Is communication clarity from fiscal authority useful? Evidence from an emerging economy

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Abstract

This study relates to the literature on the communication and clarity of the policymakers. The novelty concerns the investigation of the effect of the communication and clarity of the fiscal authority on market expectations on public debt. The article addresses empirical evidence, based on the Brazilian experience, regarding the idea that communication is essential for the coordination between the policymaker and the market participants in order to lead expectations. The findings suggest that the communications from the Brazilian National Treasury concerning fiscal policy represent an important tool to improve the effects of the management of the public debt on market expectations regarding public debt.

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1. Introduction

According to International Federal of Accounts, fiscal transparency is one of the main pillars of governance in the public sector (IFAC, 2011). In general, fiscal transparency increases the society’s confidence in the fiscal management and, as a result, implies better fiscal decisions.

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As pointed out by IMF (http://www.fsb.org/2014/10/cos_070620/), fiscal transparency is critical for effective management and accountability. In this framework, information is essential because a bad quality of information leads to wrong interpretation by users thus causing inappropriate decisions. In brief, governmental transparency is an essential element in the implementation of fiscal policy (Bolívar, Galera, & Muñoz, 2015).

The analysis regarding the relevance of communication as a tool for managing expectations is well known in the study of monetary policy.1 As suggested by Guthrie and Wright (2000) several central banks make use of statements as policy instrument (open mouth operation). However, as pointed out by Jansen (2011), regular central bank communication in a nonaccessible manner is not sufficient to assure transparency. Hence, only a correct combination between transparency and communication would reduce the uncertainty on central bank’s preferences, thereby improving private sector expectations. In short, clarity on communication is essential for the coordination between the policymaker and market participants as a way of diminishing asymmetric information.

Such as observed by Bolívar et al. (2015), government financial sustainability can be affected by the level of understandability of information transparency. Therefore, based on the argument that sound private expectations on public debt sustainability is a precondition for the success of fiscal policies and that the readability of communications is potentially an important tool to drive expectations, we analyze the impact of communications and its quality on market expectations.

Statements may be considered as a coordination tool.2 However, the success of a fiscal authority’s communication for driving private expectations depends on the credibility of the statements (Eusepi & Preston, 2011). As pointed out by de Mendonça and Machado (2013), fiscal credibility is essential to stabilize expectations in order to mitigate the risk of insolvency. Fearful markets constrain the actions of fiscal authorities, thus it is crucial to manage expectations in order to convince markets that fiscal policies are sustainable (Karantounias, 2013).

Due to the fact that clarity is necessary to lessen difficulty of the private sector in interpreting the fiscal authority’s message, such as in Jansen (2011), this paper focuses on readability. To illustrate how this works in practice, we provide an empirical analysis based on the Brazilian experience. The largest Latin American economy, in order to control the dynamic of public debt, adopted a strategy for lengthening and improving the composition of the domestic federal public debt since November 1999. Furthermore, as an important tool of communication between the policymaker and the private sector, the Brazilian National Treasury issues several daily releases (official notes of the Ministry of Finance) regarding fiscal policy. Hence, Brazil is a good laboratory to observe if the fiscal authority’s communication improves the private expectations on public debt.

The remainder of this study is organized as follows: Section 2 presents the indices of communication and clarity regarding the Brazilian fiscal authority. Section 3 presents the methodology and data used in the study. Section 4 provides empirical evidence, through an econometric analysis, of the effect of communication and clarity on the public debt expectations and their volatility. Section 5 concludes the paper.

2. Fiscal indices of communication and clarity

The analysis on how communication of the fiscal authority affects private expectations is directly connected with the success of the announced strategy in the conduct of fiscal policy.

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1 See, for example: Geraats (2002), Frenkel, Pierdzioch, and Stadtmann (2006), Gürkaynak, Sack, and Swanson (2005), Blinder et al. (2008), and Jansen (2011).

2 See, for example: Sarno and Taylor (2001), Taylor (2004), and Beine, Jansen, and Lecourt (2009).
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