

Central bank transparency: three lessons to bear in mind*

Carin van der Crujsen
(De Nederlandsche Bank)

Policy Dialogue on “*Governance, Transparency and
Accountability in Financial Institutions and Regulatory Bodies*”

April 27, 2009

Columbia University, New York

* Views are my own and do not necessarily reflect those of DNB



1/19

Outline of my talk

Lesson 1: Increases in **central bank transparency** have **predominantly** been **beneficial**.

Lesson 2: Focus not only on the amount of information disclosed but also on the clarity it creates. There is an **optimal intermediate degree of information disclosure**.

Lesson 3: Make a distinction between actual disclosure practices and transparency perceptions. **Transparency perceptions matter** for trust.

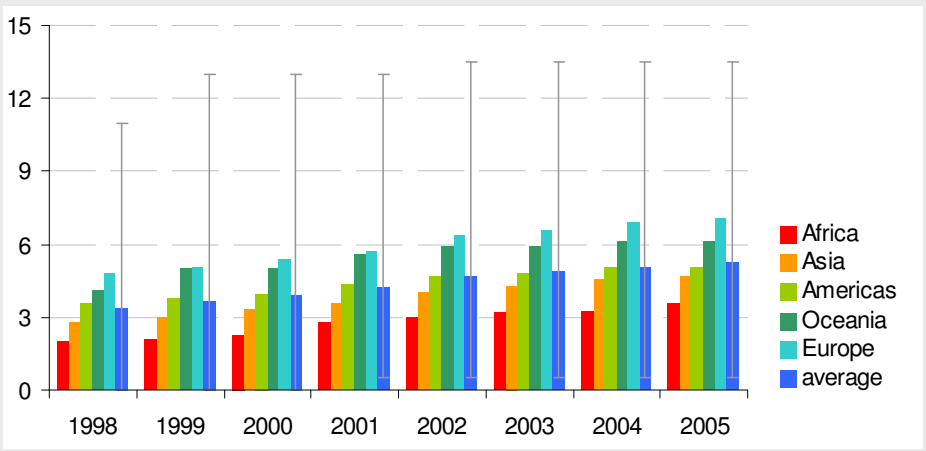


2/19

Lesson 1:
 Increases in central bank transparency have predominantly
 been beneficial.

Central bank transparency has increased worldwide...

Figure 1. The degree of central bank transparency



Source: based on Dincer and Eichengreen (2007).

...and this has predominantly been beneficial.

- ❖ Steps towards more central bank transparency are justified by accountability arguments, but what about *economic arguments*?
- ❖ Theoretical research (since mid 1980s):
More recent work is in favor of most forms of transparency.
Although within some research strands there is still disagreement.
- ❖ Empirical research (since end 1990s):
The **economic effects** of most forms of central bank transparency have been **desirable**.

Lesson 1: Increases in central bank transparency have predominantly been beneficial.



5/19

Lesson 2:

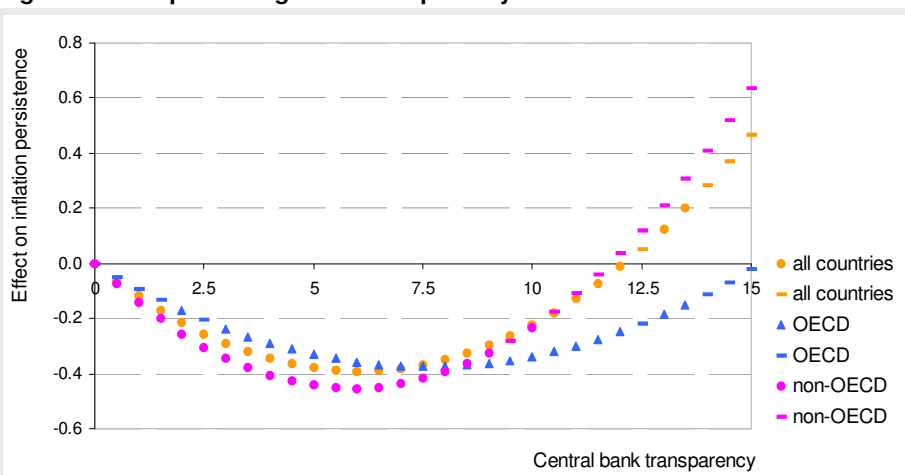
There is an optimal intermediate degree of transparency.

A case for an optimal intermediate degree of transparency

- ❖ At low levels of central bank transparency additional public information improves the quality of private sector inflation forecasts.
- ❖ However, beyond this optimal level of transparency additional information is undesirable:
 - (1) People will focus too much on the conditionality of forecasts. The (perceived) quality of forecasts deteriorates. [*uncertainty-argument*]
 - (2) People will get confused. The quality of their forecasts deteriorates. [*confusion/information overload-argument*]
- ❖ There is an **optimal degree of transparency** at which the quality of inflation forecasts is maximized. At this point, price setting is relatively forward-looking and inflation persistence is minimized.

The optimal intermediate degree of information disclosure

Figure 2. The optimal degree of transparency



Note: -'s are not observed.

Optimal transparency: a link to the crisis

- ❖ A lack of transparency of financial institutions and products is a major problem.
- ❖ Steps towards more transparency are desirable but it is important to realize that more information is not always better.
- ❖ Not only because it costs money to produce information, but also because at some point it results in an information overload.
- ❖ It is the *quality* of the information that *matters* not the *quantity*.

Lesson II: There is an optimal intermediate degree of transparency.



9/19

Lesson 3:

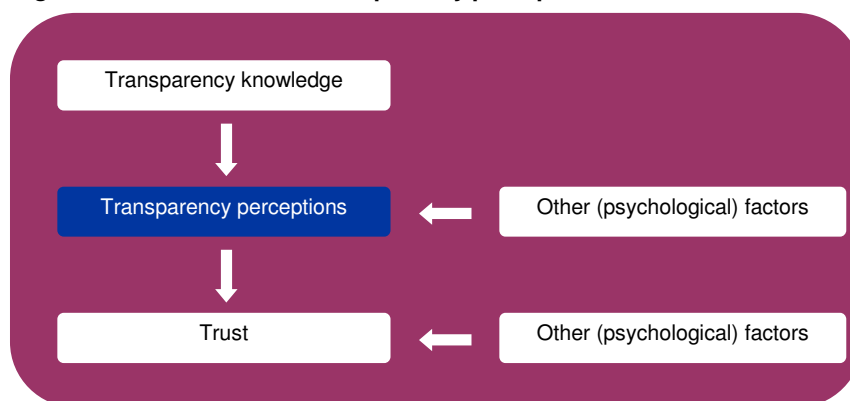
Transparency perceptions matter.

Transparency perceptions matter

- ❖ The distinction between **actual** and **perceived** transparency is often lacking in the central bank transparency literature.
- ❖ Transparency perceptions are not necessarily aligned with actual disclosure practices.
- ❖ Transparency **perceptions matter**.
- ❖ **Questionnaire** on the transparency of the European Central Bank:
 - households' transparency knowledge
 - households' transparency perceptions
 - the relevance of transparency perceptions

Transparency perceptions matter

Figure 3. The formation of transparency perceptions and the link to trust



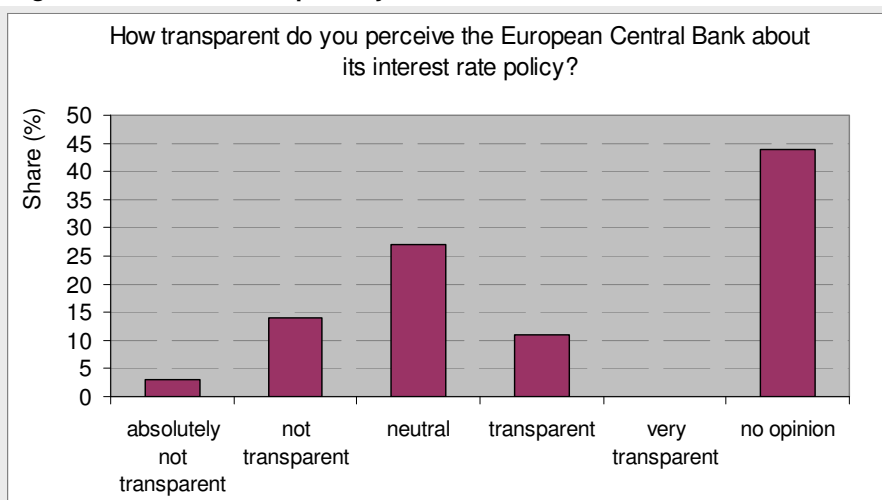
Reasons for misaligned transparency perceptions

- 1) Lack of knowledge
- 2) Psychological factors:
 - disregarding new information
 - confirmation bias, belief perseverance
 - sampling memories:

"...much evidence suggests that human perception deviates systematically from the camera benchmark and memory deviates from the computer benchmark." (Camerer, 2003, p.595)
 - individual characteristics (e.g. overconfidence and optimism)

Perceptions of central bank transparency

Figure 4. Perceived transparency



Source: CentERpanel, June 2007.

Transparency perceptions depend on...

1) Transparency knowledge

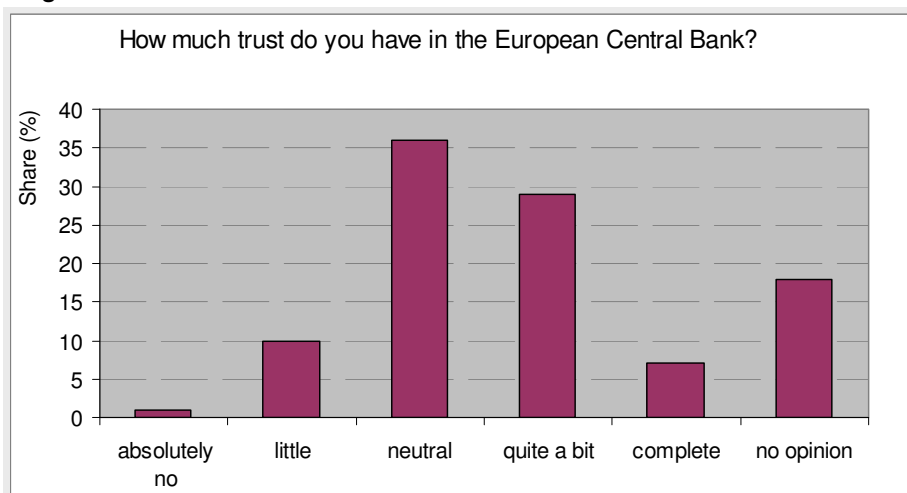
- ❖ Self-assessment (+)
- ❖ Actual knowledge:
 - political, economic and policy knowledge (+)
 - procedural and operational knowledge (-)

2) Other factors

- ❖ Optimist (+)
- ❖ Age (-)
- ❖ Job (-)
- ❖ Economic expertise (-)

Trust in the European Central Bank

Figure 5. Trust



Source: CentERpanel, June 2007.

Trust depends on...

- 1) Transparency perceptions (+)
- 2) Other factors:
 - ❖ Education (+)
 - ❖ Optimism (+)
 - ❖ Knowing the ECB (+)
 - ❖ Self-assessed economic knowledge (+)

Conclusions on transparency perceptions

- ❖ **A mismatch between actual and perceived transparency exists** because of:
 - (1) lacking and incorrect knowledge
 - (2) psychological factors
- ❖ **Transparency perceptions are important** for trust and thereby for economic decisions that economic agents make.
- ❖ Potential ways to increase transparency perceptions:
 - (1) increase actual transparency
 - (2) stress transparency strengths
- ❖ Communication will not be so easy.

Transparency perceptions: a link to the crisis

Stage 1:

- ❖ Perceived transparency was higher than actual transparency.
- ❖ As a result trust was too high (reflected in high ratings).

Stage 2:

- ❖ Perceived transparency decreased and thereby trust.

Stage 3:

- ❖ Increase actual transparency and thereby transparency perceptions such that trust is restored.