

Accountability, Disclosure, and Governance

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BALSILLIE SCHOOL
OF INTERNATIONAL AFFAIRS

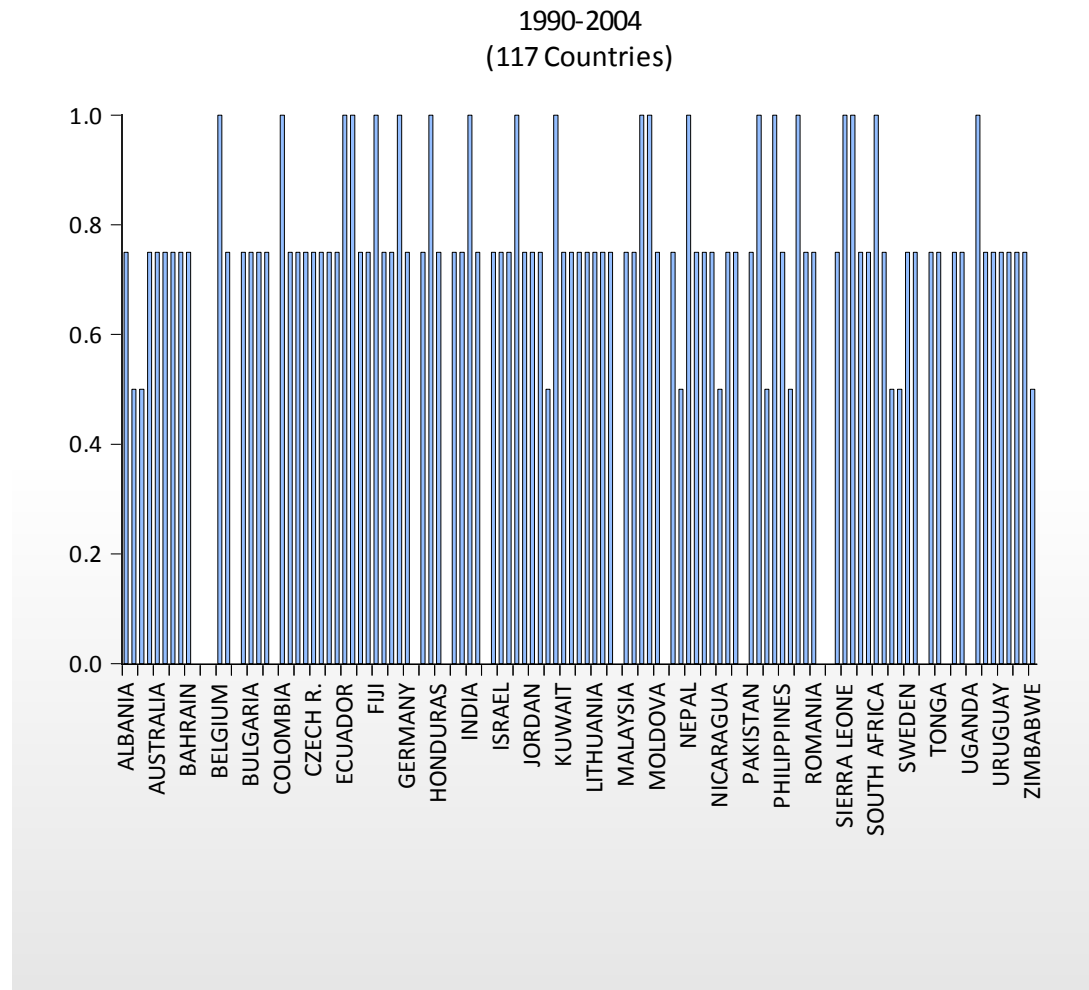
Preliminaries

- *Independence* is a difficult balancing act and is not enough
- How things have changed!
 - “Central Banking [has been] traditionally surrounded by a peculiar mystique...The mystique thrives on a pervasive impression that Central Banking is an esoteric art...revealed by an inherent impossibility to articulate its insights in explicit and intelligible words and sentences.” (Brunner 1981)

Preliminaries

- Accountability, Disclosure (a.k.a. as Transparency), Governance (**ADG**) should help. Why?
 - “...while the Bank should resist temporary gusts of public fancy, it must in the long-run show responsiveness to public opinion and be responsible to government.” (1936 *Canadian Royal Commission*)

CB Independence



Siklos (2008)
EJPE

Preliminaries

- **ADG** is inextricably linked to the choice of a *monetary policy strategy*
- But **ADG** also requires that serious thought be given to *how a central bank communicates* with the government and the public (this includes financial markets)

ACCOUNTABILITY

- Definition:
 - Clarity and precision with which the objectives of monetary policy are stated
 - The strategy of monetary policy and how it is communicated
 - The manner in which a CB is required to answer for past decisions and any sanctions that arise from the failure to be accountable

ACCOUNTABILITY

- How does the definition contribute to explaining/enhancing accountability?
 - It becomes more difficult to surprise the public
 - It enhances the public's understanding of monetary policy
 - The publication of an inflation forecast (and forecasts of other economic variables) is an obvious way of accomplishing this objective
 - The publication of an *inflation or monetary policy report* is another obvious way of achieving some measure of accountability

The Transparency Drive: Monetary Policy

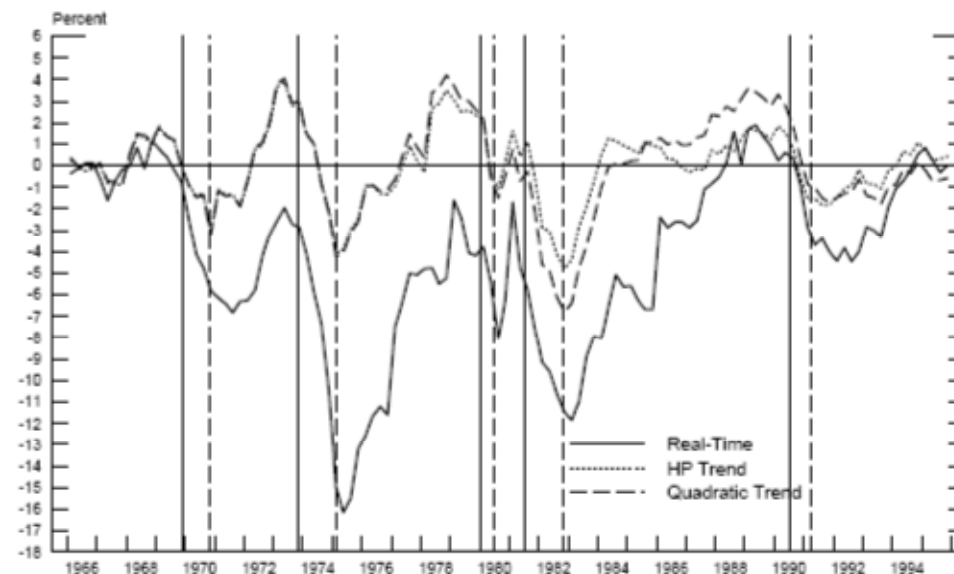
- “Transparency is the most dramatic difference between central banking today and central banking in earlier historical periods.” (DINCER AND EICHENGREEN 2007)
- **Central banks** were also participants in the drive for transparency but progress was dictated or constrained by
 - The relationship between the CB and government
 - The objectives or monetary policy
 - The ‘culture’ of central bankers

The Transparency Drive: Monetary Policy

- As in other drives to improve transparency the proximate cause was a failure to give 'good' MP
 - 'stop-go' approach

Figure 5

Real-Time Perceptions and Ex Post Concepts of the Output Gap



A. Orphanides (2004) "MP
Rules...A View from the Trenches"
JMCB

Words vs Deeds

- Action is not enough: central bank statements also matter
 - Evolution of policy making in last 2 decades makes this clear: statements accompanying policy announcements + increasing reliance on forward guidance
 - can be achieved in several ways: **qualitative** (focus here), quantitative (forward tracks)
 - Transparency also suggests that words matter: “The better the central bank reveals its thinking, the less the details (and who said what) matter.” (Blinder 2001, pg. 92)
 - Does this mean that ‘words’ don’t matter? Hardly!
 - Transparency does NOT guarantee that information is effectively communicated

DISCLOSURE

- A useful definition is from the Bundesbank
 - “Transparency [a.k.a. disclosure] here plays the part of self-imposed commitment: by disclosing the basis of the policy decisions, the central bank enables the general public to assess their adequacy and impose a sanction, if appropriate.” (Deutsche Bundesbank 2000)
- Therefore, accountability and disclosure cannot easily be separated from each other

DISCLOSURE

- Why transparency?
 - To explain to the public how inflation versus other economic considerations
 - Helps anchor expectations
- How?
 - By reducing the information asymmetry

DISCLOSURE

- To what end?
 - Enhances the predictability of policy making
 - In the **S-R**: policy rate
 - In the **L-R**: inflation reports and the rest of the communications instruments deployed by the central bank

DISCLOSURE

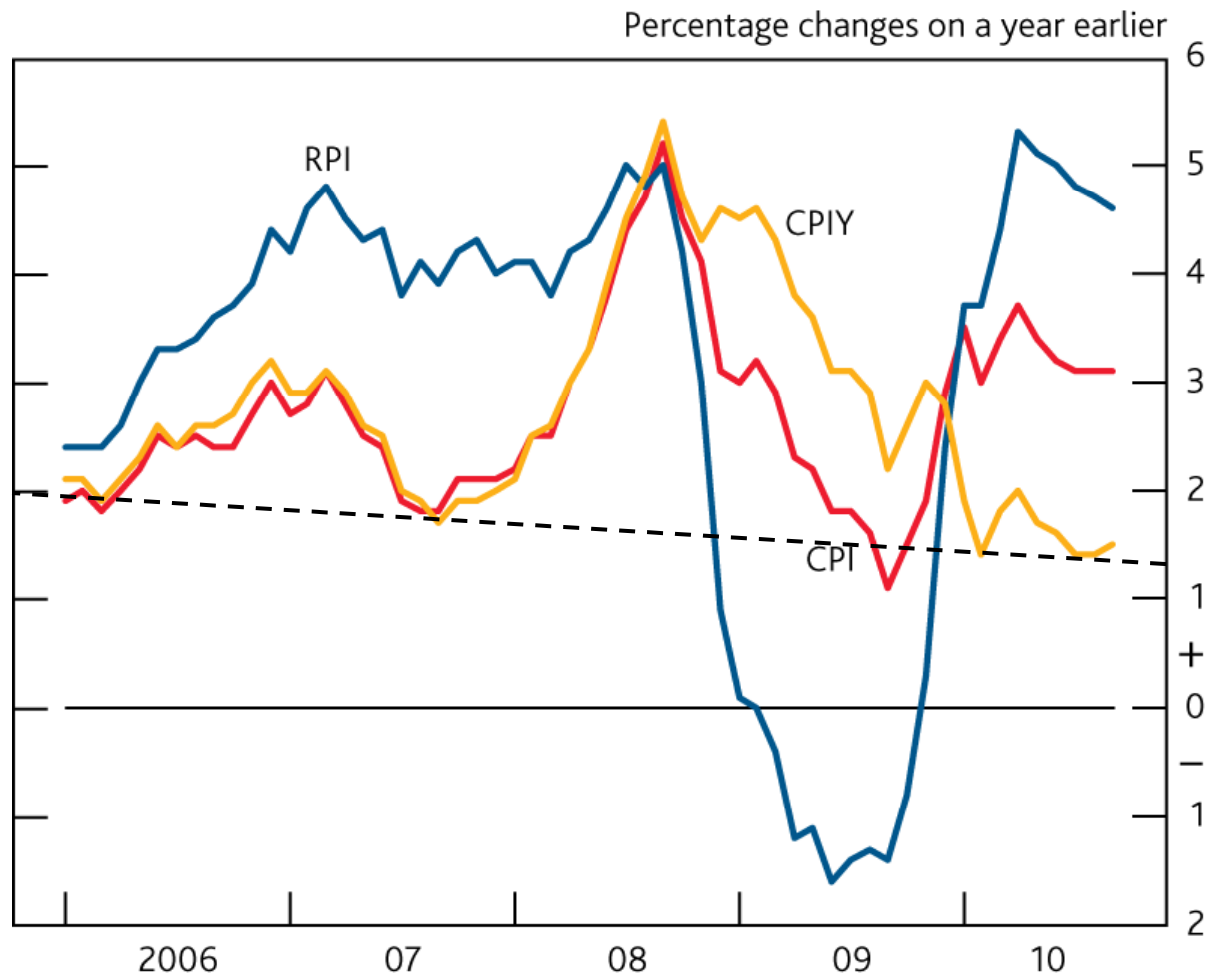
- More information does NOT, however, translate into MORE transparency
- CLARITY is just as important, if not more so, than quantity in the provision of information.
- This is clearly difficult when there exists a lot of uncertainty and easier when things are going well

Clarity is Tricky

If direct approaches to debt reduction are ruled out by political obstacles, there is still the option of trying to achieve some modest deleveraging through moderate inflation of, say, 4 to 6 per cent for several years. Any inflation above 2 per cent may seem anathema to those who still remember the anti-inflation wars of the 1970s and 1980s, but a once-in-75-year crisis calls for outside-the-box measures. Ideally, both the ECB and the Fed would engage in expansionary policy, as otherwise there could be profound exchange rate consequences. Of course, simply trying to stabilise exchange rates without overall monetary expansion – as the G7 seems to have proposed – is far less helpful.

Rogoff (2011) FT AUG 8

Chart 4.1 Measures of inflation^(a) NOVEMBER 2010 BoE Inflation Report



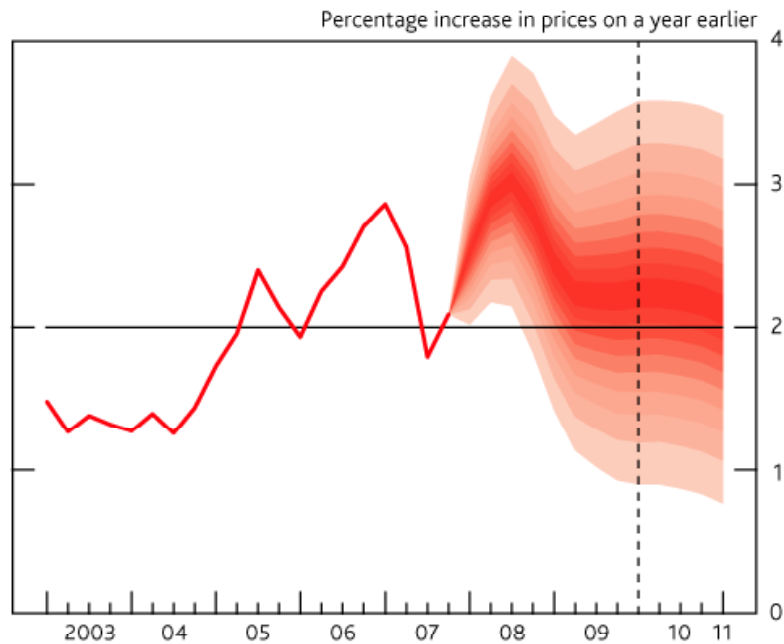
(a) Data are non seasonally adjusted.

Disclosure: Ingredients

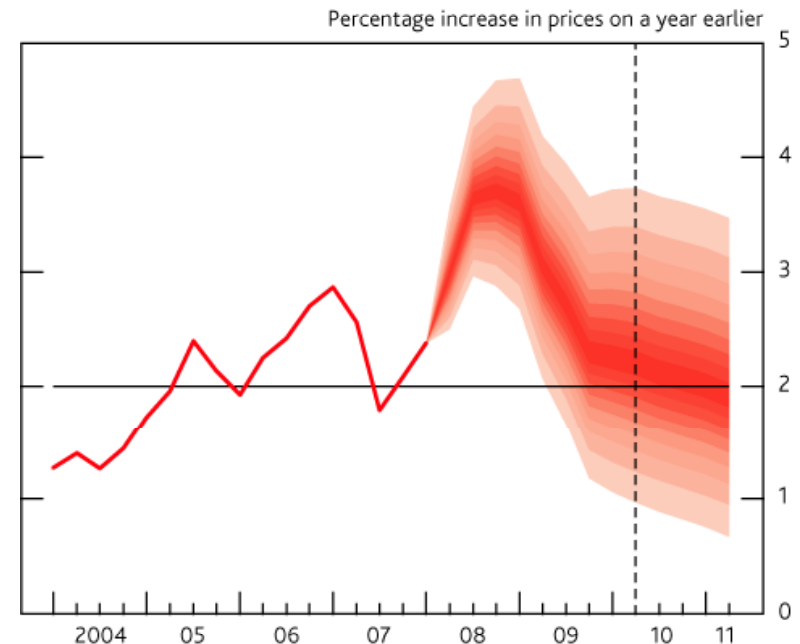
- **Projections:**

- Are they made public?
- Whose are they?
- How frequently?
- What is projected and how are they presented?

The Communication Problem with Projections: The BoE's Fan Charts



FEBRUARY 2008



MARCH 2008

The Communication Problem with Projections: Oops!

The path of Bank Rate that will be necessary to meet the 2% target is uncertain. The MPC will continue to make its judgement about the appropriate level of Bank Rate month by month.

*Letter from the Governor of the BoE to the Chancellor
June 16, 2008*

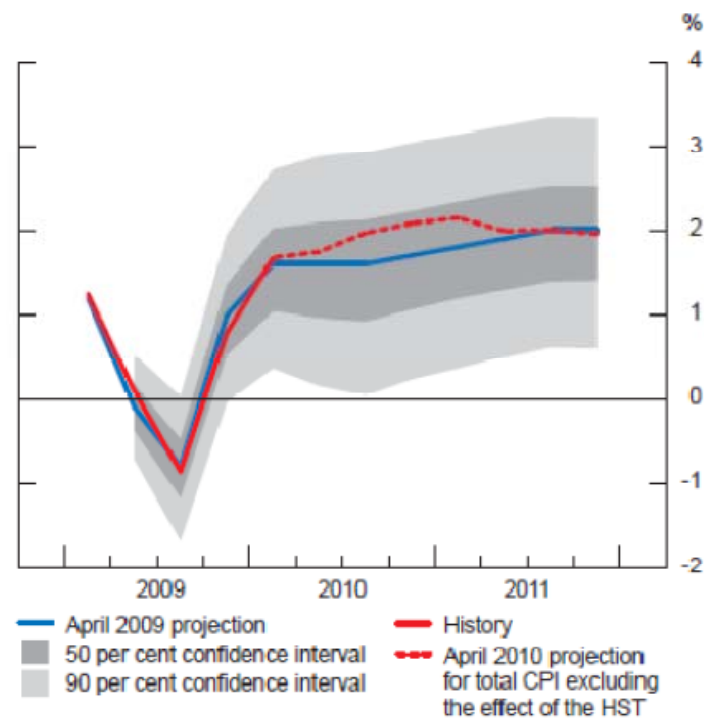
recognise the considerable uncertainties surrounding prospects, it is likely I will receive further open letters from you. Consistent with the remit, the next open letter will not be required until September if the August inflation figure is above 3 per cent.

Letter from the Chancellor to the Governor, June 17, 2008

Are Words Enough? BoC in 2009-10

- BoC as “pioneer”: ‘Conditional on the outlook for inflation, the target overnight rate can be expected to remain at its current level until the end of the second quarter of 2010 in order to achieve the inflation target, the Bank will continue to provide guidance in its scheduled interest rate announcements as long as the overnight rate is at the effective lower bound.’ MPR (2009, p. 2).
- Two years later (2011), FOMC states: “ *The Committee currently anticipates that economic conditions--including low rates of resource utilization and a subdued outlook for inflation over the medium run--are likely to warrant exceptionally low levels for the federal funds rate at least through mid-2013.*”
(<http://www.federalreserve.gov/newsevents/press/monetary/20110809a.htm>)

Chart A: Through 2010Q1, total CPI inflation has evolved in line with the April 2009 projection . . .
Year-over-year percentage change, quarterly data, CPI



Sources: Statistics Canada and Bank of Canada projections

The Core Problem: Inflation Pressure? I

$$y_t = f(i_t, x_t^e, u_t), \quad f'_i < 0 \quad (1)$$

$$\pi_t = g(y_t, x_t^e, e_t), \quad g'_y > 0 \quad (2)$$

Together, (1) and (2) imply a negative relationship between inflation and the interest rate

$$\pi_t = h(i_t, x_t^e, e_t, u_t), \quad h'_i < 0. \quad (3)$$

y=output gap; x^e = expectational variables; π = inflation; u, e = random shocks

Do CB Believe that $h' < 0$?

Chart 16: Growth in real GDP expected to rebound in 2010

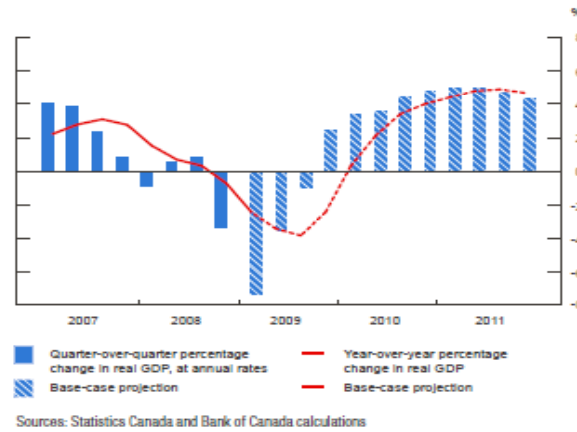
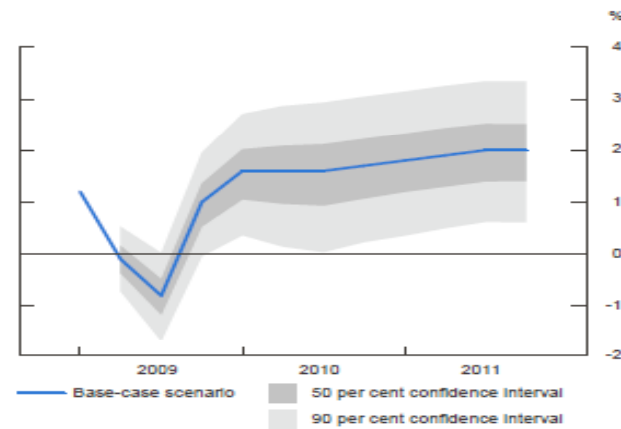


Chart B: Projection for total CPI inflation

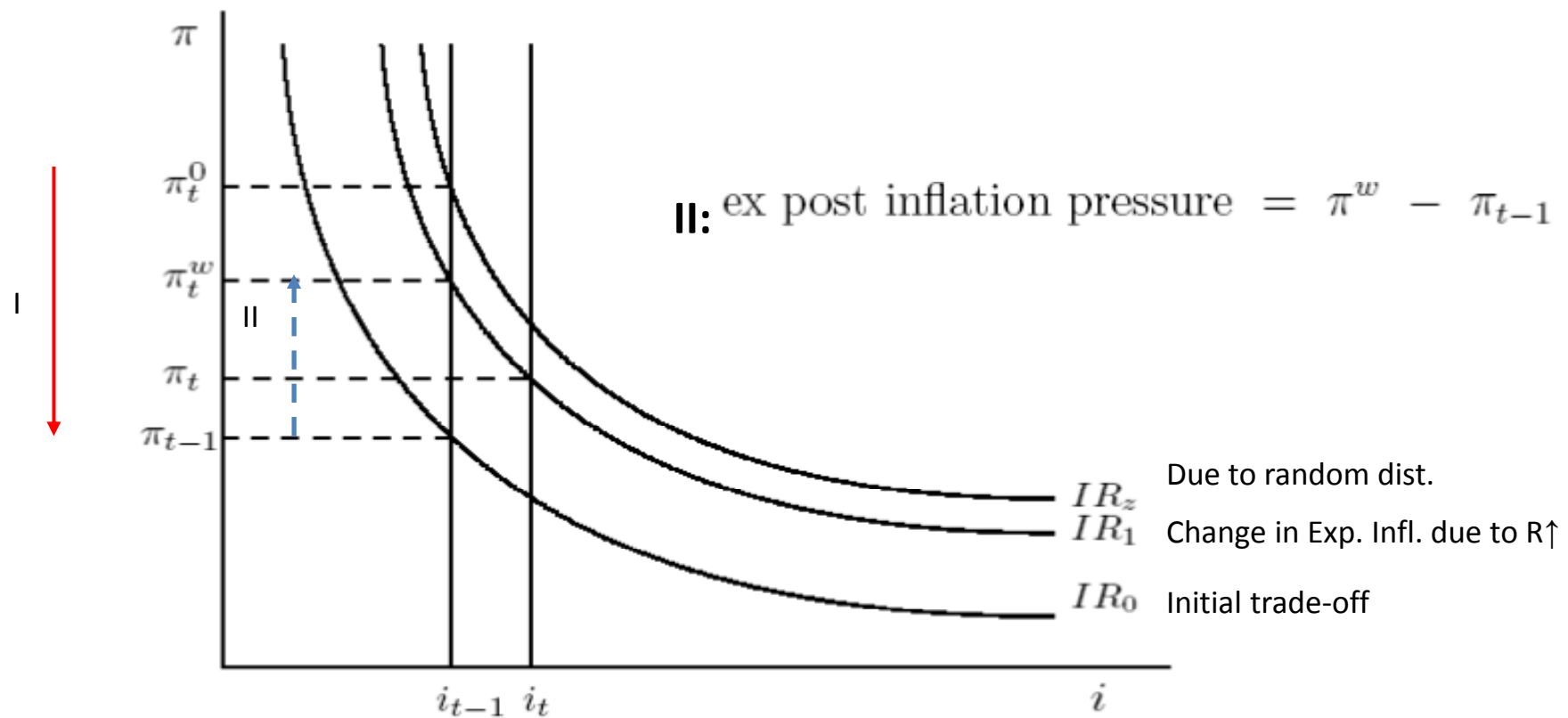


BoC MPR
April 2009

The Core Problem: Inflation Pressure? II

I: ex ante inflation pressure = $\pi^0 - \pi_{t-1}$

II: ex post inflation pressure = $\pi^w - \pi_{t-1}$



DISCLOSURE: Contra (1)

- Is there an argument for secrecy in CB?
 - “...at bottom, the FOMC [has] concluded that uncertainty in monetary markets best serves its needs.”
 - WHY?
 - Secrecy prevents ‘speculators’ from trying to manipulate or influence markets
 - Affects the execution of monetary policy. You wouldn’t want the CB to commit

DISCLOSURE: Contra (2)

- Adds shocks that affect the economy because markets overreact to news from the CB (e.g., by influencing prices in an OMO)
- Interest rate changes would become more volatile and CBs like to smooth interest rates
 - All of the above is mostly wrong, as we now know

DISCLOSURE: Contra (3)

- Is there such a thing as too much transparency?
 - YES: What if all this transparency + maintaining inflation inside a target range leads to complacency?
 - Firms and individuals become ‘lazy’;
 - They don’t care about inflation (that’s what Greenspan wanted!: “Price stability is the state in which expected changes in the general price level do not effectively alter business or household decisions” [July 1996, FOMC Minutes, pg 51])
 - Creates potentially a significant danger, namely the “Morris and Shin” problem
 - NO: the aim is to help individuals become more informed and make better decisions

GOVERNANCE

- Single decision-maker versus committee structure
 - A Governor is still first among equals even in a committee setting
 - Committees breed conformity
 - Committees can become polarized

GOVERNANCE

- Why committees can be better
 - Its harder to attack a committee than an individual
 - A committee means that several experts have to be consulted when making a decision. This adds weight to the idea that good judgment is used to arrive at a decision
 - Committees improve accountability

GOVERNANCE

- How are MPC structured and decisions taken?
- What are the main issues?
 - How members are appointed
 - Whether or not minutes are released, and when
 - How votes are taken and are they publicly announced
 - Is the entire committee accountable or are the individual members accountable?
 - Are policy decisions announced, when, and how

GOVERNANCE

- How are MPCs structured and decisions taken?
- Some prime examples:
 - Fed model
 - Bank of England
 - Bank of Japan
 - **European Central Bank**
 - Bank of Canada

GOVERNANCE

- “Deliver us from Committees”
 - Does Size matter? YES
 - Facilitates information sharing
 - Affects the free rider problem
 - Affects the costs of reaching an agreement
 - Affects opinions members have about the best way to conduct monetary policy

GOVERNANCE

- SIZE and OPERATION
 - Theory says that committee decisions by majority rule lead to better decisions than by individuals
 - But what if the members are not all equally competent?
 - But what if the effort put in by individual members is not the same
 - But what if same (full) information is provided to all? Does this not encourage free riding?

GOVERNANCE

- OPTIMAL SIZE?
 - 5
 - Therefore most MPCs are too large!

CASE STUDY: Decision-Making at the ECB

An Example of Governance Issues &
Problems

Decision-Making at the ECB

- Now: 6 EB + 15 Governors
- When € has 15-21 members: 2 groups
- When € has 22 or more members: 3 groups
 - 6 permanent (EB), 5 NCB of 'largest' NCB = 4, $\frac{1}{2}$ of NCB Governors = 8, remaining NCB = 3. TOTAL = 21

Some Features Peculiar to ECB/€ Area

- EB appointment procedure (consensus) differs from NCB head appointment procedure
- Speed of rotation + type of rotation according to # of countries in the € area
- Members with a derogation while others not

Models of Voting (1)

- Representative (Bundesbank, some international organizations)
- Delegation (Canada)
- Rotation (Fed)

Issues

- Committee too large
- Odd situations are possible (Luxembourg more influential than Poland)
- Are loyalties to the nation or to the institution?

Bottom Line

- Excessively complicated but perhaps it's the nature of the beast
 - Have to be realistic + if you think this is bad see EC voting rules under Lisbon (16 different procedures are possible)
 - Since ECB is expected to become an institution in its own right maybe 'national' preferences, if they ever mattered, will subside
 - More disagreement (transparency) would help
 - Better able to locate accountability

MEASUREMENT

- Can we measure ADG and its impact on monetary policy performance?

Dincer and Eichengreen (2007)

- Types of transparency
 - Political transparency
 - Mandate
 - Economic transparency
 - Models
 - Procedural transparency
 - Decision-making & communication
 - Operational transparency
 - Challenges in implementing monetary policy

Min = 0 Max = 15

Political Transparency

Political transparency refers to openness about policy objectives. This comprises a formal statement of objectives, including an explicit prioritization in case of multiple goals, a quantification of the primary objective(s), and explicit institutional arrangements.

(a) Is there a formal statement of the objective(s) of monetary policy, with an explicit prioritization in case of multiple objectives?

No formal objective(s) = 0.

Multiple objectives without prioritization = 1/2.

One primary objective, or multiple objectives with explicit priority = 1.

(b) Is there a quantification of the primary objective(s)?

No = 0.

Yes = 1.

(c) Are there explicit contacts or other similar institutional arrangements between the monetary authorities and the government?

No central bank contracts or other institutional arrangements = 0.

Central bank without explicit instrument independence or contract = 1/2.

Central bank with explicit instrument independence or central bank contract although possibly subject to an explicit override procedure = 1.

Economic Transparency

Economic transparency focuses on the economic information that is used for monetary policy. This includes economic data, the model of the economy that the central bank employs to construct forecasts or evaluate the impact of its decisions, and the internal forecasts (model based or judgmental) that the central bank relies on.

(a) Is the basic economic data relevant for the conduct of monetary policy publicly available? (The focus is on the following five variables: money supply, inflation, GDP, unemployment rate and capacity utilization.)

Quarterly time series for at most two out of the five variables = 0.

Quarterly time series for three or four out of the five variables = 1/2.

Quarterly time series for all five variables = 1.

(b) Does the central bank disclose the macroeconomic model(s) it uses for policy analysis?

No = 0.

Yes = 1.

(c) Does the central bank regularly publish its own macroeconomic forecasts?

No numerical central bank forecasts for inflation and output = 0.

Numerical central bank forecasts for inflation and/or output published at less than quarterly frequency = 1/2.

Quarterly numerical central bank forecasts for inflation and output for the medium term (one to two years ahead), specifying the assumptions about the policy instrument (conditional or unconditional forecasts) = 1.

Procedural Transparency

Procedural transparency is about the way monetary policy decisions are taken.

(a) Does the central bank provide an explicit policy rule or strategy that describes its monetary policy framework?

No = 0.

Yes = 1.

(b) Does the central bank give a comprehensive account of policy deliberations (or explanations in case of a single central banker) within a reasonable amount of time?

No or only after a substantial lag (more than eight weeks) = 0.

Yes, comprehensive minutes (although not necessarily verbatim or attributed) or explanations (in case of a single central banker), including a discussion of backward and forward-looking arguments = 1.

(c) Does the central bank disclose how each decision on the level of its main operating instrument or target was reached?

No voting records, or only after substantial lag (more than eight weeks) = 0.

Non-attributed voting records = 1/2.

Individual voting records, or decision by single central banker = 1.

Policy Transparency

Policy transparency means prompt disclosure of policy decisions, together with an explanation of the decision, and an explicit policy inclination or indication of likely future policy actions.

(a) Are decisions about adjustments to the main operating instrument or target announced promptly?

No or only after the day of implementation = 0.

Yes, on the day of implementation = 1.

(b) Does the central bank provide an explanation when it announces policy decisions?

No = 0.

Yes, when policy decisions change, or only superficially = 1/2.

Yes, always and including forwarding-looking assessments = 1.

(c) Does the central bank disclose an explicit policy inclination after every policy meeting or an explicit indication of likely future policy actions (at least quarterly)?

No = 0.

Yes = 1.

Operational Transparency

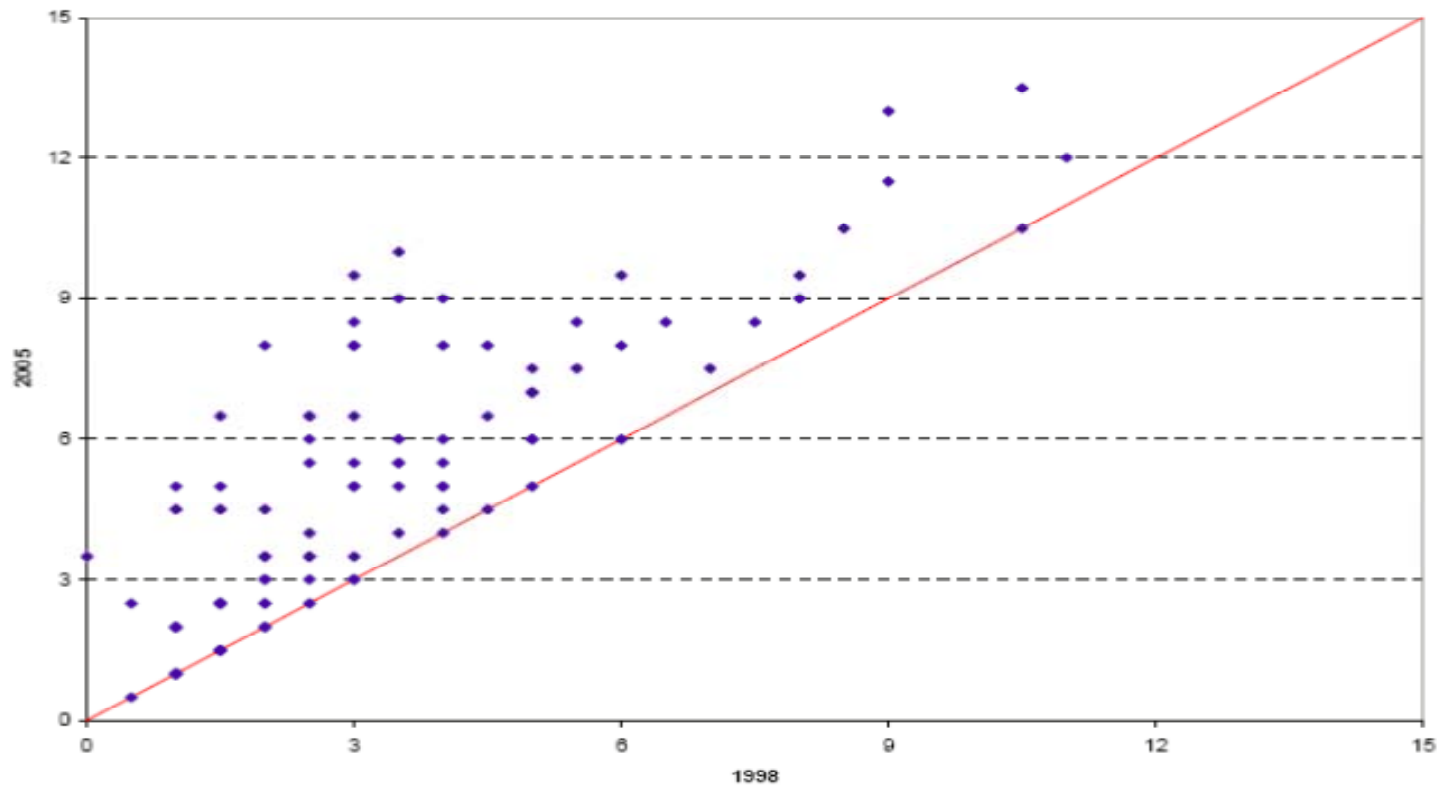
Operational transparency concerns the implementation of the central bank's policy actions. It involves a discussion of control errors in achieving operating targets and (unanticipated) macroeconomic disturbances that affect the transmission of monetary policy. Furthermore, the evaluation of the macroeconomic outcomes of monetary policy in light of its objectives is included here as well.

(a) Does the central bank regularly evaluate to what extent its main policy operating targets (if any) have been achieved?

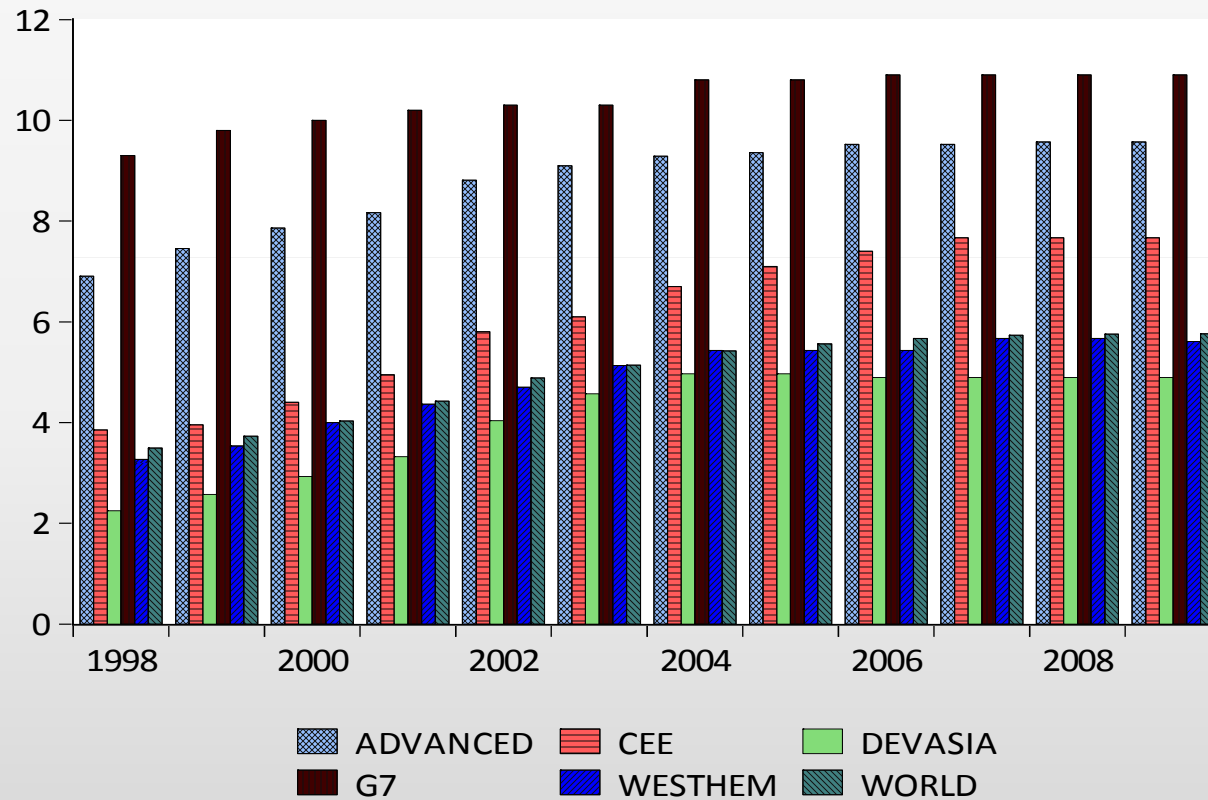
No or not very often (at less than annual frequency) = 0.

TRANSPARENCY: Dincer & Eichengreen

Figure 2. Comparison of Transparency in 1998 and 2005



D-E TRANSPARENCY: Some Evidence



Siklos (2011)

References

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