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From actual to perceived transparency: The case of the European Central Bank

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ABSTRACT

Over the last decades central banks have become much more transparent about their monetary policy making process. In the literature, the increase in central bank transparency has frequently been related to (changes in) the actions of economic actors. However, the fact that these actors might not even be aware of the increased transparency or might not perceive the central bank as any more credible or transparent as a result of it is neglected in the literature. By analyzing data of a Dutch household survey on the (perceived) transparency of the European Central Bank (ECB) we delve into those neglected issues. We find that transparency perceptions matter for inflation perceptions and expectations as well as for trust in the ECB. However, we also show that the link between actual and perceived transparency is weak. Not only because of poor transparency knowledge but also because perceived transparency is influenced by many individual and psychological characteristics.

1. Introduction

All around the world central banks have become more transparent (Dincer & Eichengreen, 2007). Transparency, which is defined as the degree to which a central bank provides information about its monetary policy making process (Geraats, 2002), is often presented as a tool that keeps central bankers accountable for their policy. Central bank transparency is also argued to have an effect on the effectiveness of monetary policy by steering market expectations that are relevant for the financial decisions of households and financial experts (Woodford, 2005). In addition, central bankers regard transparency as an important tool to build up credibility (Blinder, 2000), resulting in better anchored inflation expectations, relatively stable and better predictable long-term interest and inflation rates, and ultimately leading to more efficient investment and pricing decisions.

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One particularly striking finding of up-to-date overviews of the literature on the economic effects of central bank transparency (e.g. van der Cruijsen & Eijffinger, in press; Blinder, Ehrmann, Fratzscher, de Haan, & Jansen, 2008) is that only few of the transparency studies take into account that economic actors might not be aware of the transparency practices of their central bank or might not perceive the central bank as any more transparent as a result of transparency increases. By neglecting these issues the (implicit) assumption is made that the central bank's public fully and correctly perceives the transparency practices. However, research by de Haan, Eijffinger, and Waller (2005) shows that there are differences between the actual level of transparency of a central bank and its perceived degree of transparency. Because perceptions have a very large influence on behavior it seems fruitful to look into the causes and consequences of these transparency perceptions.

We argue and show that there are two reasons why perceived transparency significantly deviates from the actual transparency practices. First, knowledge about the actual transparency efforts of central banks is imperfect. Second, both knowledge and perceptions of central bank transparency are driven by many individual and psychological factors. Subsequently, we show that these clearly imperfect transparency perceptions have an impact on people's economic actions reflected in their inflation perceptions and expectations as well as in their level of trust in the central bank.[1]

The main contribution of our paper is that it provides more detailed and realistic insights into how central bank transparency, through people's knowledge and perceptions of central bank transparency, influences several economic outcomes. As such, it enhances our understanding of how the economic effects of central bank transparency come about, which has implications for both research and practice. As Ranyard, Del Missier, Bonini, Duxbury, and Summers (2008) point out a better understanding of the formation of inflation perceptions and expectations is desirable.

Our results provide insights into how central banks can increase the effectiveness of their monetary policy. We analyze whether simply becoming more transparent is sufficient to do so or whether other actions, such as having a clear communication policy to the general public, are required as well. Although our analysis is especially useful for the European Central Bank (ECB), the derived insights are very likely to be applicable – perhaps even more so as will be discussed later – to other central banks as well.

To realize these contributions, we analyze micro-data on people's knowledge and perceptions of the transparency of the ECB gathered through a questionnaire among the CentER-panel, which includes over 2000 Dutch households. With this data we test the above relations, which are further developed in Section 2.[2] In Section 3 we discuss our data and survey methodology. Thereafter we present the outcomes of our empirical analyses: households' knowledge about the transparency of the ECB (Section 4), transparency perceptions and their determinants (Section 5), and the importance of transparency perceptions for the effectiveness of the ECB's monetary policy (Section 6). We end this paper with a discussion of the results and their relevance (Section 7).

2. Transparency perceptions: drivers and implications

In this paper we posit the following three conjectures and then test them using the micro-data we describe above.

Conjecture 1. The knowledge that people have about the disclosure practices of the ECB regarding its monetary policy making process is imperfect.

Conjecture 2. The level of perceived transparency of the ECB is driven by:

(1) psychological and individual factors, and
(2) the imperfect knowledge about the actual degree of central bank transparency.[3]

Conjecture 3. Transparency perceptions influence the effectiveness of the ECB's monetary policy.

The first argument as to why people might not base their actions on the actual level of transparency of the ECB, as is commonly assumed in the literature, is that they simply do not have good knowledge about its disclosure practices (Conjecture 1). First, transparency about monetary policy is such a specialized topic that it is not of interest to everybody. Second, even if they search for information, it is likely that most people rely on media information, which can be obtained with relatively little effort. However, media coverage is not random – unexpected steps of the ECB get more attention and there is a bias towards discussing transparency weaknesses – and the media distort the information disclosed by the central bank (de Haan,

[1] We define trust as "... one's belief and expectation about the likelihood of having a desirable action performed by the trustee" (Das & Teng, 1998, p. 494). Here the trustee is the ECB. We use this definition of trust throughout the paper.

[2] It is important to note that, like other empirical research on central bank transparency, the existence of bidirectional relations and the relevance of other unobserved factors cannot be excluded.

[3] So even when abstaining from problems in measuring actual central bank transparency, transparency perceptions might differ from the actual degree of central bank transparency. It is difficult to measure transparency because there is always some judgement involved in the construction of transparency indices (about which aspects to include and how to weigh them).