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Don't Ignore Lessons from Canada's Inflation-Fighting Past in Shaping Monetary Policy: John Crow

Toronto, Nov. 5 – Canada's difficult experience with inflation in the past offers timely lessons for shaping current and future monetary policy, according to John Crow, former Bank of Canada Governor. In a study released today by the C.D. Howe Institute, *Canada's Difficult Experience in Reducing Inflation: Cautionary Lessons*, Mr. Crow offers an insider's perspective on the fight against soaring inflation in the 1970s through to the successful introduction of inflation targeting in the early 1990s, and draws general lessons from the historical record.

Inflation took hold in the early 1970s, and Mr. Crow describes two subsequent battles against it – a drawn out one that lasted until 1987, and a shorter one conducted between 1987 and 1992. The author answers arguments that this second campaign was not needed, that the "great inflation" was over by 1987 and that 4 percent inflation would have been good enough for the long term. Four percent, he says, was not a credible goal because Canadians and others would have been unlikely to grant much credibility to a regime that seemed content with inflation that high.

The study draws important lessons from this review of the policy record.

- The common view that the big change in inflation performance came with the introduction of inflation targets, in 1991, overlooks the way in which monetary policy after 1987 laid the essential groundwork for their subsequent success.
- While the Canadian economy is relatively small and very open, home-grown monetary policy has generated a decent domestic inflation performance since the early 1990s. External conditions can and do matter, but the evidence shows that they are not decisive. The exchange rate has behaved in a broadly appropriate way as an adjustment mechanism, allowing Canadian monetary policy to focus on stabilizing the currency's domestic value, thus making a sustained contribution to national economic well-being.

- Canadian experience supports the maxim that “inflation is always and everywhere a monetary phenomenon” – in the following particular sense: no policy regime aimed at reducing or preventing inflation can be fully effective unless the central bank takes a prominent role, or better still the lead, in articulating its goals and implementing the policies designed to attain them. Relying on the general government to take the lead in inflation control, whether by way of fiscal policy or income controls, or through executive direction in monetary policy, will not work.
- Multiple governmental objectives, and the speed with which priorities among them are inevitably shuffled by the pressures of politics, contribute to the case for delegating a key role in inflation control to the central bank. It is important that government recognizes this, and, always subject to its ultimate political authority over monetary matters, grants the central bank the latitude needed to take the lead in deciding what has to be done under any but the most exceptional circumstances.

Whatever specific modifications to Canada’s monetary policy regime may emerge from its current review, policymakers should build upon the lessons yielded by earlier experience so as to further enhance Canadians’ confidence in their country’s future monetary stability.

For the study, go to www.cdhowe.org

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Canada’s Difficult Experience in Reducing Inflation: Cautionary Lessons, C.D. Howe Institute Commentary No. 299, by John Crow (November 2009). 17 pp; \$12.00 (prepaid, plus postage & handling and GST – please contact the Institute for details).

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