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"Going Direct": Not a New Tool, But an Old Pitfall for the Bank of Canada

Whether through a "helicopter drop" of cash to consumers or a special new facility to disburse the cash, the Bank of Canada could consider "going direct" to stimulate demand rather than relying on existing monetary policy tools. But what would that mean for its independence from government?

Thorsten V. Koeppl and Jeremy Kronick

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The Study In Brief

In response to the COVID-19 pandemic, the Bank of Canada has cut the overnight rate to 0.25 percent, the threshold it sees as the lower bound for its main policy instrument. At the lower bound, the Bank can no longer use its most direct tool to influence economic activity. The federal government has simultaneously engaged in unprecedented fiscal policy action, running record deficits to bridge households and businesses through the crisis. These deficits have added greatly to public debt, leading to questions as to the limits of future fiscal policy. As a result, the question of whether central banks should have a more direct way of delivering economic stimulus arises.

Broadly speaking, the Bank of Canada can go direct in two ways. One way is to transfer extra funds directly to the general public – often described as a "helicopter drop": "cash" is printed and dropped onto people as transfers – a one-for-one, dollar-for-dollar combination of monetary policy and fiscal transfer.

Another option is through a standing facility at the Bank of Canada. In this case, the government could still make transfers to people, but their delivery would be called for and facilitated by the Bank, which would promise to accept any newly issued debt from the government to temporarily finance these transfers. The end result, however, theoretically would be the same as the "helicopter drop": an increase in the money supply through direct transfers initiated and facilitated by the Bank. This would foster aggregate demand and, thus, inflation at the right time.

In our view, "going direct" would open the door to political interference with monetary policy, even under a well-designed system. Furthermore, it is not clear what the benefits would be relative to other monetary policy options, such as forward guidance, that promises to keep interest rates low for long, or quantitative easing that flattens the yield curve across different assets.

Inflation control is one of the biggest achievements of economic policy in Canada over the past quarter-century. The general public understands the job of the Bank of Canada. That might change fundamentally, however, if people receive a cheque in the mail from the government that they know has been enabled solely by the Bank of Canada's balance sheet magic. In Canada, we have grabbed the tiger by the tail. Why involve politics once again if doing so risks the tail slipping away.

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In the wake of the COVID-19 pandemic, the Bank of Canada has cut the overnight rate to 0.25 percent, the threshold it sees as the lower bound for its main policy instrument. At this lower bound, the Bank is deprived of its most direct tool to influence economic activity.

At the same time, the federal government has engaged in unprecedented fiscal policy action, running record deficits to support private households and businesses. This has added greatly to public debt, with questions remaining as to whether this will limit future fiscal policy. These developments also raise the question of whether central banks should have a more direct way of delivering economic stimulus.

It is important, however, to distinguish between the two different lines of reasoning behind central banks' engaging in direct stimulus. One line is that, as governments accumulate large debts, instead of having them sell that debt in markets, central banks can "print money" to finance them – an especially attractive option at the moment. Money, after all, is simply a cheap form of government debt, as it does not pay any interest, while central banks absorb the transfers on their balance sheets, theoretically easing restrictions on government finances.[1] Proponents see this monetary financing as a way to relax solvency concerns for governments.

An entirely different line of reasoning focuses on the need for central banks to look at different policy instruments to achieve their mandated targets when they have no more room to stimulate economic activity with conventional interest rate policy. In this context, "printing money" and handing it to consumers is a fast and direct way – we refer to it in this *Commentary* as "going direct," a term coined by Bartsch et. al. (2019) – to stimulate the economy temporarily in order to achieve the Bank of Canada's traditional policy goal: the inflation target. This line of reasoning is the focus of this paper.

Broadly speaking, the Bank of Canada can go direct in two ways. One way is to transfer extra funds directly to the general public – often described as a "helicopter drop."[2] The analogy is not too far fetched: in the near future, central banks might issue digital currency directly to people in the form of an account entry. The second way to go direct is through a standing facility, where the government issues debt directly to the central bank against funds that are then disbursed to the public.

The reality is that, from an operational perspective, even in normal times the Bank of Canada is already involved in similar transactions. For example, it issues banknotes to financial institutions, which then distribute them to the general public on demand. It also acts as the

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1 This argument also forms the primitive for the advocates of so-called Modern Monetary Theory. From traditional monetary theory, we know, however, that issuing money is not a free lunch. With a permanently increased money supply, inflation is likely to increase, which imposes an implicit tax on people who hold money. The argument might be thought of as printing money to pay off – or, better, inflate away – existing debt to gain more room for future debt.

2 Milton Friedman (1969) first used this analogy; it was used again by Ben Bernanke when a member of the Board of Governors of the Federal Reserve System (see Bernanke 2016).

government's financial agent, making transfers on its behalf. And it purchases government debt through its regular open market operations. Hence, going direct can be thought of simply as a framework that formalizes the use of direct transfers by the central bank when interest rates have hit their lower bound.

Our assessment of this new policy tool is sobering. First, the Bank of Canada has other tools available, such as forward guidance and quantitative easing, that are likely to be deployed in the same scenarios as these direct transfers. While at the lower bound the trade-offs between output and inflation are muted, and direct transfers may offer some additional power to achieve the inflation target, the existing tools can mimic the effect of such transfers. Second, some advocates sell the tool as a way to fix fiscal policy that is either unwilling or too slow to employ transfers in crisis times. The recent experience from the pandemic, however, does not support such an argument. Third, even if the tool were to offer unique benefits and could be put into a well-designed framework of the kind we outline in this *Commentary*, it cannot overcome an old, well-known pitfall: good monetary policy is impossible if exposed to political influence.

The Idea

Central bankers have several tools with which to react to business cycle fluctuations. Traditionally, monetary policy controls short-term interest rates to influence aggregate demand. When demand and, consequently, inflation is too low, the Bank of Canada lowers the overnight rate to spur demand; symmetrically, when inflation is too high, it raises the rate to curb demand. Using textbook-like arguments, these changes in demand result in changes in inflation expectations and ultimately in stabilizing inflation, as required by the inflation-targeting framework. The effectiveness of this interest rate channel, however, might have diminished over the past decade. The principal reason is that the symmetry in conducting monetary policy is no longer a given when the overnight rate is close to its lower bound.[3] The new normal for the Canadian overnight rate since the Great Recession has been in the range of 1–2 percent,[4] which might leave too little room for the Bank of Canada to cut interest rates in the face of a significant economic downturn, such as we have experienced with the COVID-19 pandemic.

Other instruments central banks can rely on to increase monetary policy's firepower include forward guidance, quantitative easing, negative interest rates, and raising the inflation target.[5] All of these tools rely on the interest rate channel, but they have important limitations. Negative interest rates are intended to spur spending, but are hard to implement against the backlash of households facing a tax on savings. Quantitative easing aims to lower rates through purchases of debt – both sovereign and non-sovereign – or other

3 This problem has been commonly labelled the "zero lower bound problem," as nominal interest rates cannot theoretically fall below 0 percent, otherwise it would be cheaper to hold cash, which earns 0 percent interest. Due to other factors such as the convenience of non-cash holdings, the Bank of Canada has estimated the lower bound to be around –50 bps, where a bps is 1/100 of a percent (see Witmer and Yang 2016). Officially, however, the Bank has announced 0.25 percent as a floor for its interest policy.

4 Carter, Chen, and Dorich (2019) estimate the nominal neutral rate – the long-run real rate plus inflation expectations (2 percent) – to be between 2.25 and 3.25 percent. The nominal neutral rate has fallen over the past couple of decades, partly because real interest rates have fallen over this time period (see, for example, Beaudry and Bergevin 2013).

5 For an excellent overview of alternative monetary policy tools, see Gagnon and Collins (2019). Bernanke (2020) gives a wide-ranging overview of the effectiveness of such tools. Interestingly, he does not discuss or mention "going direct" as an option.

financial assets on the secondary market.[6] Such interventions, however, necessarily involve credit and operational risk. And raising the inflation target comes at the cost of higher average inflation and possibly destabilizing inflation expectations.

Enter "going direct." At the heart of the proposal is that the central bank "prints money" that is put directly into the pockets of households via transfers. One option is to use the aforementioned "helicopter drop": "cash" is printed and dropped onto people as transfers – a one-for-one, dollar-for-dollar combination of monetary policy and fiscal transfer. Of course, it is not the case that the central bank literally delivers cash to households. As we outline below, one option is for the bank to deposit money into household bank accounts at financial institutions.

Another option for "going direct" is through a standing facility at the Bank of Canada. In this case, the government could still make transfers to people, but their delivery would be called for and facilitated by the Bank, which would promise to accept any newly issued debt from the government to temporarily finance these transfers. The end result, however, theoretically would be the same as the "helicopter drop": an increase in the money supply through direct transfers initiated and facilitated by the Bank. This would foster aggregate demand and, thus, inflation at the right time.

How "Going Direct" Would Work

The analogy of a helicopter drop formalizes the idea that a central bank can create "money" out of thin air. Cash issued by the Bank of Canada is ultimately a liability issued by the Government of Canada. As legal tender, it can be used in principle to pay one's taxes. Although the Bank could simply print more cash and distribute it, it operates – like other financial institutions – under a balance sheet (see Box 1). Hence, any transaction by the Bank, including "going direct," involves an operation linked to its balance sheet.[7]

Consider two alternatives for "going direct" (see Boxes 3 and 4, with Box 2 describing standard open market operations). One has the Bank of Canada issuing transfers directly to households.[8] What is new here is that such transfers would not involve any interaction with the federal government or with financial markets, as the Bank does currently with, for example, quantitative easing. The transfers would entail issuing a liability against the Bank's equity,[9] but a look at the Bank's current balance sheet suggests that issuing such transfers would push its equity into negative territory. This would not really be a problem for the Bank, as its shares are fully owned by the Government of Canada. A negative equity position simply implies that the government has an implicit liability against the Bank.[10] As a Crown corporation, the Bank does not necessarily need a capital buffer, but a negative equity position might have ramifications for its independence, an important point we return to later.

The second alternative would see the Bank of Canada accept government debt directly from the federal government, and credit the government's

6 This interest rate channel of quantitative easing is but one channel through which this tool provides monetary stimulus. See the July 2020 Monetary Policy Report for more (Bank of Canada 2020).

7 Consider, for example, a commercial bank that borrows from the Bank of Canada. This typically involves a repurchase agreement (repo) transaction, where the Bank temporarily purchases a security from the commercial bank (an asset) and credits the amount paid to the commercial bank's account (a liability).

8 Coincidentally, this would be operationally feasible if the Bank of Canada were to introduce central bank digital currency in the form of "accounts for all," possibly implemented as segregated accounts at private financial institutions; see Box 3.

9 Historically, before the establishment of the Bank of Canada, private banks did precisely this when issuing banknotes.

10 For an excellent discussion, see Buiter (2008).

Box 1: The Bank of Canada's Balance Sheet

Assets	Liabilities
Loans to financial institutions	Banknotes (cash)
Government of Canada debt	Deposits
Other assets	Government of Canada
	Settlement balances
	Equity (including reserves)

At the start of 2020, before the COVID-19 pandemic, the size of the Bank of Canada's balance sheet was about $120 billion. Banknotes in circulation were the Bank's major liability, making up about 75 percent of its balance sheet; most of the remainder was in a deposit account held by the Government of Canada, with financial institutions holding settlement balances, traditionally $250 million, filling in the rest.

Importantly, financial institutions are not required to hold reserves with the Bank of Canada. The small amount of overall settlement balances enables the smooth operation of the Bank's large-value payment system. This implies that the Canadian monetary system does not rely on multiplier* effects linked to reserve requirements to increase money supply. Hence, such effects only depend on people's desire to borrow and the willingness of financial institutions to lend.

Assets consisted mainly of debt issued by the government and its Crown corporations (nearly 90 percent), with most of the remainder being assets purchased under resale agreements (repos) – short-term loans to financial institutions with an agreement that the financial institution will buy back the asset sold at a higher price. In normal times, repos are a way for financial institutions to obtain liquidity in the form of deposits against securities posted as collateral. Such loans typically are "sterilized" by swapping bank deposits against Government of Canada deposits to keep settlement balances constant.

The Bank of Canada's equity position is usually very small – a little over $550 million in early 2020.

Balance Sheet Transactions

In Boxes 2 to 4 below, we describe three ways the Bank of Canada can expand the money supply as required to bring inflation back to target. One way is to purchase government debt in financial markets, which we refer to as open market operations or asset purchases. The Bank already uses such transactions regularly, and they serve merely as a reference point. The second and third ways are new in the context of "going direct," and are transactions that can directly influence the amount of cash outstanding or the amount of settlement balances available for financial institutions. Importantly, as we discuss in more detail next, the mechanics of the balance sheet expansion do not necessarily lead to an increase in broader monetary aggregates, which is critical for hitting the inflation target.

* Amount of money commercial banks create for each dollar of reserves they must hold at the central bank.

Box 2: An Old Tool: Open Market Operations/Government Asset Purchases

Assets	Liabilities
Loans to financial institutions	Banknotes (+1?)
Government of Canada debt (+1)	Deposits
Other assets	Government of Canada
	Settlement balances (+1)(–1?)
	Equity (including reserves)

Note: Account entries without "?" are mechanical balance sheet operations. Entries with "?" are possible effects on the Bank of Canada's balance sheet after the initial operation, and depend on whether or not there is an increase in the demand for cash.

Open market operations and government asset purchases are the traditional instrument for interventions by a central bank. The Bank of Canada regularly purchases debt that is issued by the Government of Canada to manage its balance sheet. Currently, however, the Bank of Canada is using this tool as part of its Large-Scale Asset Purchase Programs – more commonly referred to as quantitative easing. Here, the Bank purchases already-existing government debt (and newly issued Treasuries) in financial markets in a bid to drive down borrowing costs. This, in addition to the expansion of repos, has led to a significant increase in settlement balances and, as we explain next, to an increase of the balance sheet.

Suppose the Bank of Canada purchases $1 of existing government debt on secondary markets, typically from financial institutions. This increases the asset side of the balance sheet, and leads to a credit for the deposits of such institutions on the liability side of the balance sheet. The effect is an increase in the Bank's balance sheet through an increase in the settlement balances (or reserves) of financial institutions. This is precisely what the Bank has done in response to the current pandemic, in addition to more repos, leading to a significant increase in settlement balances far beyond $250 million.**

This transaction alone, however, would not necessarily increase the money supply. There would be an increase in broader monetary aggregates only if financial institutions used the additional reserves to lend to households or businesses. The increases in the money supply could come in one of two ways. First, as we show here, there could be an increase in banknotes, although this would depend on whether households and businesses demanded actual cash after receiving loans. If they did, this would reduce settlement balances and lead to an increase in banknotes outstanding. Second, if households and businesses drew on their loans to make purchases within the broader payment systems, these purchases would end up again as household or business deposits. Here, settlement balances would remain unchanged, but the balance sheets of the financial institutions would have increased. There would be new loans on the asset side of financial institutions balance sheets and new deposits on the liability side, thereby once again increasing broader monetary aggregates.

** As of the week of August 5, 2020, settlement balances totalled a staggering $283 billion. It should be noted that a significant amount of the increase in settlement balances is also being balanced on the asset side by repos. As such, the Bank of Canada hopes to allow these assets simply to run off, thus bringing down settlement balances naturally – that is, without any market intervention. By doing so, the balance sheet will shrink, and the hope is that this natural reduction in the balance sheet will counteract inflationary pressures.

account on the liability side with extra balances. These balances can then be disbursed as transfers to households. What is new here is that – irrespective of who decides and how these transfers were made – the government would explicitly issue debt to the Bank of Canada, unlike quantitative easing, in which the Bank buys this debt in secondary markets.[11]

Here, Bartsch et al. (2019) have proposed setting up a standing facility on the asset side of the central bank's balance sheet, under which the Bank could then decide to draw new debt from the government. Interestingly, the central bank would require the government to issue new debt outside financial markets when using the facility. The crucial difference is that the Bank, not households, would hold this debt. Hence, it would not be an asset swap on households' balance sheet, but a net increase in their current wealth once transfers have been made.

Guiding Principles for Employing the Tool

We now look at guiding principles for implementing "going direct" in Canada in the context of the Bank of Canada's inflation-targeting framework. We start by noting that the framework has been an unequivocal success story – see, for example, Parkin (2016). This is due to the independence of the Bank in making decisions and to the clear goal associated with monetary policy. Hence, any implementation of "going direct" should be seen in this context. We view three principles as being of first-order importance.

First, the Bank of Canada should be put in charge of "going direct" to minimize any influence from the government. As such, the decision to use the tool, which would have to be recognized as an option in the *Bank of Canada Act*, should be a decision solely taken by the Bank's Governing Council. Any influence by the government would threaten the Bank's independence. Of course, the Bank is not truly independent, in the sense that (i) its mandate can be revoked by the government per directive; (ii) the governor and the senior deputy governor are appointed formally by the government; and (iii) there is coordination between fiscal and monetary policy in difficult economic circumstances. In our view, however, far-ranging independence is critical to the long-run success of central bank policy; we return to this pivotal issue below.

Second, the threshold to employ "going direct" should be high, as it is meant to be a last resort when there is no more room for lowering interest rates. The onus should be on the Bank of Canada to argue that (i) more stimulus is required to meet the inflation target; (ii) using the tool is likely to help achieve the target; and (iii) using the tool is advantageous relative to other central bank tools that might still be available. Importantly, without a change in the Bank's mandate, this would imply that the stimulus must help to bring inflation back within the range of the inflation target within the medium term. In our assessment of the tool, this is a key point to consider.

Third, the measure should be deployed in a transparent and accountable way. One way to do so is for the governor of the Bank of Canada to issue a formal letter to the minister of finance to initiate the move. The letter should specify why the Bank needs to use the tool, to what degree it will use it and what the circumstances are for exiting the measure. This would be significantly different from the Bank communicating an ordinary interest rate decision, and would commit the Bank to a significant degree to future policy actions.

11 Hence, the analogy of a helicopter drop of "money" is important here. The Bank of Canada would put "money" directly into people's hands either against an explicit (debt) or implicit (reduced equity) claim against the government.

Box 3: "Going Direct": Direct Transfers (Helicopter Money)

Assets	Liabilities
Loans to financial institutions	Banknotes (+1?)
Government of Canada debt	Deposits
Other assets	Government of Canada
	Settlement balances (+1)(–1?)
	Equity (including reserves) (–1)

Note: Account entries without "?" are mechanical balance sheet operations. Entries with "?" are possible effects on the Bank of Canada's balance sheet after the initial operation, and depend on whether or not there is an increase in the demand for cash.

Here, the Bank of Canada makes a direct transfer to deposit accounts at financial institutions. Note that the Bank cannot force people to hold cash. Even if it dropped cash on people from the figurative helicopter, they might just deposit the extra cash in their accounts. The distinctive feature here is that this transaction would not involve the asset side of the Bank's balance sheet, but would only increase the Bank's liabilities and thereby decrease its equity position.

As before, the effect on the money supply would depend on which of the following occurred. In the first scenario, households would simply keep the extra funds – or deposit them – in their bank accounts, leading to an increase in settlement balances, but no increase in the money supply. On the other hand, if households demanded more cash for spending or if financial institutions used the increased deposits or settlement balances to give out new loans, broader monetary aggregates again would increase.***

As a side note, if the Bank of Canada were to introduce central bank digital currency (CBDC) in the form of accounts, it could directly credit households with these transfers. This could be seen as a direct increase in banknotes, but now in a digital format. Depending on the precise design of the CBDC, households could still convert such digital currency back into regular deposits.

*** This is consistent with Jakab and Kumhoff (2015, 2018), who argue that money is created by savers only when an increase in deposits is accompanied by an increase in loans. Without this, no new deposit is actually created.

The Design of "Going Direct"

Our proposed guidelines for "going direct" are meant to minimize political interference, but they leave open a wide range of design options for the Bank of Canada concerning the types of transfers and their size and duration.

Transfers could either be universal and uniform or they could target households with specific characteristics. The former is closer to the tradition of monetary policy in that the Bank of Canada has a clear objective – price stability – that affects the asset values of all Canadians, and has complex non-trivial implications for the distribution of income and wealth. In the case of "going direct," a universal and uniform transfer would deliver a fixed payment into the hands of all households. The idea

Box 4: "Going Direct": Standing Facility

Assets	Liabilities
Loans to financial institutions	Banknotes (+1?)
Government of Canada debt	Deposits
Standing facility (+1)	Government of Canada (+1) (–1)
Other assets	Settlement balances (+1?)
	Equity (including reserves)

Note: Account entries without "?" are mechanical balance sheet operations. Entries with "?" are possible effects on the Bank of Canada's balance sheet after the initial operation, and depend on whether or not there is an increase in the demand for cash.

With a standing facility, the Bank of Canada would obtain newly issued government debt, which it would credit to its asset side of the balance sheet and record a liability to the Government of Canada's deposit account. What is new here is that the Bank would obtain the debt directly from the government against funds deposited to the government's deposit account, rather than purchasing the debt in financial markets. The purchased debt would be recorded under a special entry for the standing facility, as shown here. The Bank would swap the initial liability to the government for a liability to households, as with direct transfers (or "helicopter money"). The effect on monetary aggregates and settlement balances would be similar to the other cases, and would depend on whether households increased their demand for cash for spending and/or whether financial institutions increased lending of direct transfers.[****]

[****] We note that in the scenario where the transfer is just returned to the Bank of Canada, the net asset position of households would not change, but the net asset position of the government (treasury) would. Its outstanding debt would not change, but now more of its interest payments on the debt would go to the Bank, which would remit them to the treasury in the form of profits, assuming the Bank's operating expenses did not change. This option would preserve the Bank's independence in the narrow sense that the treasury has more resources and must decide how to use them; the Bank would not need to take a stance on this issue.

is that such a transfer would increase aggregate spending, although not all people might increase their spending equally, with some instead saving the transfer or using it to reduce their debt level.[12] But ultimately, such transfers would be in the spirit of the traditional tool of changing the overnight interest rate and letting the monetary transmission mechanism – an increase in lending, that leads to an increase in spending – take its course.

To the contrary, a targeted payment for certain households would be more in the spirit of fiscal policy, and would deliver more bang for the buck.

12 This savings increase was a prominent feature of the 2001 tax rebates by the Bush administration in the United States (see, for example, Shapiro and Slemrod 2003).

For example, the impact of a transfer could be higher for households that are constrained in their spending and, thus, have a higher propensity to consume additional income.[13] Such targeted transfers, however, are problematic in this context. The Bank of Canada would be financing or even making direct transfers to specific subgroups of households, putting the Bank directly in the crossfire of political discussions.

Consequently, universal transfers would seem to be the better option to protect the Bank of Canada from politics.[14] And to shield the Bank further from political influence, the use of the facility should be defined under clear rules. First, the overall amount drawn from the facility by the Bank should depend on the circumstances (for example, how long and how far inflation is expected to miss its target) and should be calibrated to achieve the Bank's objective of moving inflation back to target. Here, a basic principle stands out. In line with basic monetary theory, to affect inflation, the stimulus needs to involve a permanent increase in the growth of the money supply (see Ambler 2017). This implies that a one-time stimulus is unlikely to be sufficient, as rational households would be induced simply to save the additional funds received.

Second, the Bank of Canada should specify when access to the facility will stop. This should be linked to the Bank's specific goal of achieving 2 percent inflation over the medium term. Hence, it would be reasonable to link exit from the use of the facility to moving inflation firmly back into the 1–3 percent range. Further, when exiting, it should be clear that any direct transfers that households received could not simply be undone by the Bank if the inflation-targeting mandate required a shrinking of the balance sheet. One option would be for the government to retire the standing facility – in other words, pay back the debt – by raising tax revenue or selling additional debt to households. Similarly, to reduce any negative equity position for the Bank, the government would have to inject capital, most likely in the form of newly issued debt.[15]

Third, the Bank of Canada should be required to review the need for the facility on a regular, relatively short-term basis – say, 6 or 12 months. Such a period would take into account any lags when employing the tool, and would allow the gathering of data on its effect on achieving the target, also in the context of other measures taken simultaneously by the Bank or the government.

Should "Going Direct" Be Part of the Bank of Canada's Toolbox?

"Going direct" is meant as a monetary policy tool of last resort at the lower bound for the overnight rate. It likely would be employed only in extraordinary circumstances – such as the financial crisis of 2007–09 or the current COVID-19 pandemic. In such circumstances, once the lower bound has been hit, monetary policy will always resort first to emergency measures such as liquidity provision and asset purchases, through, for example, quantitative easing. Hence, "going direct" is unlikely to be used in the context of dealing with the immediate impact of a crisis or severe recession, but only during the

13 See, for example, Kaplan, Moll, and Violante (2018) for a model that has this prominent feature.

14 An alternative would be to ask for coordination – on the measure and its size – between the Bank and the Department of Finance on how to deploy the funds (of course, outside the regular budget). The problem with this solution is that deployment decisions can be slow, and are often guided by political considerations rather than their economic impact – the exact thing "going direct" would aim to solve.

15 As well, the Bank could, with agreement from the government, retain more seigniorage to reduce its negative equity position.

stage when recovery is slow and inflation remains "too low" – in other words, if the Bank of Canada were unable to achieve its inflation target. The question remains: would "going direct' be effective in stimulating a recovery?

Any argument in favour of this policy tool relies on the exploitation by these monetary transfers of the basic Phillips curve trade-off: monetized fiscal policy (through helicopter money or the standing facility) increases inflation, with the potential benefit of higher demand, larger output and lower unemployment. It is far from clear, however, how strong this relationship is, especially when we are at the zero lower bound (see Ng, Wessel, and Sheiner 2018). Current and past experience with larger central bank balance sheets shows that reserves – or settlement balances in the Canadian context – increase with little or no effect on broader monetary aggregates or demand – as was the case in the United States with the Federal Reserve after the financial crisis.

Some "going direct" advocates (see, for example, Bartsch et al. 2019) see the tool as a replacement for fiscal stimulus in the form of government spending or tax cuts. This argument is based on the idea that the main challenge of discretionary fiscal stimulus is that the political process prevents or slows down its delivery, and it is often not clear where and how it is best placed. In the current pandemic, however, many governments have resorted to significant and swift actions.[16] Furthermore, Carter and Mendes (2020) have shown that a combination of quantitative easing and forward guidance can approximate the effects of direct transfers to households. If so, one can rely on the existing toolkit.

A subtler argument is that "going direct" through the standing facility would provide an indirect wealth effect. Financing government transfers through increased settlement balances can lower interest rates for governments, which thus reduces increases in future taxes. But current yield curves are so flat that the effect on government budget constraints is very small. Furthermore, quantitative easing already provides a channel to deliver cheaper interest rates for all economic actors – private and public households alike – across the yield curve.

The biggest problem for the tool, however, is that it could put the Bank of Canada in a no-win situation once it has been deployed. What if inflation stayed stubbornly low? There would be pressure from the government and the general public to keep the facility open and even expand it. Although some might argue that this is exactly what would be necessary to achieve the inflation target, it would feel like the situation in Japan or Europe, where monetary policy pushes indefinitely on a string: the balance sheet expands, at least in the case of the standing facility, with little or no effect on real activity.

What about the opposite situation, where inflation took off? Think about stagnant demand and a negative supply side shock, from, for example, broken supply chains that disrupt productivity. The Bank of Canada would be required under inflation targeting eventually to normalize its policy. This would mean a stop to the program, but possibly also to a normalization of its balance sheet. As discussed earlier, that ultimately would mean a sell-off of government debt to households combined with an increase in interest rates. This would raise the possibility of panic, as was the experience in the United States with the Fed's efforts to normalize its balance sheet during the so-called Taper Tantrum in 2013. Interest rates rose sharply, stirred by fears that prices on debt would fall significantly when the Fed started to shrink its balance sheet. For the

16 Automatic stabilizers are another way to deliver fast and direct stimulus in case of a severe and prolonged downturn. Hence, an alternative to "going direct" would be to employ more and better designed stabilizers. Examples are unemployment insurance and the use of wage subsidies along the German model of *Kurzarbeit* (see also footnote 18).

Bank of Canada, this could lead to significant losses as the prices on debt fell, leaving the Bank with a sizable negative equity position and endangering its operational independence.[17]

In either direction, there likely would be immense pressure on the Bank of Canada to continue the policy. Although pressure from government might be controlled through a well-designed framework, one cannot be sure that the general public would accept putting a stop to "going direct." After all, was the Bank not able to make or facilitate direct transfers to people? Why could it not continue with this magic permanently? Controlling interest rates is one thing, putting money directly into people's pockets is another.

It is, therefore, not clear to us how such an exit strategy would be best designed, although, at a minimum, it would need to be tied to certain performance measures – the inflation target, certainly, and perhaps some measure of real activity. Along with the plan would come the additional challenge for the Bank of Canada to communicate its strategy clearly. Moreover, the challenge would go far beyond the traditional strategy of issuing a statement, holding a press conference or issuing a monetary policy report to accompany any regular interest rate decision. It would endanger the reputation of the Bank unless it commits clearly and unequivocally to its policy actions. At its core, then, "going direct" would expose the Bank to more pressure from public opinion and financial markets than other, conventional or unconventional, tools in its toolbox.

The Tale of a Tiger

In our view, "going direct" would open the door to political interference with monetary policy, even under a well-designed system. Furthermore, it is not clear what the benefits would be relative to other monetary policy options, such as forward guidance, that promises to keep interest rates low for long, or quantitative easing that flattens the yield curve across different assets.

A better approach would be to unleash the potential power of fiscal policy through, for example, the design of better automatic stabilizers[18] (see, for example, McKay and Reis 2016). The COVID-19 pandemic has shown that countries with such stabilizers and sufficient fiscal room can move very quickly, with large stimulus packages and in a more direct way than they can with monetary policy.

Inflation control is one of the biggest achievements of economic policy in Canada over the past quarter-century. The general public understands the job of the Bank of Canada. That might change fundamentally, however, if people receive a cheque in the mail from the government that they know has been enabled solely by the Bank of Canada's balance sheet magic. In Canada, we have grabbed the tiger by the tail. Why involve politics once again if doing so risks the tail slipping away.

17 The government could also force a write-down of the facility, once again leading to losses and negative equity for the Bank.

18 Automatic stabilizers are adjustments to taxes and government transfers that occur without explicit government action. They are meant to stabilize fluctuations in GDP. For example, most countries have progressive income taxes, and as such, when household incomes fall in recessions, people pay lower taxes.

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