Erkki Liikanen: Is more always better? Transparency, accountability, and the clarity of message

Introductory remarks by Mr Erkki Liikanen, Governor of the Bank of Finland, at the Panel Discussion "Is More Always Better? Transparency, Accountability, and the Clarity of Message", ECB Central Bank Communications Conference, Frankfurt am Main, 14 November 2017.

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Why do we need transparency? Is more always better?

There are two basic reasons for transparency in monetary policy: The first is public accountability of central banks. The second reason is better policy effectiveness.

Anders Chydenius, the 18th century Finnish clergyman and economist drafted the world's first freedom of information act (enacted in the Kingdom of Sweden in 1766). This was 98 years after the Riksbank was founded. Chydenius summarized the connection between transparency and political liberty in the following way:

"*The liberty of a nation is preserved not only by the laws, but by public information and knowledge as to how they are being administered*."[1]

Chydenius' statement presents the accountability argument for transparency in its simplest and the most forceful way. The rule of law alone is not sufficient for freedom, but the transparency of the use of executive power is also necessary.

Until a generation ago, central banks were rather secretive organizations, shrouded in a kind of monetary mystique. This started to change in the 1990's, when the independence of central banks rose to the top of the reform agenda, in order to improve the credibility of monetary policy.

As central banks became more independent, it was natural that accountability and transparency had to develop as well. Citizens and their political representatives needed to be able to monitor how central banks used their independence.

Considering the ECB, an important forum for its accountability are the regular hearings of the President of the ECB at the European Parliament. These hearings are both a forum of scrutiny and a venue for communication of policy goals and strategies.

The accountability framework was strengthened further after the ECB was entrusted with the powers of banking supervision in the euro area. Since then, also the Chair of the Supervisory Board appears regularly in the European Parliament.

Beyond the formal accountability requirements, the ECB was the first major central bank to organize regular press conferences after each monetary policy meeting of the Governing Council. They are not just one-directional communication but enable useful interaction between the press and the President and the Vice-President of the ECB.

A more recent, but a very important step was when the accounts of the Governing Council's monetary policy meetings were published starting from the January 2015 meeting. They enable the analysts to get a comprehensive view of the discussion that has taken place among Governing Council members, and of the main arguments presented. The accounts also include the presentations by the Executive Board members on market developments and the economic situation. So, the monetary policy deliberations are public three weeks later.

Is there an area, where more is not always better? This is one question for the panel.

Bengt Holmström, last year's Nobel Laureate in economics, has pointed out that in some cases transparency can be counterproductive. His point is that, in asset markets, too much transparency can lead to a loss of liquidity compared to situation where all market participants would view some asset class as homogeneous because of their opacity.[2]

Are there limits to transparency in central banking? Are there trade-offs between the transparency and quality of decision-making? Is there an area where a space should be left for confidential reflection?

Keynes is quoted as having said: "*When my information changes, I alter my conclusions. What do you do, sir?*"[3]

How could we take into account this wise advice in monetary policy making?

When policy-makers review the most recent information and fact-based analysis of the economy, an opportunity should be given to make candid questions on the basis of the available information. It is justified to keep this exchange of views confidential when it is separated from the discussion of the future monetary policy stance.

In this way, members have the space to compare the analysis they were prepared beforehand to the analysis which is given to all members at the same time at the central bank. In my view, this is not in contradiction with the transparency and accountability of the decision-making itself.

In this session, we will discuss the different varieties of transparency and their relation to the effectiveness of monetary policy, and the accountability of the central banks.

Is our transparency already optimal from the accountability point of view? There will certainly always be room for improvement. One area where further development may be warranted is the transparency of central banks regarding their management of the financial risks in their balance sheets.

Of course, central banks must give priority at all times to their monetary policy and financial stability responsibilities over their financial result. At the same time, our stakeholders in parliaments, governments, and the general public deserve to know how the assets accumulated in the central banks are managed, and how the central banks assess the financial risks involved. This knowledge strengthens the support of the policies of central banks.

Since the beginning of the financial crisis, the ECB and the Eurosystem have made a lot of progress in the transparency of the balance sheets. In particular, the content of the on-going asset purchase programme is made public, on a country-by-country and security-by-security basis. At the same time, we must always put financial risks in central banking in the broader policy context and take into account the objectives and results of such policy.

In general, disclosure is necessary, but not enough. Central banks need to ensure that the political decision-makers and the general public understand what the central banks are doing and why. Deep and coherent participation by the central banks in the public economic debate at the national and euro area level is needed.

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Transparency is useful also for other reasons besides retroactive accountability. It is important for policy effectiveness.

Monetary policy is largely about managing expectations. In order for monetary policy to do its job smoothly, it is important that the market participants understand the intentions of the central bank. This, in fact, makes communications the first, although not the ultimate instrument of monetary policy.

In monetary policy, communication is an active form of transparency: transparency about the current interpretation of the economic situation, and about the goals and intentions of the central bank. **Charles Evans** spoke about the distinction between "Delphic" (or predictive) communication and "Odyssean" (committing) communication, where promises are involved. These terms were recently discussed by **Ben Bernanke** in his speech and paper about monetary policy in a new era.[4]

At present, the role of communications is especially large, because of the increased reliance of central banks on forward guidance. When forward guidance is credible, it adds an important instrument to the central bank's toolbox. It has proven useful, especially when the room of movement for the principal instrument of monetary policy – the interest rate – is restricted by the Zero Lower Bound.

Using the Chicago terminology, the ECB took an Odyssean step in 2013 when it started to use forward guidance regarding its future interest rate policy. Later, the degree of precision and commitment in the ECB's forward guidance went further when the large-scale asset purchase programme was launched in 2015.

Forward guidance in an environment of very low interest rates has been a success, but it was not the first instance of using transparency as a commitment device.

The most important thing to be transparent about are the policy objectives. The ECB was an early advocate of goal transparency. The commitment to the famous definition of price stability in 1999 and its clarification in 2003, "below, but close to 2 per cent in the medium term" are the most important cases in point. The latter step was taken to underline the symmetry of our price stability objective, meaning that downward deviations from the definition are just as undesirable as upward deviations.

I now invite the distinguished members of our panel to address the question of transparency in monetary policy each from their own point of view.

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1 Chydenius, A.: Memorial on the freedom of printing. In Jonasson, M. and Hyttinen, P. (eds.): Anticipating the Wealth of nations. The selected works of Anders Chydenius (1729 – 1803). Routledge 2012.

2 e.g. Holmstrom, B.: Discussion of The Panic of 2007 by Gary Gorton. In: Mantaining Stability in a Changing Financial System, Proceedings of the 2008 Jackson Hole Conference. Federal Reserve of Kansas City 2008.

3 This widely used quote is according to "The Keynes Centenary" by Paul Samuelson, published in The Economist, Vol. 287 (1983), p. 19. There has been some debate about whether Keynes actually ever said this.

4 Bernanke, B.: Monetary Policy in a New Era. Conference on Rethinking Macroeconomic Policy, Peterson Institute, Washington DC, October 12–13, 2017.