

Workshop on “Transparency and Communication in Monetary Policy”,
25th January, DNB

A case against Transparency and Communication?

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Let me first begin by saying that given the nature of my role, I feel I ought to use a disclaimer. I will do my best to summarise the case against ever-increasing transparency and communication as I see it and any views expressed here are not necessarily those of the DNB.

Out of the very many definitions of transparency that you will find in every day monetary policy parlance, I would like to simply draw your attention to an important in my view distinction. This distinction has to do with transparency and accountability.

In a democratic environment, the institutional set-up of the Central Bank, and in that respect the Central Bank is not different to any other public institution, cannot be less transparent than the absolute minimum society requires. So when I talk about containing transparency, I will not refer to levels of transparency which would jeopardise the institution’s democratic legitimacy. I do not believe that a Central Bank is actually given much choice when it comes to that. In this context then, a less transparent central bank does not mean a less accountable central bank. I, instead, will be talking about those aspects of transparency that may or may not improve the central bank’s economic efficiency. So, the actual question at hand, is whether more transparency and more communication can improve economic outcomes.

I feel that this is an important point to make upfront, because what I want to say next is that actually transparency of the latter kind is neither here nor there. Credibility is what’s important. I like to think of this in two ways: first, you can have credibility without transparency and there are various examples in history that show this; and second what’s the point in being transparent if you are always wrong (and therefore not credible)? Hence credibility without transparency is possible; and at the same time transparency without credibility is uninteresting.

So, with this in mind, let me now refine the question raised at my title: are there instances for which greater transparency can actually damage a Central Bank’s ability to be credible?

I will argue that there are three ways in which this could happen.

1) The effects on expectations

My first point has to do with the effect transparency arguably has on private sector expectations. The main benefit of being transparent that is put forward is that in its presence the private sector understands better what the Central Bank's intentions are and forms expectations which are in line with its objectives. Is this always good?

My objection here falls in the category of how one can some times become the victim of their own success. By that I mean that, having managed to tie down expectations maybe a little too well, a Central Bank may find it difficult to move them when it is necessary for these expectations to be moved. In the 80s when the discussion on the desirability of transparency first started, people were talking about the need for Central Banks to use “**constructive ambiguity**” in order for society to benefit from the stabilisation effects of occasionally unexpected inflation. In the more recent literature, people talk about the **time-inconsistency of “commitment”**, or in other words, the incompatibility between wanting to be entirely predictable in a world where you are reacting to unpredictable events. Both views call for flexibility. There will always be circumstances in which the Central Bank needs to move inflation; if expectations are tied down very rigidly, as a result of a Central Bank's own success, it will take all the more effort for the Central Bank to move prices in the desired way.

My point therefore, would be that it is perhaps difficult to keep doing a good job if you are left with little to no room for manoeuvre. Circumstances will *some* times warrant *some* flexibility. I would let the experts then decide when and how much that flexibility should be.

2) My second point has to do with the gathering of information. And my argument here will question the perception that greater transparency and communication unequivocally lead to better informed agents.

My objection comes from the distinction between public and private information and how it is used. Public is the information given by the Central Bank (amongst others) and is therefore

common to everyone, whereas private is what individual agents collect for themselves and is therefore unique to them.

The argument here is that if information is costly to acquire, then private agents rely more on what the central bank has to say rather than make their own independent analysis. In other words private agents refrain from gathering their own information and rely a little too much instead on what the Central Bank communicates. And the more information the Central Banks gives, the more this *crowding out* effect occurs.

Why might a Central Bank want to take this issue into consideration when deciding exactly how much to communicate? Well, it might because the inflation outcome (when all is said and done) is determined by as much what the central bank does, as by what private agents believe about inflation, namely the expectations they form. And if private agents do not take the time and effort to properly evaluate the circumstances at hand, because the Central Bank provides them with enough information, then decisions are sub-optimal and society as a whole loses out. And the bank cares about delivering the correct policies for the circumstances at hand. But there is only so much the Central Bank can do to get to the right outcomes. The rest needs to come from the markets.

You can see this worry very clearly, in the following two quotes, by ECB members: The first is taken from an interview given by Padoa Schioppa, Wall Street Journal 2004:

“The danger that I see is that markets become lazy”

The second is taken from a speech by Bini Smaghi, 2006:

“...market participants’ incentive to make their own assessment on underlying fundamentals tends to fade”

The lesson we draw here is that if private sector expectations have a very important role to play (which I believe they do), then they need to be utilising all information available. The least the Central Bank can do, is not prevent the private sector, by giving the wrong incentives, from taking a shot at analysing the facts.

3) “Spinning the message”

My third point has to do with the distinction between *giving out information* and actually *communicating*, bringing, a given message across.

Is it true that just because we talk more, we actually say more? And is it possible that we might say less?

My argument here therefore differentiates between *how much* we communicate versus *how effectively* we communicate. In other words, information given out is not necessarily the same as information gone through, understood by everyone. Moreover, that information which is gone through is not necessarily understood by everyone in the same way. All parties involved have their own specific ways of interpreting what is being said. Just like beauty, information is in the eye (and ear) of the beholder! So what happens here is that any given message communicated by the central bank will be filtered by the recipient, and differently by different agents.

Central Banks now recognise that their messages are subject to such filtering and do make attempts to first understand how these filters differ and second identify a common denominator for their communication attempts.

A good example of how Central Banks do this is through *media monitoring*, which ranges from the direct monitoring of what is reported about them to handling direct inquiries.

Media monitoring is a way of understanding communication processes and how key messages are perceived, that could help fine tune future communication attempts.

But such practices carry also important risks as you may end up drawing your own conclusions as to how good your communication is. But more importantly the close monitoring of the way one is perceived runs the risk of setting the motions for reacting to those issues that get a good response while suppressing those messages that do not get a good response. This sounds remarkably like spin-doctoring!

And the risk of spin-doctoring is augmented if the demand for communication exceeds the supply of information because then your emphasis shifts entirely from the message you are trying to convey, to the way you are trying to convey it. So my point here, is that one should

be aware that requests for more transparency or for communication go hand in hand with a greater risk for miscommunication.

Whichever way you look at it, when it comes to communication, the whole is simply not more than the sum of its parts and it is important to stop before the point where communication begins to conceal more than it actually reveals.

Conclusions

Finally, indisputably there are very good reasons why we ask Central Banks to be transparent. What I would add however, is that as transparency is a means to an end not an end in itself, it needs to be applied only if it improves economic efficiency.

And economic efficiency requires a lot more than just transparency: what is it? It requires that Central Banks exercise flexibility when flexibility is needed; it requires that various parties assess events at hand, because that helps the Central Bank, the decision process and the outcome itself, and finally, it requires an appreciation of the fact that there is a risk side to communication relating to the shift of emphasis from substance to presentation.

To conclude I cannot help but feel that there is a greater need to communicate when one is not doing very well. Or, in other words, there is a greater need to explain and describe what you are doing when you are not doing it very well. There is therefore, an association with underperformance when you are seen to communicate more than is strictly necessary. In this respect, I find Henry Kaiser's (American Industrialist) was actually right when he said:

When your work speaks for itself, don't interrupt.

- Henry Kaiser (American industrialist)

That's what I think Central Banks should aim for. Thank you.

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