Turn Your Money-Sucking Mutual Fund Into A Winning Portfolio - Part 2
Michelle Hung Page 11

A Stand Against Capital Punishment – Ways To Minimize Your Capital Gains Tax Bill - Part 2
Colin Ritchie Page 8

IN THIS ISSUE:
STOCK COMPETITION YIELDS A HIT AND A MISS
Norm Rothery Page 19

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What's New in TAX?

Taxes... A different perspective

Brian Quinlan Page 16

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Congratulations go to champions Frederico Gomes, Michael Sproule, and Vinicus Vilhena from the University of Toronto. They were keen on Computer Modelling Group at $5.40 per share or less, which is now well below its recent price of $7.08 per share making it a "no-buy".

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Debunking Economics

Modern Monetary Theory In Canada

Brian Chang

Modern Monetary Theory (MMT) is a controversial economic theory that has recently been garnering renewed support in Canada and many other developed countries currently struggling with deficit spending. As politicians increasingly look for ways to fund elaborate spending promises for various vote-garnering social programs, MMT's promise of "self-financed" government spending has proven to be an irresistible siren call for those policymakers and activists who believe that budget constraints simply no longer matter. While MMT has recently been rising on a tide of populist support, the backlash against its theories from establishment economists has been both swift and unrelenting, with critics from most mainstream economic schools of thought coming together to condemn MMT's liberal advocacy of unrestrained government spending.

What Is Modern Monetary Theory?

At the heart of MMT is the concept of "monetary financing", whereby all spending by the government is simply funded by newly-created money from the central bank. While it is true that in most countries the central bank is largely considered an arms-length entity independent from government, MMT generally considers this to be an artificial distinction and advocates the consolidation of the central bank and the government into a single operational entity.

Under this backdrop, governments have no need to tax their population for revenue, nor access the debt markets for interest-bearing loans to fund social programs and other government projects. Rather, if the government needs funds, it simply creates money out of thin air (via the central bank) and spends it. Under this scenario, the only real limitation on government spending is inflation, and the government can, in theory, simply remove money from the economy via taxation if this ever becomes an issue.

The risk that most critics point out, of course, is that governments simply cannot be trusted to respond to an inflation problem in a responsible and credible manner if it means cutting back on the various social programs that the general public has come to rely on for everyday services. What few people realize is that no country currently engages in MMT-like operations quite to the extent that Canada does, with "monetary financing" routinely conducted by the Government of Canada and the Bank of Canada as part of regularly scheduled bond auctions.[1]

How The Bank Of Canada Funds Government Spending

Currently, when the government needs to borrow money to fund spending, they simply issue bonds and treasury bills which they auction off to various bidders in the primary market, usually on a competitive basis to primary dealers (typically banks). What is generally overlooked is that the Bank of Canada is currently a large and regular buyer at government bond auctions, directly purchasing approximately 13%[2] of auctioned government bonds on a non-competitive basis using newly-created money they simply conjure "out of thin air".

In exchange for the bonds, the Bank of Canada credits the account that the federal government maintains at the Bank of Canada, and the Canadian government is subsequently free to spend down this account on salaries, military equipment, social programs, or whatever else they so please. Using the method of double-entry accounting, the Bank of Canada records the bond as an asset on their balance sheet and records the new deposit they now owe to the government as a corresponding liability.

But if the Bank of Canada is now the holder of government bonds, does this not mean that the federal government (and by extension, the taxpayer) must now pay interest on the bonds to the Bank of Canada? In other words, since this type of financing is hardly the definition of "free money" for the government (in the sense that they must still pay interest), how does it assist the government with financing its spending programs any more than if it had simply gone to the private debt markets for a normal loan?

> **Given the rich history of countries that have ultimately driven their currencies to near-worthlessness by choosing to run their printing press all out, critics are right to be concerned that MMT may start us down a slope that is simply too slippery to one day walk back from.**

The answer to this question lies in the fact that as a crown corporation of the federal government, the Bank of Canada is required to return its revenue (including all interest payments on the assets it holds) to the Government of Canada. Effectively, the government pays interest to the Bank of Canada on its loan, and the Bank of Canada simply turns around and returns the interest to the government. Through its bond issuances, the federal government is essentially gifted interest-free funds to support government programs with money the Bank of Canada simply printed into existence.

A History Of Monetary Financing In Canada

It is particularly noteworthy that this type of monetary financing is strictly a Canadian phenomenon since, unlike most other countries in the developed world, Canada operates without a fence around its Central Bank. Most other nations today explicitly forbid their central banks from directly financing government spending. In other words, central banks in other countries cannot simply purchase bonds directly from the government in order to fund new programs but are instead limited to purchasing pre-existing bonds on the secondary market.

Given the current Canadian legal framework, Canada is effectively the poster child for MMT-like operations in the developed world, with no current barrier preventing the Bank of Canada from effectively funding one hundred percent of government spending if it so chooses. While the above process may sound rather disturbing to the average Canadian, few people realize that this type of monetary financing has been taking place in Canada for the better part of a century. The Bank of Canada has in fact been printing money to fund government deficits since the 1930s, with the proportion of outstanding government bonds held by the Bank of Canada reaching a post-WWII peak of approximately 25% in the 1950s and 1970s.[3]

What few Canadians realize is that monetary financing of government spending has essentially been occurring continuously since the establishment of the Bank of Canada in 1934. While the level of monetary financing currently undertaken in Canada is a far cry from the peaks of the 1950s and 1970s, the Bank of Canada nevertheless continues to fund a considerable proportion of government spending today. Recent studies have shown that total Bank of Canada loans to the Canadian government between 2007 and 2017 have fluctuated from anywhere between 8% to 13% of total outstanding government debt, with the peak of 13% having been reached as recently as 2017.[4]

MMT Goes To Ottawa

Yet, if the Bank of Canada routinely monetizes Government of Canada debt and has been doing so since the 1930s, what exactly is the concern over MMT? Indeed, MMT advocates often point to the fact that Canada has been engaged in monetary financing for decades without any serious inflation problems, and that given the relatively benign inflation problems to date, Bank of Canada financing of government debt should be expanded to fund social programs for the betterment of its citizens.[5]

Importantly, this matter has now moved well beyond pure economic debate in Canada and into the political arena, with Green Party leader Elizabeth May sponsoring a petition in 2016 calling on the Bank of Canada to simply create money for the purpose of extending interest-free loans to the government for "human capital" and other infrastructure expenditures.[6] This petition was soundly rejected in 2017, as was a related lawsuit filed against the federal government by the Committee on Monetary and Economic Reform, which called for a renewed commitment by the Bank of Canada towards monetary financing not only for the federal government, but for all levels of government.[7]

And yet the Bank of Canada hardly requires formal petitions and lawsuits in order to fund government deficits on a grand scale when it is deemed necessary, for this is effectively what occurred in 2011 as part of the government's Prudential Liquidity Management Plan (PLMP)[1]. In an effort to create an emergency "disaster fund" of sorts in the event that a future financial crisis were to disrupt traditional government funding sources, the Bank of Canada simply acquired an extra $20 billion of government bonds with newly-created money, deposited the $20 billion payment into the government's account at the Bank of Canada, and returned all interest payments made by the government back to the treasury. As a result, the federal government is now sitting on a $20 billion stockpile of funds acquired with money simply "printed" into existence by the Bank of Canada, all essentially with zero cost of funds to government.

The Slippery Slope Of MMT

It is true that, on the surface, operations such as the PLMP may seem relatively benign since the government has no intention of spending down their account unless a crisis were actually to develop. But what exactly are the limitations on the government simply directing the Bank of Canada to do the same type of operation again, but this time using the money for various social programs like health care, education, or employment insurance? The answer, of course, is that there is clearly no legal impediment given the lack of fence around the Bank of Canada. The only thing stopping this type of operation from being undertaken on a grand scale is the self-imposed discipline of our elected government officials and the voting public they ultimately answer to.

Given the rich history of countries that have ultimately driven their currencies to near-worthlessness by choosing to run their printing press all out, critics are right to be concerned that MMT may start us down a slope that is simply too slippery to one day walk back from. Although Canada's experience with monetary financing would seem to demonstrate that not every example of "self-financed" government spending results in runaway inflation, it has never been utilized in Canada even close to the extent that MMT proponents advocate.

This is not to say that large-scale self-financed government spending will never be attempted, as all of the plumbing necessary to undertake extensive monetary financing in Canada already exists, ready to be enacted at a moment's notice as soon as the necessary public consensus exists to provide cover for politicians to pursue expansionary fiscal policy without limit. While MMT is ultimately a political view of how deficit spending should be used to provide the general public with unlimited government programs, the mechanism by which it proposes to finance this spending is in fact already "ready-and-waiting" in Canada.

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1 https://lop.parl.ca/sites/PublicWebsite/default/en_CA/ResearchPublications/201551E

2 https://www.bankofcanada.ca/2019/08/background-information-bank-canadas-balance-sheet/

3 http://www.levyinstitute.org/pubs/wp_848.pdf

4 https://www.bankofcanada.ca/wp-content/uploads/2018/09/sdp2018-10.pdf

5 https://canadiandimension.com/articles/view/the-bank-of-canada-should-be-reinstated-to-its-original-mandated-purposes

6 https://petitions.ourcommons.ca/en/Petition/Details?Petition=e-337

7 http://www.comer.org/content/SupremeCourtDecision_4May17.htm