thank you, witnesses, for appearing here this morning.

I want to begin my questioning with Mr. Alexander. You mentioned before that the Bank of Canada, through its low-interest-rate policy, has provided great stimulus to the economy. Could you talk more about that?

Mr. Craig Alexander: When we think about how monetary policy responded to the financial shock of 2008, we need to understand that there was actually nothing structurally wrong with the Canadian economy before the financial crisis hit. What effectively happened to Canada was that we were hit with a massive external shock.

The simple reality is that fiscal policy and monetary policy in Canada cannot change external economic conditions. Canada is a small open economy. More than a third of our economy is exports. We're heavily influenced by what happens outside our borders.

When the economy went into a very steep decline and a very severe recession, there was aggressive easing of monetary policy, taking interest rates down, with the overnight rate eventually reaching zero percent.

You could actually see the positive impact that had in terms of boosting domestic demand. The best evidence of that is the fact that, starting I think in March of 2009, we had the most unique situation. We had rapidly rising unemployment accompanied by rapidly rising home sales. We have never had that correlation in the past. It was one of the reasons forecasters like me got all of their housing market forecasts wrong.

This was complemented by the renovation tax credit to help boost the inclination of consumers to spend. Ultimately, what was fiscal and monetary policy trying to do? When private sector demand was contracting, they were trying to push the other way, to encourage Canadians to do things they otherwise wouldn't have done in those economic conditions. We can actually materially see that it had a positive impact in terms of boosting the economy and limiting how deep the recession became.

Now, it does create challenges, because I do think that household debt has become very high, but I think one of the lessons we have learned from recent experience is that we need to understand that monetary policy has to be accompanied by sound fiscal policy and sound regulatory policy. One of the core differences between Canadian and U.S. experience has been that the Canadian financial system has been better regulated, has taken less risk, and was less leveraged. So while we do have challenges around the fact that rates being low for so long has boosted consumer spending and household debt, which is an issue we're going to have to address when interest rates eventually rise, I would argue that the conduct of monetary policy was extremely sound.

● (1205)

Mr. Mark Adler: And was it the same for fiscal policy?

Mr. Craig Alexander: As I said, I believe that fiscal and monetary policy both contributed to limiting how deep the recession became.

Mr. Mark Adler: Okay.

Also, you mentioned that the Bank of Canada pursued some “out of the box” thinking. Could you expand on that a little bit too?

Mr. Craig Alexander: As I said, I think the best example of that was the decision to make a conditional commitment to keep interest rates low for an extended period of time with an actual specific date associated with it. We'd never had that happen before, and it did have a material impact on the thinking in financial markets.

One of the core challenges is that investment banking, brokerage, traders will respond to day-to-day changes in economic numbers, and those will change their thinking. If you start to get some good economic numbers, but you're just coming off a very bad decline, markets will start to think about the Bank of Canada moving off the sidelines and raising rates. They would have started to price in tightening earlier than the Bank of Canada actually delivered in practice, because as the economy was recovering, markets would have gotten excited about the possibility of rates rising sooner.

The conditional commitment helped to anchor short-term rates, and then by definition the anchored low short-term rates pulled down the yield curve for longer-dated maturity. For example, a conditional commitment, in my opinion, also limited the rise in five-year mortgage rates. So it provided stimulus across the entire borrowing segment.

There is a challenge here that business confidence.... There are limits to what policy can do, and Canada was hit with a massive external shock. There was nothing Canada could do about that, other than try to temper the impact on our domestic economy.

Mr. Mark Adler: Thank you.

The Chair: Thank you, Mr. Adler.

We'll go to Mr. Marston, please.

Mr. Wayne Marston (Hamilton East—Stoney Creek, NDP): Thank you, Mr. Chair. It's interesting to see the discussion at that end of the table. I appreciate it.

Many years ago, in the eighties, I was on our local labour council's full employment committee. And from labour's standpoint, if I told an unemployed worker at that time that 3%, 4%, 5% was full employment, I won't say what would have happened, but it wouldn't have been nice. I would suggest that the use of the term “full employment” in that context is a misnomer, because people think full employment should mean everybody capable of working has a job. So there's quite a gap when you think about it. As Mario indicated, we saw the acceptance of 7% and 8% as full employment, which is a real problem.

The other thing that's happening.... I fully accept targeting inflation. I'm one of the people who had a 10.25% rate in 1980 and it went to 21.75% in one jump, so you're not going to get an argument from me.

Kevin Page was before us recently, and he talked about the fact that the government side talks about 600,000 net new jobs. I'm not arguing that point, except that there are still 300,000 fewer people working than pre-recession. The news we just heard today—I think it was from Mr. Stanford—is that some 70,000 have lost their jobs in the latest figures. Well, he was predicting 100,000 for this year. So we've taken out 70,000 of that number already. We've got ourselves a very serious problem right here and right now.

I really wanted to get those points in. As for a question, does inflation targeting limit the Bank of Canada's ability to respond to the global financial crisis?

Mr. Stanford, would you like to take that one? Are there lessons that have been learned from this? Have they changed direction, or is it necessary to?

● (1210)

Dr. James Stanford: Firstly, Mr. Marston, in regard to your earlier points, we really do have a serious problem. While monetary and fiscal policy in Canada was tremendously important at the outbreak of the crisis at the end of 2008 and the beginning of 2009, we have stalled since roughly the spring of 2010. We've had no continuation in recovery in employment rates, in per capita incomes. Governments and consumers are both maxed out on their credit-fueled spending. The business sector has not kicked into gear in the way that it needs to. So we still have a problem, without taking away the value that came from that stimulus effort. The stimulus has been over for a while, and we're not out of the woods yet. We're going to need more help.

In terms of the inflation-targeting regime, it clearly did limit the Bank of Canada's ability to respond, because we were starting from such a low level of inflation in the first place. So you reached the zero bound on policy very quickly. If we had targeted inflation at a higher level or if we hadn't any target or if we just had higher inflation, they would have had more flexibility. One of the most powerful arguments against the 2% target, anyway, if not against targeting in general, is the problem that happens when interest rates get to zero.

I think that was Mr. Sumner's point as well. If the target had been at nominal GDP instead of inflation, there would be an added dimension of flexibility where the bank could have gone after it more aggressively. That being said, I think our bank was creative and committed in what they have tried to do. I don't think inflation targeting helped their effort and I think in some ways it probably constrained it.

Mr. Wayne Marston: Would anyone else like to respond?

I thought somebody might.

Mr. Craig Alexander: I have two points. One, on the full employment side, we don't know where full employment is. We know there is always going to be transitional unemployment. Just as anecdotal evidence, when Alberta saw its unemployment rate get down to 4%, when Calgary was in the 3% to 4% range, you started to see that they were past full employment, because that's when you started to get signing bonuses for people to hire at Tim Hortons and at McDonald's. You saw exceptional labour market challenges created by remarkably low unemployment. That was hit in the 3% to 4% range.

Mr. Wayne Marston: Also, inflation within those communities too.

Mr. Craig Alexander: Right. So you could see that full employment isn't zero. Let's be very clear. We don't actually know where it could be. Maybe it's not 6% to 8%; maybe it's 5% to something else.

There is another thing I would point out in terms of the conduct of the Bank of Canada's monetary policy. Ask yourself this question. How much more of a boost would the economy get if interest rates were lower? Consumers have taken on as much debt as they really can. And the problem, from a business point of view, is not the cost of borrowing; the problem is the willingness to spend and invest, because balance sheets are flush with cash.

The Chair: Thank you.

Unfortunately, we do have to move on. We're going to move on to Mr. Van Kesteren, please.

Mr. Dave Van Kesteren (Chatham-Kent—Essex, CPC): Thank you, Chair.

From the sixties, I think you'd all agree, we've had a dramatic shift. Back in the sixties there was one wage earner, not both parents working. The demographics today are 1.7 compared to heaven knows what, and we have an aging population. We have a different world today.

Taking that into consideration, it's been said, I've heard, that the perfect inflation rate would be 1%, but wouldn't you agree that 0% is the perfect rate? Aren't a lot of these problems a result of pressures on non-market decisions? For instance, we do a lot of things today, right or wrong. We have the ramifications of energy production. That's not driven by market forces any more. You could even argue something like minimum wages. They're all social issues. We've put a whole mess of different things into the porridge. As a result, what should be a very simple subject, economics, now becomes one of the most complex.

I have to tell you that the more I listen to you, the more complicated it gets. I remember one time reading a book by Goodman, *Paper Money*. He was asking a banker about the policies of lending between banks and he asked how many people understood this. They said a handful of senators and one or two congressmen. I don't know if it's that bad today, but the fact of the matter is it's complicated.

Wouldn't you agree that the reason we are having a lot of these problems is that we've decided to just mix in a whole mess of things that aren't really what we'd call traditionally economics? I'd like to have your thoughts on that.

● (1215)

Mr. Craig Alexander: That's a very broad observation.

Let me just start with 0% as the ideal target. It might be the ideal target, but the problem is inflation fluctuates, and that would mean you would be spending part of your time with deflation, and deflation is extremely corrosive, because—

Mr. Dave Van Kesteren: But we have those things. I guess what I'm trying to say is that we're having this discussion about whether or not this is the right policy, and it seems to me that this is the best of an imperfect world.

Mr. Craig Alexander: If we had a perfect theoretical world where we had complete stability, then you could have inflation running at 0%. But in the practical world that exists today, you can't target 0% because of the damage that you could create by creating deflation. That was why I was saying that from a point of view of lowering the target to 1%, you start to run the risk that because of the way we measure inflation and some of the imperfections of the measurement, you actually could be creating a deflationary style of environment.

On your other observation, I actually don't think economics is rocket science. I actually think most of this is pretty simple.

Mr. Dave Van Kesteren: It should be.

Mr. Craig Alexander: Part of the problem is the language we use. And unfortunately, in this context we're talking about things like full employment, NAIRU. Really what we're trying to talk about is trying to create price stability that creates an environment of economic growth that then creates a better standard of living for Canadians.

Also, you made a good point: monetary policy doesn't work in a vacuum. In actual fact, fiscal policy is terribly important in terms of setting out the structure, the competitiveness of the economy. And the structure of the economy matters in a very big way. Monetary policy can only change the cost of borrowing or the supply of money, and then what impact that has on the domestic economy. I think people give the Bank of Canada too much credit in terms of being able to micromanage the economy, just as I think markets and many people think that the government has more control over the exchange rate than it will ever have.

Mr. Dave Van Kesteren: Mr. Ragan, do you have any comments?

Prof. Christopher Ragan: On the 0% inflation idea, there is a compelling argument, actually, or at least a compelling benefit from having 0% inflation, and that is that the money we use would retain its value. I worry less actually than Craig about periods of deflation followed by periods of inflation. My concern is if we actually have a target of 0% inflation, there are potential costs that come possibly from the 0% lower bound, possibly from the inability of labour markets to fully adjust. There is a reasonable debate among economists about whether there would be net benefits going from 2% down to 1% down to 0%, but there is certainly a gross benefit of being at 0%. The question is whether there are also costs that would offset that.

Let me stop there.

The Chair: Thank you, Mr. Van Kesteren.

[*Translation*]

Mr. Giguère, you have five minutes.

Mr. Alain Giguère (Marc-Aurèle-Fortin, NDP): I just wanted to let all the witnesses know that the Bank of Canada is equipped with a number of tools including the exchange rate, the value of the Canadian dollar, the inflation target of 2% and special drawing rights.

I think there is a problem with the simultaneous interpretation.

[*English*]

The Chair: You can switch between English and French on the mike, and adjust the volume as well.

[*Translation*]

Mr. Alain Giguère: I am going to ask my question again.

● (1220)

The Chair: Go ahead.

Mr. Alain Giguère: It sure seems like the Bank of Canada is equipped with some tools, including the exchange rate, the inflation target and special drawing rights.

The bank operates in a country that is vast geographically, but that is even more so economically. There are great regional economic disparities, there are different economies. In addition, there is a serious lack of investment whereas, ironically, $500 billion on the credit side are tied up.

We also suffer from the so-called Dutch disease. The Dutch disease is basically what happens when a country that exports natural resources, such as oil, sees a major drop in its manufacturing jobs. There is also the influence of other countries.

When we factor in all those aspects, there is always an explanation for an inflation target of 2%. But with an inflation controlled at 2%, how can we overcome the Dutch disease? How can we overcome the lack of investment and regional economic disparities?

I am not happy with what you are telling me because you are explaining what you are doing at the moment, but I want to know where the Canadian economy will be heading in 10 to 15 years. The Governor of the Bank of Canada told us to forget the American market and go elsewhere. I have a problem with that.

In 15 years, what is the Canadian economy going to be like if we continue to lose our manufacturing jobs by 35,000 positions per month? That's my question. How will Canada be able to maintain its status as a thriving industrial nation? I do not want an Iranian model or a Saudi model.

What is being done for Canada to keep its status of an industrial nation in the next 15 years, if its daily inflation is controlled at 2%?

These questions are for all the witnesses.

[*English*]

The Chair: That's a very big question.

[*Translation*]

Prof. Mario Seccareccia: Thank you for your questions. I am going to answer quickly.

First of all, I am very familiar with the Dutch disease. We actually have a problem. We have a flexible exchange rate that essentially reacts to what is happening, since the Canadian dollar has become a type of oil currency, the way it is in Saudi Arabia. That's because of the successful increase in our exports, not only in raw materials in general, but also in oil specifically.

It is a very specific problem, but I don't think the monetary policy can really make a difference directly. If not, another possibility would be to try and control the exchange rate just to try to make us more competitive in the manufacturing sector, to the extent possible. We might be able to play with that, but other problems might also ensue.

And if we look at other countries that have had fixed exchange rates—it is not Europe's case at the moment, but it has been historically—we can see that there have been specific crises. I personally don't think this is the way to get us out of the slump the manufacturing sector is in. We should first do something about the tax side of things.

Mr. Alain Giguère: Mr. Stanford can also answer the question.

[*English*]

The Chair: We have time for one more person to comment.

Mr. Ragan, I think you wanted to comment.

Prof. Christopher Ragan: Actually, I'm in uncharacteristic agreement with Mario. There are many problems, many challenges ahead. Most of them do not relate to monetary policy. Monetary policy has to be recognized as a blunt instrument that cannot be used to solve a large set of problems. It can really be targeted at one, which is where the price level is going over the long run. I agree with everything Mario just said.

Mr. Craig Alexander: Just very quickly—

The Chair: Very briefly.

Mr. Craig Alexander: —I think one of the core issues we have right now is that there is every reason, every incentive, for businesses to invest and expand; the problem is confidence. The lack of confidence relates to the external environment we're operating in, with worries about a European banking crisis and worries about the U.S. economy.

So if we think about the ability of companies to invest and hire in Canada, they have the ability to do so. The real issue is that you need confidence, and you're not going to have that confidence until you get greater clarity over what's happening to the external risks we don't have any control over.

● (1225)

[*Translation*]

The Chair: Thank you.

[*English*]

We'll go to Mr. Jean, please.

Mr. Brian Jean (Fort McMurray—Athabasca, CPC): Thank you, Mr. Chair.

Thank you for attending today.

My first comment is in relation to Monsieur Seccareccia. I just wanted to make a comment. I disagree with you in relation to the success of our economy right now. I agree that it's in relation to oil, but it's also in relation to the oil sands, which are in my riding, and it's in regard to innovation, to patents. More patents come out of that area than all the rest of Canada combined.

So it's about persistence and hard work in a resource that really is a manufacturing resource; it's not just a pump-out like Saudi Arabia. I think that makes a big difference. As you can tell by the cost to produce it, it costs about 10 times or up to 15 times more than it does in Saudi Arabia. So I think it's about Canadian persistence and a real success story.

I want to ask a question in relation to the inflation-targeting system, keeping in mind two specific questions.

First of all, what fiscal policy can we adopt to reduce debt for Canadians? That's obviously ignoring the first one, which is increasing interest rates, which will encourage people to pay it off quicker but of course will encourage their debt.

Secondly, the fiscal policy to balance.... Keeping in mind that I'm from Fort McMurray, if we have 3% unemployment, I can't find that 3% of the people. There are fiscal and unemployment differences regionally across this country. How do you set fiscal policy, especially regarding the inflation-targeting system, keeping in mind the differences across the country?

In Saskatchewan, where Mr. Hoback is from, and in Alberta, where I'm from, we don't have problems with people being unemployed. Finding labour is just about impossible. I've been running businesses there for 30 years and I can assure you that with those bonuses to work in car washes, like I have to give—about $10,000 to keep one employee—it's very difficult indeed. How do we balance that fiscal policy, keeping in mind the inflation-targeting system of the central bank?

Prof. Mario Seccareccia: First, very quickly about Saudi Arabia and all of that, I mentioned that simply because the Canadian dollar largely has become a petro-currency. That's not to suggest that we are like Saudi Arabia in terms of processing end, of course.

However, with regard to the issue of how we deal with matters to do with, in this case, the fiscal side of things, I'm one of those who believes very strongly in functional finance here. That is the principle that it is up to the fiscal authorities to run deficits when we're plunging into a recession, when we see growth slowing down—

Mr. Brian Jean: So you agree with what our government has done in relation to that?

Prof. Mario Seccareccia: Absolutely, except that I don't agree in the recent one right now. I mean since 2010—

Mr. Brian Jean: I understand. My one question is—

Prof. Mario Seccareccia: What we did immediately after—

Mr. Brian Jean: I'm sorry. I'm looking for ideas and fiscal ideas in relation to those two points, and I'm limited in time, so if I may...?

Mr. Craig Alexander: Very quickly, I just addressed the question about what we should be doing about debt. I think you have to set interest rates for the entire economy. If you have concerns about debt, they're not going to be on corporate debt. The issue is going to be around consumer debt.

When we look at the growth of debt on the consumer front, we see that the vast majority has been debt related to real estate. The debt-to-income ratio in Canada is now higher than it is in the United States, at 147% in Canada and 146% in the United States. By my estimation, if the government had not tightened up the mortgage insurance rules, we would have a debt-to-income ratio of 160%. We would be at the peak that the United States hit.

In my opinion, if we see household debt accelerate, it would be appropriate to look once again at whether we need to tighten mortgage insurance rules to dampen the acquisition of debt. If we have consumers over-responding to the continued low interest rate environment, then I think that you would start to consider that.

However, I would not recommend doing such actions in the current environment, when there's so much uncertainty related to what's going on in Europe and the United States. That could pose a new external shock. But you might want to consider policies to act if the external risks don't play out.

Mr. Brian Jean: Very briefly, are there any other comments, in point form, in relation to what I've asked?

Prof. Christopher Ragan: Well, when you said “fiscal policy to reduce debt”, it wasn't clear to me whose debt you were worried about.

Mr. Brian Jean: Consumer debt: that's the real issue.

Prof. Christopher Ragan: Then I'll add nothing to what Craig said.

Mr. Brian Jean: Thank you.

The Chair: Thank you, Mr. Jean.

We'll go to Ms. Glover, please.

Mrs. Shelly Glover (Saint Boniface, CPC): Thank you, Mr. Chair.

Welcome to all our witnesses.

I kind of feel bad for Mr. Sumner. He hasn't had much of an opportunity to respond.

Mr. Scott Sumner: I'm still here.

Mrs. Shelly Glover: Yes, I see you there. Thank you for joining us, sir.

I am going to ask Mr. Ragan a question, because every once in a while we get a witness who comes before committee and who leaves a lasting impression or says something that sticks. When you said "anchor the expectations", that is ultimately the key to our recovery, the key to making sure that we as a country stay in a fiscal advantage. We are in an advantage right now; we need to maintain that. Mr. Alexander also touched on it when he talked about confidence.

When you refer to the anchoring of expectations, I want you to address what you mean by that exactly. Also, how important is that, should we be negatively impacted again by what's going on in Europe or the United States?

● (1230)

Prof. Christopher Ragan: Thank you. That's an excellent question.

I think one thing that economists and monetary policy-makers have learned over the past 30 years is that an important part of keeping inflation on target, whatever that target is, is about keeping expectations anchored. This is why the communication of monetary policy is so important.

If you look at the evolution of Canadian monetary policy or that of other countries, you'll see that communication, which used to be intentionally obfuscating, is now intentionally transparent, because they're trying to make it very clear what their goals are and they're trying to make it very clear what actions they're going to take to achieve those goals.

What I mean by anchored expectations—and you can see this if you look at inflationary survey data about future inflation expectations—is that those expectations don't seem to change much in response to shocks. So you have a big positive shock to the economy or a big negative shock to the economy, and those expectations for inflation two years or five or more years down the road are not perfectly constant, but they are remarkably stable, more stable than they were in the past and more stable than they are in other countries that do not have inflation targeting. This is one of the big benefits of inflation targeting.

As I think I said earlier, one of the huge advantages of having well-anchored expectations is that when a shock happens and the central bank wants to respond aggressively, it can do so and still maintain its credibility and its credible commitment to that target. Financial market participants believe that they will come back to that target—that's why those expectations aren't moving—and it gives the central bank the latitude in the short run to take more aggressive actions than it could otherwise take.

You talk about the fiscal advantage. I think expectations play a role in the fiscal advantage as well. I don't think we want to get into a discussion—I don't think—about whether we are on the appropriate fiscal track, but I do think that expectations play a key role. In the extreme cases that we're now observing in parts of Europe, expectations are driving the fiscal crisis.

Mrs. Shelly Glover: I'm leading you down a path here, because now I'm going to ask you for a comparison. When Mr. Sumner talks about using nominal GDP as an alternate, or if we talk about full employment targeting as an alternate, tell me how that affects your anchoring of expectations. Does it affect it?

Prof. Christopher Ragan: Thank you. I'm happy to be led down that path.

In my view, what enhances the anchoring of inflation expectations is a very simple, easily understood objective, and today and for the past 20 years there has been absolute clarity in that objective: the inflation target was 2%, period. There was a particular measure of inflation: headline inflation. The bank uses core inflation in an operational sense over the short run, but it's absolutely clear that the target is 2%. In a world of nominal income targeting, that clarity would be lost. There would be a target on nominal GDP—

Mrs. Shelly Glover: Agreed.

Prof. Christopher Ragan: —but there would no longer be a target on inflation or real GDP. It would be the sum of the two.

In a world of full employment targeting, as full employment.... And Mario suggests quite rightly that in fact our measures of full employment or NAIRU move over time. Of course they move over time. All kinds of real variables move over time in response to changes in labour market policies, productivity growth, technological change, etc.

As those things change over time, does that mean we're going to have a shifting target from the central bank? That mobility in such a target, if that happened, would be not a simple thing to communicate. To me, the big advantage.... I mean, if you buy the argument that anchoring expectations is important, then it's only a hop, skip, and a jump to buying the idea that inflation targeting is also very valuable, because it has those simple communications.

The Chair: Thank you.

Thank you, Ms. Glover.

We'll go to Mr. Julian, please.

Mr. Peter Julian: Thanks very much, Mr. Chair.

This is a very interesting discussion. I come from British Columbia, of course, and I often find the discussions we have up here in Ottawa don't really relate to how people are feeling on the ground and in communities across the country. The reality is the job figures we talked about earlier in the month of October have been pretty disastrous. We've seen an erosion of good-quality manufacturing jobs—and I know Mr. Stanford's aware of this—and about half a million have been lost over the last few years. There have been only about 200,000 new jobs, even though the labour market has grown to be much larger since May 2008. On average, those new jobs pay about $10,000 less than the jobs they replaced did. A lot of families in my area of the country are really struggling. They're struggling with record debt loads. They're struggling with the increasing income inequality we're seeing in this country.

I want to ask Mr. Stanford and Mr. Seccareccia whether they feel there's a role for monetary policy in addressing some of those issues or whether this is just primarily a fiscal failure, that governments have not put in place the fiscal policies to address all of those issues the middle class are living through.

● (1235)

Prof. Mario Seccareccia: Maybe I could answer very quickly.

I think it's primarily a fiscal policy issue, needless to say. How do we deal with being able to meet a certain income level so you can reduce your debt load, etc.? As a household you should be deleveraging somewhat at this point, given the current environment. In that regard, as I said, it's primarily a fiscal issue—how you want to generate incomes for individuals out there. You do it through fiscal policy in a time of recession, as we've witnessed over the last while.

Having said that, I think there's also a role for a monetary policy. It's kind of interesting that here we were emphasizing all this stuff about anchoring expectations about inflation, but we should also be trying to anchor expectations about employment down the line. Because again that's what households are concerned about in terms of their own state of finances. Why is it that we're so concerned about one issue, which I think is of less concern to many people, when they're struggling to make ends meet or if they lose their job? There are more and more of them, as we're seeing down the line here.

My point here is that there's also a role for monetary policy, but it should deal with employment or unemployment issues. Those are things that should be on its radar screen directly and officially rather than merely implicitly. In that regard, I think there is, but it's kind of a macro issue in a sense. Fiscal policy could deal at the level of individuals and could deal with how we could provide transfers for those who are in need, in a sense, and how we could generate jobs through fiscal measures here, as we did through the fiscal stimulus kinds of packages that we implemented, going back a couple of years.

Mr. Peter Julian: Thank you.

I'll let Mr. Stanford answer as well.

Dr. James Stanford: Thank you.

I think monetary policy has absolutely exacerbated the inequality in our society, because it has explicitly targeted inflation control. One effect of that is to enhance the real value of wealth—that's how Chris put it—at the expense of targeting full employment, trying to get to a situation where an average worker even in a Tim Hortons has a shot at getting a higher standard of living. In Fort McMurray, the Tim Hortons worker has a shot at getting a higher standard of living, but the Bank of Canada is there to ensure that situation does not occur outside of a few small isolated areas.

That's why the wage share of national income has declined secularly, not just under inflation targeting but under the whole sort of shift towards inflation control as the top priority. The wage share has declined. The share of income going to those who own wealth has increased, and that is absolutely paralleled in the growing personal disparities of income in society. If we want to address that, yes, fiscal transfers are important, but we also have to give people a fighting chance of getting a job and getting a higher income from that job.

The Chair: Thank you.

Thank you, Mr. Julian.

I wanted to raise two issues. The first issue was raised by Mr. Alexander with respect to moving away from the inflation targeting and moving to one of the other models. My concern is the impact on the purchasing power of individuals and on their savings and income.

Mr. Alexander, you raised it, but perhaps I'll give Mr. Stanford.... I mean, that's my primary concern in terms of moving away from the model we have now. Obviously people on fixed incomes are of concern as well. Can you just sort of address the concern that I would have in terms of purchasing power of individuals if we move away from the model we currently use?

● (1240)

Dr. James Stanford: First of all, there's been a very wide range of risks to the real purchasing power of Canadians' savings, and I would suggest volatility in the inflation rate is near the bottom of the list compared to what's happened in financial markets, the value of assets, and so on.

But my more important response would be: where do Canadians get their savings in the first place? For most of us, you have to have a job that pays you enough to pay the bills, and then sock away a little bit of money. So in that regard, I think more of an emphasis on reducing unemployment—and increasing incomes from employment —would actually benefit Canadians' savings, because they'll have more money going into the bank.

Secondly, the nominal rates of interest are going to increase if the overall level of inflation increases as well, and that can have a benefit.

The Chair: Okay.

Mr. Alexander, do you want to briefly address that? Then I want to move on to my second point.

Mr. Craig Alexander: I guess it comes back to what the impact of even easier monetary policy than what we currently have would be. We already have an extraordinarily stimulative monetary policy. It could help to bolster economic growth to some extent, but I think the down side of it is that we would have much more rapidly rising home prices as well as much more rapidly rising household debt, and we'd have an even greater household debt imbalance that we'd have to address down the road.

One of the things we learned from the U.S. experience is that this wouldn't be a prudent path to follow.

The Chair: Okay.

The second point I want to address is with Mr. Sumner in terms of targeting nominal GDP, because you talked as well about the long-term rate of inflation. You indicate that you could actually address both—which I wish would be true, but I have to admit I'm skeptical of targeting nominal GDP and at the same time addressing the long-term rate of inflation.

Can you just explain to me how you could actually accomplish both? It seems to me that if you move the models, then you do move away from inflation targeting. I'm not sure how you could actually do both, if you do the targeting nominal GDP model.

Mr. Scott Sumner: Of course nominal GDP growth is the sum of inflation and real GDP growth. In most countries, including the U.S. and Canada, real GDP growth has been remarkably stable on average over long periods of time. Of course, it varies over the business cycle.

So if we picked, say, a 5% nominal GDP target, we would have had about 3% real growth and about 2% inflation over a period of many decades—maybe even a century. There are ways of adjusting that for demographics that I won't get into here.

But I would also point to the fact that even if it didn't work perfectly, that flexibility really could help in certain situations. I would point to Australia as a country Canada might look at. By the strict inflation targeting criteria, it hasn't done quite as well as Canada, but that also gave them more flexibility and they didn't fall into the liquidity trap, partly because of slightly higher inflation than nominal GDP growth.

Yet Australia would still be viewed as a country that would have fairly good performance on price stability and was able to almost completely avoid the recession this time around. Now, of course there are differences between the countries, but I think that would point to an example of a country that's somewhat similar to Canada in terms of its industry mix, and also was able to do somewhat better by being a little bit more aggressive on nominal GDP growth during this recession.

But again, long-term real GDP growth is remarkably stable, and if there are demographic shifts, that can be built into the model. If you do that, you're going to have some year-to-year fluctuation in inflation, but you're going to come very close to that average inflation rate you're looking for.

The Chair: I have time for one more person to comment. Mr. Ragan or Mr. Alexander, would you want to comment on that?

Mr. Ragan.

Prof. Christopher Ragan: On the nominal GDP targeting, I do believe that in Canada—it's less true in the United States—there will be a decline in GDP growth that will be significant over the next 25 years from population aging. I think that is almost inevitable, frankly. Nominal GDP targeting would then have either a steadily increasing inflation rate, which I don't think is a good thing, or it would have steadily adjusted official targets, which I think, from a communications point of view, would be about as close to a nightmare in monetary policy as I can imagine.

Plus, I am not convinced that there are the shorter-run benefits over the business cycle, given that you have flexibility in the current inflation targeting system. I think that's an important thing to recognize about the Canadian system—that there is flexibility built in, and in fact it has been on display very well over the past few years.

● (1245)

Mr. Craig Alexander: I think I would also caution you about using the Australian example, because the fundamental difference is that Canada's major trading partner is the United States, and Australia's major trading partner is Asia and China.

The Chair: Okay. I'd like to keep that going, but my time is up.

I'm going to move to Mr. Brison, please.

Hon. Scott Brison: With respect to the question on Australia, Mr. Sumner raised this, and it's an interesting one, given that Australia is facing some of the same opportunities and challenges, I guess you could say, of commodity-based economies, with a lot of disparity between commodity-rich regions and other regions. I would actually want to relate that back specifically to Canada's situation.

Again, it's this whole issue. Given the differences between how well our commodity regions are doing in those sectors—the oil and gas sector in particular—and how badly other value-added and traditional sectors in the Canadian economy are doing, again, does that not strengthen the arguments for the consideration of nominal GDP targeting? Given that high commodity prices push up inflation, in some ways artificially in terms of the impact on the real economy, and that they also crowd out, because of the higher dollar, a lot of traditional manufacturing jobs, does that not augment the arguments for nominal GDP targeting in a balkanized Canadian economy?

Maybe Mr. Sumner could begin.

Mr. Scott Sumner: Yes, I think it does. I think it better balances the sorts of trade-offs between real growth and inflation and it better trades off the regional disparities.

I certainly agree that Australia was lucky with the Asian export connection, but I think it's also important not to overlook the problem of interest rates falling to zero. I think that's less likely to occur with nominal GDP targeting.

In Canada, if they could have done a little more monetary stimulus—easily by cutting rates—it seems to me it would have been more beneficial, but with the inflation target, that was difficult to do. If you look at the inflation numbers for Canada, you see that they've actually been fairly low for the last three years. So in a sense it may not have been the inflation rate per se that was limiting the adjustment or the response, but the fact that really unconventional monetary policy techniques would have been required, and with nominal GDP targeting it would have been probably easier to do that with interest rates, as Australia did.

But again, I think that although there are differences with Australia, the regional disparities and the manufacturing commodity split and so on have some similarities to Canada. I think it's at least a case worth studying to see if it applies to the Canadian experience. I do think nominal GDP targeting does provide more flexibility to deal with regional or sectoral shocks.

Hon. Scott Brison: Thank you.

Mr. Alexander.

Mr. Craig Alexander: Very quickly, in terms of the amount of stimulus provided, the overnight rate went down to 0.25%, functionally the floor for nominal interest rates. Then the Bank of Canada could have embarked on quantitative easing to inject more, but quite frankly I think we could have a debate about whether more stimulus would have actually had a materially greater impact on the economy.

I'm not convinced that the inflation target actually did restrict the reaction function of the Bank of Canada. I think they put a lot of emphasis on the flexibility side of the equation. In fact, it goes back to the issue around anchored inflation expectations, because they could afford to provide a lot of stimulus knowing that the market would still expect inflation to get back to 2%.

Hon. Scott Brison: You're kind of saying that because we had inflation targets that had been successful in the past, we could ignore inflation targets in terms of—

Mr. Craig Alexander: Right, because actually the objective is to get to 2% inflation over the medium term, not a given year, so there was the ability to respond through the flexibility of the system.

Also, I do question this issue around the better ability of the Bank of Canada to respond to the environment by using nominal GDP when we're a commodity-heavy economy. If all else was equal and all that happened was that oil prices went up, nominal GDP would go up and we'd end up with tighter monetary policy. So you'd actually have to work out—

The Chair: Okay—

Mr. Craig Alexander: —some sort of measure of core nominal GDP to eliminate the temporary impact of higher energy prices on nominal GDP targeting. I guess we could come up with something like that, but that's one of the reasons why the Bank of Canada uses the core CPI as the—

● (1250)

The Chair: Okay. Thank you.

Thank you, Mr. Brison. We'll have to continue this discussion after the meeting, unfortunately.

One more round, Ms. Glover, please.

[*Translation*]

Mrs. Shelly Glover: Thank you, Mr. Chair.

I simply wanted to correct something Mr. Giguère had said. Mr. Giguère actually said that one of the tools the Bank of Canada has is the exchange rate, but that's not possible.

Mr. Seccareccia, can you correct what has been said?

Prof. Mario Seccareccia: It is not a question of... It might be a tool; it depends on what we mean by “tool”.

Mrs. Shelly Glover: The Bank of Canada has no power...

Prof. Mario Seccareccia: At the moment, we have a flexible exchange rate, a floating exchange rate. The Bank of Canada does not actually have an exchange rate target. It is not a tool that we use. As I was saying earlier, the so-called reaction function of the Bank of Canada has to do with the inflation rate, period.

But...

Mrs. Shelly Glover: Thank you. You...

Prof. Mario Seccareccia: ... there are other aspects. The exchange rate stems from that, but it is not...

Mrs. Shelly Glover: I'm sorry, it is my turn. You can leave it at that. I just wanted to correct what had been said.

[*English*]

I'm going to switch to something Mr. Julian said about losses in manufacturing jobs. The statistics are clear, with 600,000 net new jobs being created because of a number of factors. Yes, there was a bad month there; we are not immune to the effects of the European challenges and the challenges in the United States.

But when he talks about manufacturing job losses, I mean, we're talking about monetary policy. But there's fiscal policy, as you've said, that's linked, and I mean, this is a colleague of mine who is emphatically against trade, and trade agreements are what is driving much of the recovery in the manufacturing sector—

The Chair: Point of order, Mr. Julian.

Mr. Peter Julian: Thank you, Mr. Chair. It's a point of order to correct my colleague. I'm not against trade, of course. I'm against bad trade—

The Chair: Mr. Julian—

Mr. Peter Julian: —which this government has—

The Chair: Mr. Julian, as an experienced parliamentarian, you know that's not a point of order. It's a point of debate.

We'll return to Ms. Glover, please.

Mrs. Shelly Glover: As I said before, he's emphatically against trade agreements.

The reality is that we as a government have to also make decisions, hard decisions on things like having moderate increases to EI instead of the 35% increase that both the Liberals and the NDP suggested, which would have been a $4-billion hit. Maintaining those anchored expectations, when we're talking about corporate tax rates, is another way we are trying to leverage what we already have as far as a fiscal advantage goes.

So I found it very interesting that Mr. Julian would bring up losses of jobs, because, frankly, if we had followed the plan on that side of the table—a $10-billion tax hike, EI rates that total $4 billion, doubling of the CPP—that, in my opinion, would have absolutely negatively impacted on jobs and killed jobs.

I'm going to ask you, Mr. Ragan and Mr. Alexander, to switch hats for a moment and just comment on whether inflation would have had any kind of benefit. If we had gone on that track, would we have seen worse losses in jobs?

The Chair: Okay. We have about two minutes, so that's about a minute per person.

Prof. Christopher Ragan: I think my answer is that you have seen a massively expansionary monetary policy in the last three years, and I can't imagine.... Well, I can imagine what a more expansionary policy would look like; it would have been U.S.-style or U.K.-style quantitative easing. But we have had expansionary monetary policy. It's still expansionary. It's not obvious to me that there would have been a big difference if the Bank of Canada had been following a different targeting system.

Also, I certainly agree with Craig that the current inflation targets were not constraining the Bank of Canada's actions.

● (1255)

Mr. Craig Alexander: Well, we certainly have seen weakness in the manufacturing sector, but when we think about the weakness we're seeing, a lot of it is a reflection of the external environment that is happening in terms of demand for Canadian exports. We have a very weak U.S. economy, which in my opinion is experiencing a lost decade. Regrettably, it's the destination for 73% of our exports, and an awful lot of those exports are manufactured goods. So it's a reflection of the weakness in the external environment.

In terms of fiscal policy, I think the best thing the government could do was to provide the right incentives for business to invest, and I think in fact that has happened. The problem is that business confidence has impaired the reaction of businesses to those incentives. Again, as I said earlier, I think the concern here around confidence relates to the external environment.

When we look at the last three quarters, we've actually seen very strong business investment, even at a time of very volatile financial markets. You can just imagine how much stronger it would have been if confidence had been higher.

The Chair: Okay. Thank you.

I want to thank all the gentlemen for being with us here today and for their comments and responses to our questions. It was a very interesting discussion, and we sincerely appreciate it.

Maybe we will take up Mr. Ragan on his suggestion that we do a future panel on the impact of Europe on the Canadian economy. That would be a very interesting discussion as well.

Mr. Sumner, thank you so much for joining us by video conference. We appreciate your time here as well.

Colleagues, I just want to remind you all that we need you to give your pre-budget recommendations to the clerk on a USB key by tomorrow at 9 a.m.

Again, thank you all for being here.

The meeting is adjourned.

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