**Financing a Basic Income Through the Money Creation Powers of the Bank of Canada**

As explained by the Economics, Resources and International Affairs Division of the Parliamentary Information and Research Service in a paper entitled “How the Bank of Canada Creates Money for the Federal Government: Operational and Legal Aspects”[[1]](#footnote-1), the Bank of Canada routinely creates money for the Government of Canada by purchasing a certain percentage, say 15-20%, of newly issued bonds and or treasury bills. It would appear that this money which the Bank of Canada creates is not typically spent into the economy, but is used as a type of insurance to provide for various contingencies:

“In June 2011, as part of the debt management strategy**[2](https://lop.parl.ca/sites/PublicWebsite/default/en_CA/ResearchPublications/201551E" \l "ftn2" \o "Note 2)** included in its 2011 Budget, the Government of Canada announced its intention to borrow $35 billion over the next three years in order to increase its deposits with financial institutions and the Bank of Canada by about $25 billion and to increase liquid foreign exchange reserves by US$10 billion. The intention of this ‘prudential liquidity plan,’ as it is known, is to ensure that there are sufficient liquid assets to cover at least one month of the federal government's net projected cash flows, including interest payments and debt refinancing needs.

The government justified this plan by stating that liquid financial assets ‘safeguard its ability to meet payment obligations in situations where normal access to funding markets may be disrupted or delayed,’ and that this ‘supports investor confidence in Canadian government debt."[[2]](#footnote-2)

The money creation process employed by the Bank of Canada is quite simple and mirrors the money creation process which, through the private banking system, is responsible for the greater majority of our money supply.[[3]](#footnote-3) Contrary to what many people assume, banks are not borrowers and lenders of pre-existing money, but are rather creators and destroyers of the money that they issue in the form of bank credit. The same holds true for the Central Bank. Whenever an auction of new government securities is held, the Bank of Canada buys a certain percentage of these securities by creating digital accounting entries in the Federal Government’s deposit account with the bank. This deposit is recorded as a liability of the bank, while the newly purchased security is recorded as an asset on the Bank of Canada’s balance sheet.

Now, the Bank of Canada, the BoC, unlike many other Central Banks around the world, is publicly owned. It is a Crown corporation, an organ of the state. This means that when the Bank purchases newly issued securities from the Federal Government, the transaction can be regarded as an internal government process. In other words, the government can, in effect, order the BoC to comply with whatever policy requirement it deems appropriate. For example, the Federal Government, through the Bank of Canada, can, in principle, fund its operations without having to rely on private banks or other investors buying its securities whenever there is a deficit, i.e., a gap between government expenditures and tax revenues. The government is not obligated to sequester the deposits in an account with the Bank of Canada. As noted in the same paper which was quoted previously: “The federal government can spend the newly created bank deposits in the Canadian economy if it wishes.” Furthermore, while there are certainly prudential and political limits to the total amount that the Bank of Canada may create for the federal government, the operational and regulatory limits which apply to private commercial banks do not apply to BoC operations.

In the last few years, there has been a very interesting court case playing out between a Toronto-based Canadian think-tank COMER (The Committee on Monetary and Economic Reform) and the Canadian Government. Unfortunately, the Supreme Court eventually refused to hear it, but the case was nevertheless instructive in what it revealed about the current financial operations of the Federal Government as opposed to how it had operated in the past.

According to the Bank of Canada Act, the Bank has the ability to use its money-creation powers to make interest-free loans to municipal/provincial/federal governments for “human capital” expenditures (such as education, healthcare, other social services) and/or infrastructure expenditures. Indeed, according to Rocco Galati, the constitutional lawyer who represented COMER, that was the very purpose for which the Bank of Canada was originally established. And, as he explained at a public lecture he gave in 2015 at Toronto City Hall, this was how Canada paid for its World War II activities, the Trans-Canada Highway, the Saint Lawrence Seaway, the building of many university campuses, and so forth.[[4]](#footnote-4) Apparently, since 1974, the government has ceased all interest-free borrowing from the Bank of Canada and has been borrowing instead from private banks. What this means is that the federal government, to take just one example, has been pursuing a financial policy that has unnecessarily cost the taxpayer billions of dollars in interest payments … payments that could have been avoided had the government relied on the Bank of Canada for its financing needs.

Now, what I want to suggest, in the context of the basic income, is that not only can the Bank of Canada fund the Federal Government’s deficit with much lower interest, or rather merely at the cost of administration (since any profit on loans would go back to the government, there would be no point in charging more interest than is necessary to cover costs), it could also provide the economy with a steady injection of ‘debt-free’ or non-repayable credit distributed in the form of a basic income. I, together with the other panelists, maintain that the economy needs a steady injection of debt-free credit (i.e., credit that does not need to be repaid to its issuer) to, or on behalf of, consumers, in order for it to achieve an automatic and self-liquidating balance or equilibrium between the flow of costs and prices attached to the flow of consumer production and the flow of consumer purchasing power that is simultaneously being distributed to consumers in the form of incomes: wages, salaries, and divdiends. The claim here is that there is a chronic and underlying deficiency of consumer buying power in the form of income in our economies, and that instead of compensating for this deficiency by relying on ever-increasing bank debt for more production, both public and private, whether it be needed or not, or more debt-money for consumption in the form of consumer loans, we could substitute a flow of debt-free credit to increase the buying power of consumers to whatever level is necessary to clear the consumer market and to enable retailers to meet their costs.

If this issuance of non-repayable credit were accounted for in accordance with the existing accounting practice, this would amount to the BoC forever increasing its assets in the form of government securities which, for all intents and purposes, would never be redeemed. Alternatively, the accounting system could be changed so that the BoC would regard unsold or unsellable consumer production in the country as “assets in trust” and the money it creates for the federal government’s basic income programme as the corresponding liability. All it would be doing is, in effect, monetizing the nation’s surplus production. When that production is sold to the consuming public with the help of the basic income funds, both the production and the funds would disappear from the bank’s Balance Sheet.

The main advantages of funding a basic income through the money creation powers of the state would be that it would not require juggling with taxation, or increased taxation, or selling more government securities to private investors. By avoiding those funding methods, you will necessarily avoid all of the problems with them that were mentioned previously by my colleagues.

The only question that remains is whether and under which conditions the creation of Bank of Canada credit and its injection into the economy in the form of a ‘debt-free’ basic income would be inflationary. And that particular concern will be the main subject of the next paper in our series.

Thank you.

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1. Cf. https://lop.parl.ca/sites/PublicWebsite/default/en\_CA/ResearchPublications/201551E. The type of paper is described as follows: “Papers in the Library of Parliament's ***In Brief*** series are short briefings on current issues. At times, they may serve as overviews, referring readers to more substantive sources published on the same topic. They are prepared by the Parliamentary Information and Research Service, which carries out research for and provides information and analysis to parliamentarians and Senate and House of Commons committees and parliamentary associations in an objective, impartial manner.”  [↑](#footnote-ref-1)
2. *Ibid*. [↑](#footnote-ref-2)
3. Cf. *Ibid*: “However, it is important to note that money is also created within the private banking system every time the banks extend a new loan, such as a home mortgage or a business loan. Whenever a bank makes a loan, it simultaneously creates a matching deposit in the borrower's bank account, thereby creating new money (see Appendix B). Most of the money in the economy is, in fact, created within the private banking system.” [↑](#footnote-ref-3)
4. https://www.youtube.com/watch?v=CTd1PV4AnDg [↑](#footnote-ref-4)