CENTRAL BANK TRANSPARENCY – IMPLICATIONS AND IMPORTANCE

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1. Introduction

De Haan, Amtenbrink & Eijffinger (1998) consider transparency as one of the three components of an adequate level of accountability, because, according to these authors central bank accountability couldn't exist without transparency. The authors define transparency as a premise of gaining accountability, because when missing transparency there is an impossible way to evaluate the central bank. Briault, Haldane & King (1996) consider also central bank transparency as being an essential part of accountability. Publishing the central bank Board meetings minutes and presenting inflation and monetary policy reports represents a part of the informational sets throughout the central bank can communicate with the wide public. The idea behind this hypothesis is that an external mechanism of the central bank regarding the communication process can be seen as an essential premise of central bank accountability.

According to Eijffinger & Geraats (2004, p. 2):”monetary policy transparency can be defined as the situation in which the central banks reveal the information connected by central bank decision process”. However, the author's definition has the disadvantage of a one-dimension notion because of the quantitative information requested to be revealed by the central bank. Winkler (2000, p. 18) sustains that transparency must encompass high qualitative degree: ”in a world in which...cognitive limits matters, a high quantity of information and a adequate detailed process of this neither translate, implicitly, in a higher transparency degree and a better perception of this information, nor of bettering the decision process efficiency”.

Winkler (2000, p. 18) propose a comprehensive definition of the aspects regarding central bank transparency: “A different vision of transparency: clarity, honesty and a universal understanding”. An excessive set of information is a problem often remarked in practice, reason why Winkler introduced the concept of *optimal information quality,* i.e. the level in which the informational benefits equalize the associate cost of the efforts made for the analyzing and interpreting this information. Winkler institutes the transparency definition through including in it three aspects of the informational transmission process. Beyond the degree of information openness, the author takes into account aspects as clarity, honesty and informational efficiency:

- *the public openness degree of information* regards the volume of information which the central bank must disclose to the wide public;
- *Informational clarity* – the information must be short and be able to do some critical analyzes at the multiple levels. Before communicating the information to the wide public, this needs to be transformed in common terms, which is considered an essential condition of a large scale understanding it. The information must be grouped, filtered, and finally published; at the same time, the central bank must avoid communicating the information through ambiguous ways that can have

consequences a complicated interpreting of it;

- *The communication process* must have as a common base intelligible for both parts: the one that communicates the information and the one that receive it. The problem according to this issue does not concern on the language needed to be adopted but as well as the *technical jargon* who needs to be adapted to the targeted type of audience;
- *Honesty* – the information offered by the central bank needs to be fully credible and corresponding to the *internal circle* of the central bank. It needs to be avoided some consequently modification of the information that can cause misinterpreting it. Transparency needs to be offered started with the premise of a better understanding by the wide public of the monetary policy process. If a central bank will present and explain the macroeconomic models used for its policy, than it is necessary that these models to correspond the internal models used in the decision process of delegating monetary policy. Moreover, honesty is considered as a very special characteristic of central bank transparency.

In our opinion, central bank transparency needs to confer a high degree of information quality and a less degree of quantity and useless of information. The existence of such situations in which appear gaps between some public statements and some monetary policy reports will undermine central bank credibility of the central banks and confusing the financial market behaviour, leading finally to an influence in the monetary policy final output. According attention to the presentation of these materials needs to have background the relevance and consistency on the information which the central bank will disclose. On contrary, by disclosing some reports that offer some contradictory information, the transparency objective will be seriously affected.

2. Central bank transparency consequences

Analyzing the economic literature we consider that central bank transparency can lead to improving monetary policy performances, it can be identified eight reasons that suggest the importance of transparency for a central bank:

1. *Enhancing central bank credibility.* The time inconsistency problem reveals the importance of credibility in reducing the inflationary bias. The external possibility of communicating the adopted decisions, objectives, projections and forecasts will lead to increasing the degree of central bank credibility. In cases in which the objectives and measures adopted have a high accuracy, the private sector will be capable to estimate the monetary policy results leading to an increase in the degree of central bank credibility. Constructing through transparency a high degree of trust, the central bank will be more capable to influence the economy: the private sector will know that once central bank had statements, she cannot deflect form the target. Credibility can influence in a positive manner the financial sector behaviour and, implicitly, improving economic performances.
2. *Inflationary expectations.* The central bank can improve the degree of trust by announcing the targets and the communication policies, elements that are in compliance with accomplishing these targets. Economic agents will consider this announce and will adapt their expectations accordingly. A central bank needs to communicate al the adopted decisions, the motivations behind the prevalence of one or other measures, the economic variables included in the decision process, the forecast process will allow the economic agents to a better and a more clear understanding of the central bank operations rationale. Being aware of the monetary policy decision process, the

wide public will continue having faith in the central bank, as well as in cases in which she doesn't accomplish its objectives. This situation happens because transparency allows evaluating the central bank according to its operations and the registered results. Economic agents have an adequate degree of discernment in distinguish situation in which central bank register failure because of a high number of unforeseeable factors or a poor management process or incompetence.

1. *Safeguarding central bank independence.* An independent and transparent central bank gains a higher probability of maintaining its independence over a non – transparent central bank. The communication channels adopted by the central bank will allow the economic agents to evaluate the adopted monetary policy measures. Transparency can suggest that if the central bank has been subject to some pressures regarding the formulation of monetary policy. In case of a transparent framework, the possible pressures realized by government will become visible, and she will have to avoid making any pressures to the central bank officials because it can interfere with the electorate. It can be remarked that it can be identified other potential sources, beyond government; the presents of some pressure groups, which request undertaken of several actions and measures that can have impact upon the monetary policy decisions. For minimizing these pressures, a fully – fledged transparency in the decision process and the vote mechanism of the central bank will be an important argument. If all the motivations and decisions correlated with any monetary policy direction are public undertaken, that the possible pressures can be easily avoided.

2. *Improving monetary policy public understanding*. A high degree of central bank transparency will lead to increasing the perception and knowledge capacity of the ways in which the central bank elaborates and implement monetary policy. Publishing in term of the Board decisions regarding the private sector will allow a better understanding of the decisions. In normal terms, central bank can make known the way in which can perceive the signals from the economy. For this purpose, the economic agents will be more capable to forecast with accuracy the future decisions of the central bank as a reaction to these signals. This fact will reduce the gap between the shock time reaction from the central bank and the understanding of its actions by the private sector and leading to an accelerating transmission of the monetary policy mechanism.

3. *Decreasing informational asymmetry and uncertain in the financial markets.* A higher availability to offer and gain information means an increasing capacity of knowledge regarding the economic system and the discrepancies between public expectations and actual results. Studies made by Eusepi (2003) regard the impact of central bank transparency upon its performances and abilities in influencing economic stability. Eusepi (2003, p. 2) sustained: " if the market participants have access to some information referring to the central bank actions, this fact can lead their capacity of forecasting and stabilizing the economic system. Some degree of transparency and credibility can lead to improving the private sector learning process, affecting under this process of learning the stability". For example, a transparent central bank will need to confer information, explaining the adopted monetary policy choices, forecasts and projections of the inflation and output which are used in formulating monetary policy. In this definition, Eusepi considers central bank transparency as an important role in the transmission mechanism of the monetary policy. In a world with a delayed monetary policy mechanism, the presence of central bank transparency takes an crucial role in the

private sector expectation formation, helping at the economic system stabilizing. Lack of transparency will cause the inability of formulating some accurate projections over the private sector, undermining central bank credibility. Moreover, Eusepi (2005) shows that in the presence of some uncertainties at the future level of inflation or of the monetary policy strategy, a higher level of transparency will lead to an optimization of the targets in the presence of expectation errors. Lack of transparency will led, instead, to destabilization of the economic equilibrium because of the internal expectations which will affect the social and economical welfare. The private sector is forced to formulate its own expectations based on a reduced set of information, this fact leading to a higher instability of the economic system. As a consequence for a non – transparent central bank, she can stabilize the private sector expectations only by adopting a suboptimal monetary policy rule. As a consequence, transparency is an essential aspect of the independent central bank monetary policy delegation process. In this sense, transparency can reduce the uncertainties regarding central bank preferences. Eijffinger & Hoeberichts (2000) sustain that transparency can clarify the public degree of inflation aversion of a central bank in this way transparency can lead to an increase in the accountability level of a central bank.

4. *Improving financial market efficiency.* In situations in which the private sector has trust that the central bank will publish the new set of data in term of several shocks, that she will act in compliance with the situation. In the presents of several shocks, the society will be capable of modifying quickly the investment options, due to the central bank publications. Another psychological important aspect is one of expectations; in the presence of shocks, the society knows that the central bank will act in compliance with the communicated measures and previously adopted.

5. *Decreasing government uncertainty regarding the monetary policy performance.* As it can be seen, in the delegation process of responsibilities, the government entrust to the central bank the monetary policy responsibilities, fact that make the central bank accountable and responsible. Transparency is important from this point of view because it sustains the whole activity of the central bank through its communications methods, allowing the government to realize verifications upon the way in which it fulfil its obligations. The government can verify rapidly if the central bank fulfils its duties being capable, if necessary, to interfere for limiting the risk caused by uncertainties and mistakes made by the central bank.

6. *Improving the degree of coordination between fiscal and monetary policy.* A high degree of transparency will confer the government a consistent set of information regarding the conduct of monetary policy, as for she can plan its own fiscal operations, everything being known public. In consequence, the monetary and fiscal policy operation efficiency will increase concomitant with the avoiding of some operational overlaps of these policies.

3. The correlation between central bank transparency and social accountability

Searle (2005, p.10) sustains that: “the institutions conceived by the people are above all anything else, because, these create a power...a special type of power (...) which is marked by some elements as: rights, duties, obligations, authorisations, tasks, assignments, necessities and certifications. I name all these elements as *deontic powers.*

In our opinion, central banks powers, named generic by Searle “deontic powers” find themselves under these rights and obligations mentioned *above by the author and who mandates central banks with "ethical and moral powers" resulted from some collective assignment of important and specific functions: money issue, cash withdrawal from the market, market liquidity injections, evaluating and revaluating GDP, (un)monetizing budgetary debt and the national economy design.*

For gaining monetary and fiscal policy credibility over the private entities, central bank officials will construct *ethical power* for signalling this credibility in different markets. *Ethical and moral power* gains because of those capacities to create of destroy money throughout the monetary base and credits granted to the commercial system.

Because of the disintermediation process, the long term credit cost and offer is much more determined by the bond market entities and less from the commercial banks of whose monetary policy practices can interact very quickly. In this sense, for determining the long term offer and costs, central banks wish to present the current and future monetary policy paths, both for the bond market entities and for the community that realize investments.

In cases when the future directions of monetary policies are presented transparent from the markets, the entities upon this market can be seen as transmission *vehicles* of monetary policy through the economy. Svensson (1999) sustain that bond markets must act as a multiply timer of the monetary policy power. Private entities are considered a financial governance mechanism in the service of the central bank.

The meaning of transparency in the contemporary literature who regards monetary economics and central banking occurs from the rationale expectations theory upon the time inconsistency problem of monetary policy.

The economist Benjamin Friedman realized a focused analyze upon the *scientific neutrality* regarding *economy rhetoric* sustaining in this context: "the meaning attached to the ordinary demands in an explicit context, often depends on the evaluation way of the word used in the specific context" (Friedman 2003, p. 118).

The term very often used of central bank credibility gain in the context of sustaining central bank independence in the economic literature. Similarly, the frequently used term of central bank transparency is tied of supporting the direct inflation targeting regime. Central bank transparency is necessary to lead to an increasing degree of central bank credibility. Different forms of transparency regard the decision process proceedings, the methods and the central bank's objectives.

The meaning of transparency has a social tempt in the economic literature having several intersubjective forms between economist and central bank decision makers. Central banks have taken transparency as a *multiplying force* of the monetary policy, engaging in constructing communication strategies in order to transmit and learn the social meaning of objectives, methods and procedures in the central banks framework, in an adequate manner so these can be shared intersubjective with the private entities.

4. Conclusions

The communication strategies of the central banks, as well as focusing attention upon transparency consists premise of high governance efficiency. The central banks are focused upon transparency in a direct inflation targeting regime, especially upon the impact of bond market decisions; an example in this sense is represented the risk premium of which the bond investors assume when they are buying a long term debt instrument. These risk premiums represent a way of measuring monetary policy credibility, in case of monetary debt, as well as the business credibility and payments balance in cases of private of corporative debts.

In situation in which the central bank engages in these communication and transparent strategies it doesn't know certainty if it is necessary to replace the individual, particular or institutional bond investor. However, the central bank wishes to realize more transparent the decision making process. The central bank wants to modify the financial market entities decisions, by modifying the social accountability of the accumulated expectations over the future directions of interest rates by notifications of monetary policy future paths.

Because of the government fiscal policy importance in modelling decisions, this represents, also, a target of the central bank communication strategy in negotiating upon the governance capacity.

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