Let the Sun Shine In!

Policy Transparency Improves Economic Outcomes
The Experience of Monetary Policy, with Lessons for Fiscal Policy

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Executive Summary

Monetary policy transparency has been radically transformed over the past half-century as central banks have become much more open and accountable. This increase in transparency has improved the effectiveness of monetary policy and contributed directly to the achievement of the primary goal of price stability. The gains in transparency have been led by jurisdictions that adopted inflation targeting, which also entailed important governance changes, including a clearer specification of the objectives of monetary policy—namely, an explicit inflation target—and the operational independence of the central bank. These reforms have constrained discretion, increased accountability, and rendered monetary policy more credible, thereby contributing to the achievement of low and stable inflation over the three decades prior to the COVID-19 pandemic. The resulting benefits of increased transparency have greatly outweighed any potential negative effects—for example, criticisms that monetary policy communications have become excessive. Many central banks now have an opportunity to go further as the frontier of transparency expands with innovations in technology and communications. In addition, the experience of the pandemic has posed new challenges for central banks and for the transparency of monetary policy. The use of non-traditional tools, such as large asset purchases and explicit forward guidance, has raised questions about their efficacy and their potential consequences for fiscal outcomes and financial stability.

Fiscal authorities in Canada and other major economies should draw important lessons from the experience of central banks for the conduct of fiscal policy, especially in light of the massive increase in government spending and public debt levels during the pandemic. Fiscal policy should become more transparent, by adopting more explicit objectives, statutory rules, and independent reviews of fiscal outlooks. Increased fiscal transparency would reduce uncertainty and the threat of fiscal dominance over monetary policy, thereby improving economic outcomes.

Introduction

After almost three decades of low and stable inflation in major economies, inflation has taken off over the course of the COVID-19 pandemic to rates not seen in 40 years, and in some cases reaching double-digit levels. This unprecedented situation has posed a unique challenge for central banks, and they have responded with extraordinary policy actions. At the same time, they have stepped up their communications to explain the forces behind this spike in inflation—namely, the global supply shocks caused by the pandemic and health-related restrictions, the fiscal stimulus, and the Russian invasion of Ukraine, as well as the policy responses needed to achieve the banks' price stability mandate. Their communications have received widespread media coverage and public attention, but this elevated degree of transparency was not always the case. Fifty years ago, central banks conducted monetary policy in an opaque, secretive manner and made little attempt to explain what they were doing and why. Montagu Norman, Governor of the Bank of England from 1921 to 1944, captured well the prevailing mantra of central banking in this era with his well-known personal motto, "Never explain, never excuse."[1]

Since then, however, central banks have become progressively much more transparent about the conduct of monetary policy and as a result, monetary policy has become more effective and successful in achieving its primary mandate: price stability. Central banks have undergone a complete about-face, going from opaque, sheltered bureaucracies to more open, accountable, and independent policy and research institutions. They have greatly increased openness about their objectives, policy tools, strategy, and economic and policy outlooks via vastly improved communications with different audiences through press releases, monetary policy reports, speeches, and press conferences, as well as the release of data, models, and research. Consequently, all aspects of the conduct of monetary policy are now better explained and thus better understood by the general public, whose rising demands for central bank accountability have now been largely met (Freedman and Laxton, 2009).

In turn, greater monetary policy transparency has strengthened central bank independence and credibility. Monetary policy that is well understood and more credible is more readily transmitted via financial markets to the broader economy, and has a larger impact on interest rates and overall monetary conditions in the near and longer terms. Moreover, it helps to anchor household and business expectations of inflation (Woodford, 2005). Increased transparency, working through the interest-rate and inflation-expectations channels, enhances the effect of monetary policy on overall economic activity and, ultimately, on inflation. With

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1 Cited, for example, by US Federal Reserve chairman Ben Bernanke (2007).

this openness, monetary policy was successful in achieving low and stable infla-tion over the 30 years priori to the pandemic (Yellen, 2013).

Nonetheless, there are some who feel that monetary policy transparency has reached its limit and that further steps are likely to be counterproductive and, hence, undesirable. For example, Goodhart (2001) and Mishkin (2004) question the marginal benefit of publishing the projected future path of the central bank's policy interest rate. In addition, some have argued (e.g., Blinder, 2004) that monet-ary policy communications have gone beyond the optimal amount and are sim-ply creating noise, not better public understanding, by having too many central bank voices expressing different and sometimes conflicting views. Other critics of monetary policy transparency decry the "false precision" of central bank com-munications, especially about the economic outlook, thereby masking the true degree of uncertainty and causing the general public to rely too heavily on such communications.

The purpose of this paper is threefold. First, it analyses the radical transform-ation in the transparency of monetary policy and related changes in monetary policy governance over the past few decades to highlight the important innova-tions and their positive economic effects. Second, the paper examines different approaches to measuring transparency, and discusses trends across time and juris-dictions to help identify best practices. Third, it considers various criticisms of monetary policy transparency, and argues that the benefits far exceed any costs. Moreover, it posits that there are still gains to be had by increasing transparency further in many countries, especially in view of potential innovations that make use of new technologies. It also explains that the limits to monetary policy trans-parency typically are dictated by the governance structure of monetary policy. The paper draws an important lesson for fiscal policy from the monetary policy experi-ence—in particular, it highlights critical differences between the transparency of monetary and fiscal policy as they are currently practised in Canada.

A key theme of the essay is that monetary policy governance—the legal structure, mandate, and practice of monetary policy decision making—has had an important influence on monetary policy transparency. The increase in trans-parency was underpinned by a concomitant strengthening of the governance of monetary policy. In particular, the independence of major central banks for con-ducting monetary policy was clarified, as were their monetary policy mandates. More emphasis was placed on price stability, typically with an explicit inflation target. Monetary policy decision making was also enhanced, most often with a devolution of responsibility from a sole decision maker, the governor, to a com-mittee with some degree of individual accountability. These reforms fostered the trend toward greater monetary policy transparency, while the specific institutional structure across central banks has had an impact on the extent and nature of mon-etary policy transparency and on the effectiveness of monetary policy.

The need for transparency has only increased since the Global Financial Crisis and again during the global COVID-19 pandemic as central banks had to cope with extraordinary, largely supply-driven shocks to inflation and with the effective lower bound of zero on their policy interest rate. They responded by using a wider set of tools from their extended or unconventional toolkit, including large-scale asset purchases and explicit forward guidance on the future path of the policy interest rate[2], to provide additional monetary stimulus. More explanation from central banks was required when these additional tools were used because their implementation and effectiveness were less well known.

Improvements in transparency and governance have often come after major economic upheavals, such as the Great Inflation of the 1970s, or with significant changes in the monetary policy regime, such as the adoption of inflation targeting. They have often been supported by academic research demonstrating the advantages of clear policy mandates, constrained discretion, and enhanced central bank independence and credibility. These reforms not only have served to mitigate the time inconsistency problem in monetary policy,[3] but also and more important, have rendered monetary policy more effective.

Moreover, these reforms of transparency and governance, especially within an inflation-targeting monetary policy framework, have been self-reinforcing and have contributed importantly to the success that central banks have had achieving the relatively low and stable inflation that prevailed in many countries over the three decades prior to the COVID-19 pandemic.

Before this transformation, opaqueness in monetary policy was the norm. Central bank mandates were vague, and central banks provided little information about their policy goals, their use of policy tools, or their economic and policy outlooks. This lack of transparency reflected the desire of central bank officials to avoid close scrutiny, as the theory of public choice and bureaucratic behaviour would predict. This opaqueness also provided wide scope for policy discretion.

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2 The use of forward guidance on the policy interest rate by central banks will be considered in future research by the authors of this essay.

3 The concept of time inconsistency, developed by Kydland and Prescott (1977), occurs when the public does not believe that the central bank will achieve its announced inflation target because this objective is perceived as incompatible with the central bank's incentives over shorter horizons (Jenkins, 2021). For example, suppose the central bank announces that it will tighten monetary policy to reduce inflation to target. Such a policy would be time inconsistent if the public believes that the central bank has a strong incentive to deviate from it before the target is attained and ease monetary policy to support economic activity or employment. Transparency about the central bank's inflation target and its achievement reduces this problem because it constrains the bank's scope for discretion, as it will be held accountable for any deviations. Some analysts—such as Barro and Gordon (1983) and Taylor (1993)—argue, however, that central banks should adopt more rigid monetary policy rules to further limit their discretion.

This central bank behaviour was driven, in large part, by weak governance over monetary policy. Central bank mandates and their independence from the political authorities were not well defined.

These serious weaknesses were exposed by the Great Inflation of the 1970s. Because central banks and their monetary policy lacked credibility, inflation expectations became unanchored as inflation shot upwards. Consequently, it took draconian tightening of monetary policy and the resulting severe recession of the early 1980s to break the back of elevated inflation expectations and help reduce the inflation rate from double-digit levels.

The transparency revolution in monetary policy communications has occurred over time and across all central banks. The improvement in monetary policy transparency has been led by inflation-targeting central banks; interestingly, the most innovative have been those in small advanced open economies such as New Zealand, Canada, Sweden, the Czech Republic, and Chile, which have developed and adopted approaches to increase monetary policy transparency that are now widely seen as best practice.

The next section of the paper provides a brief historical overview of the broad trends in monetary policy transparency and related changes in central bank governance. This is followed by a survey of the literature that compares the evolution of monetary policy transparency across central banks over time and draws lessons on best practices. An assessment of the impact of enhanced monetary policy transparency is also provided. We then review the criticisms and limits of transparency, and argue that improvements in transparency are generally beneficial, although they might be constrained by how monetary policy is governed. In the penultimate section, we argue that fiscal authorities (as well as other public agencies) in Canada and elsewhere can draw useful lessons from the experience of central banks to strengthen monetary policy transparency and governance, increase policy credibility, and improve economic outcomes. The final section provides some brief concluding remarks and discusses some challenges to central banks and to their transparency stemming from the fallout of the COVID-19 crisis and related events.

The Transformation of Monetary Policy Transparency

In the early 1970s, central banks provided little, if any, public communications about monetary policy. Many of the communications vehicles we take for granted today, such as policy rate announcements, monetary policy and inflation reports, press conferences, speeches, and minutes did not exist or were not widely used. Most central banks simply announced policy rate decisions with little or no forewarning or explanation. Moreover, not only was the conduct of monetary policy opaque; central banks' monetary policy mandates were fuzzy, monetary policy tools, their use and effectiveness were not well known or understood, and the objectives these tools were supposed to achieve were unclear.

Some of this opaqueness about monetary policy reflected the fact that most jurisdictions were operating under the postwar Bretton Woods exchange-rate system in which countries' exchange rates were pegged to the US dollar, but could be de- or revalued to reduce ongoing current account imbalances. Consequently, central bank secrecy helped mitigate the risk of any speculative behaviour that could arise and be self-fulfilling if information were to leak out that suggested the peg might be changed.[4]

Other factors were also at work, as this opaqueness continued well after the Bretton Woods system collapsed in 1971[5] and the period of generalized floating exchange rates across the currencies of most advanced economies began. Interestingly, this opaqueness also largely remained in place in Canada, despite its leaving the pegged-rate system in 1950 to adopt a flexible rate, only to rejoin it in 1962, and then abandon it for good in 1970 (for more information, see Bordo, Gomes, and Schembri, 2010).

To explain this opaqueness of monetary policy, Acheson and Chant drew from the theory of public choice—specifically, the theory of bureaucratic behaviour—to analyse the transparency of monetary policy by the Bank of Canada and other central banks (see Acheson and Chant, 1973; Chant and Acheson, 1972; Chant, 2003). They argued that the opaqueness of monetary policy across objectives, tools, and outcomes reflected optimal bureaucratic behaviour. Central bankers wanted to

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4 During the Bretton Woods period, governments and central bank leaders routinely would say they had no intention of adjusting the peg right up until the moment they actually changed it. Because devaluations entailed a cut in real purchasing power, they were politically unpopular and often delayed, leading to more speculative pressure, which often proved self-fulfilling.

5 The August 1971 collapse was caused by the United States' decision to suspend the convertibility of the US dollar into gold.

maintain and even increase their prestige as public institutions and to preserve their status and resources by avoiding close public scrutiny and accountability. This behaviour was exacerbated by unclear goals and weak governance.

The monetary policy mandates of most central banks at that time were not well defined. The legislation that governed them typically provided a wide-ranging mandate with multiple vaguely defined goals. Although price stability was almost always one of these goals, it was not well specified, and its ranking relative to other goals was not clear, making decision making and accountability difficult. Moreover, the governance of central banks—in particular, their independence from political influence—was uncertain.[6] This uncertainty rendered central banks not only less credible, but also less willing to be held accountable for their actions. Their incentive was to be opaque about monetary policy.

As well, although central banks had a range of monetary policy tools, their effectiveness was not well known, and it was not obvious that central banks could achieve specific goals easily given their toolkit. Again, opaqueness was optimal, given that central bankers felt unsure they could readily achieve any specified objectives of monetary policy with the tools on hand. Moreover, a theoretical case was made that ambiguity enabled central banks to generate monetary surprises and higher unexpected inflation, thereby stimulating economic activity.[7] Such an argument could also be used to explain why monetary policy authorities were purposely unclear. For example, Alan Greenspan, chairman of the Fed from 1987 to 2006, was quoted as saying, "Since I have become a central banker, I have learned to mumble with great incoherence. If I seem unduly clear to you, you must have misunderstood what I said."[8] That argument, however, became less compelling as monetary policy became more transparent and had a greater impact on inflation expectations (Woodford, 2005).

A number of factors contributed to the subsequent trend of increased monetary policy transparency. An important cause was the Great Inflation experience of the 1970s. Not only was inflation very high relative to past experience, but economic performance was also dismal as unemployment rates rose to postwar highs and the term "stagflation" was born. While skyrocketing oil prices contributed to dramatically higher measured inflation and rising structural unemployment,

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6 Unclear governance over monetary policy and central bank opaqueness might have helped monetary authorities to preserve discretion over policy and shield them from intense political oversight, as Mishkin (2004) argues, but it left the door open for political influence. Blinder (2022) provides an overview of the conduct of monetary policy in the United States since the 1960s, and examines instances of political influence on the Federal Reserve's monetary policy.

7 See Cukierman and Meltzer (1986) and Lustenberger and Rossi (2020) for more information.

8 Quoted in the *Wall Street Journal*, September 22, 1987.

monetary policy lost its moorings with the collapse of the Bretton Woods system. Consequently, inflation expectations rose steadily over the period. [9]

Because of high inflation and weak growth over the 1970s, there was widespread dissatisfaction with central bank performance, and political support swelled for a strengthening of monetary policy governance. The most notable reform was the Humphries-Hawkins Act of 1978 in the United States, which explicitly defined the monetary policy mandate of the Federal Reserve as price stability, full employment, and low long-term interest rates. The first two objectives were given priority and became known as the "dual mandate."

During this high-inflation period, central banks began searching for a new nominal anchor for monetary policy, given that maintaining a pegged exchange rate to the US dollar was neither feasible nor desirable. Several central banks, including the Bank of Canada and the US Federal Reserve, tried money supply growth targeting, with mixed results for controlling inflation.[10] Consequently, the search for a new nominal anchor continued in earnest for much of the 1980s. New Zealand and Canada were the first to adopt an explicit inflation target, in 1989 and 1991, respectively. Many other advanced and emerging market and developing countries subsequently followed, so that now about 45 central banks conduct monetary policy with an inflation target (Rose, 2020).

As governments and central banks clarified the objectives of monetary policy, the governance of monetary policy was strengthened. In particular, central banks became more independent of government in their conduct of monetary policy. In this regard, it useful to draw the distinction between goal independence and operational independence for monetary policy (Debelle and Fischer, 1994). Goal independence implies being able to define independently the objective of monetary policy within the governing legislation of the central bank. In contrast, operational independence speaks to the central bank's authority and ability to achieve an independently defined monetary policy objective. Many central banks gained operational independence with the introduction of inflation targeting. As for goal independence, while central banks have an overarching price stability mandate in

9 The adoption of market-determined flexible exchange rates by most advanced economies also led to the removal of controls on capital flows, as they were no longer needed to help maintain exchange-rate pegs. These developments spurred the expansion and deepening of financial markets to hedge exchange-rate risk and other risks associated with increased international capital flows. Increased monetary policy transparency also contributed to this financial market deepening, as it reduced uncertainty and improved market functioning.

10 The demand for money over the latter part of the 1970s proved to be very unstable, in part due to high and variable inflation, but also due to innovation in payments. These and other factors made money supply growth targeting difficult. Gerald Bouey, Governor of the Bank of Canada at the time, noted that the Bank had not abandoned money supply targets; rather, monetary supply targets had abandoned the Bank (Bouey, 1983).

their governing legislation, how that mandate is specified as an objective for monetary policy varies across jurisdictions. For example, many major central banks have a 2 percent inflation target, but in the United States this was set by the Federal Reserve Board, in the United Kingdom by the Treasury and in Canada jointly by the Bank of Canada and the Department of Finance (see Amano, Carter, and Schembri, 2019).

In Canada, the inflation target is specified by the Joint Inflation Control Agreement between the Bank of Canada and the federal government (see Bank of Canada, 2021a), which established an explicit inflation target in February 1991. The agreement was renewed in 1995, when the target became the 2 percent midpoint of a control range between 1 and 3 percent,[11] and the Bank was given the operational independence to achieve this target. Importantly, the agreement committed both the Bank and the government to the inflation target, implying implicitly that both monetary and fiscal policy would work together to achieve the target. While the Joint Agreement is not legislation, it has proved to be very successful and has been renewed six times.

Financial markets—in particular, short-term money markets—expanded and deepened over this period, driven by deregulation and rapid financial innovation. Consequently, central banks were able to undertake different financial market operations to target an overnight or short-term borrowing rate as the main monetary policy tool, thereby foregoing moral suasion and other opaque tools that Acheson and Chant (1973) had studied. By influencing the short-term borrowing rate, central banks could affect the term structure of interest rates, the exchange rate and other asset prices, and thus influence domestic monetary conditions and the overall level of economic activity.

With a well-defined operational objective for monetary policy, an effective and well-understood policy tool, and enhanced and, thus, more certain independence, the veil of opaqueness receded quickly among those jurisdictions with an explicit inflation target. Many of the elements of transparency that we are familiar with today, such as monetary policy statements and reports, press conferences and speeches, and minutes or summaries of deliberations, were put in place over the course of the 1990s. In addition, to promote transmission of monetary policy communications through the media, fixed decisions dates—four, six, eight, or twelve times a year—were adopted.

Some central banks went further than others in terms of transparency. Some decided to publish a projected path for their policy interest rate consistent with their base-case projection scenario—for example, New Zealand, Sweden, Norway, Chile, and the Czech Republic. The US Federal Reserve introduced the "dot plot" in 2012, a summary of interest-rate expectations of members of the Federal Open Market Committee. Although the dot plot does not represent the interest-rate

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11 This specification was renewed in 2001 and every five years since then, most recently in 2021.

path incorporated in the Fed's economic projection, it provides some guidance about the future evolution of the policy interest rate. Other, less extreme forms of guidance about the future direction of the policy rate were also used.

Complementary governance reforms were also put in place. For example, the role of the governor as the single decision maker for monetary policy devolved to a monetary policy committee. For these committees, different practices were implemented across central banks: some, such as the Bank of England, adopted voting rules; others, including the Reserve Bank of Australia, relied on reaching a consensus. In addition, some monetary policy committees, which in the past had consisted entirely of members who were senior executives of the central bank, included part-time external members in order to offer a more diverse and independent perspective.

In general, the adoption of explicit inflation targets[12] and related governance and transparency reforms worked well in lowering inflation from the much higher rates that prevailed in the 1970s and 1980s and helped keep inflation low and stable for much of the 30 years prior to the COVID-19 pandemic (see figure 1). The inflation target, which in many advanced economies was set at 2 percent, served as the focal point for price and wage setting and helped anchor inflation expectations at the target. With inflation expectations well anchored and monetary policy more credible and certain, monetary policy became more effective, as changes in the nominal policy rate translated one-for-one into reductions in the real (i.e., inflation-adjusted) interest rate. Moreover, other asset prices, chiefly the exchange rate, could play a shock-absorber role for the economy (Adrian, Laxton, and Obstfeld, 2018). Because monetary policy was more effective and better able to achieve the inflation target, it increased the target's credibility, thereby creating a virtuous feedback loop.

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12 Some forms of inflation targeting are more explicit than others. For example, the European Central Bank and the Bank of Japan have a 2 percent target, while the Bank of Canada, the Reserve Bank of New Zealand, the Swedish Riksbank, and the Bank of England have a 2 percent target midpoint within a 1-3 percent band, which reflects normal inflation volatility. The Reserve Bank of Australia has a 2–3 percent band, and inflation is expected to average 2.5 percent over the medium term. They all describe themselves as "flexible" inflation targeters, where the flexibility primarily reflects the horizon over which inflation would be returned to target after a significant shock. This horizon is normally six to eight quarters, but can be adjusted to take into account the possible impact on output volatility or on financial stability. The US Federal Reserve in 2020 adopted a new monetary policy strategy called "flexible average inflation targeting." With this strategy, inflation is expected to average 2 percent over the medium term, but the target is asymmetric. While a period of below-target inflation is to be made up for by allowing inflation to overshoot the target by some amount over time, the strategy does not entail aiming for an inflation undershoot when inflation is above target. For more information, see US Board of Governors (2020).

Figure 1: Consumer Price Inflation, Selected Economies, 1980–2022
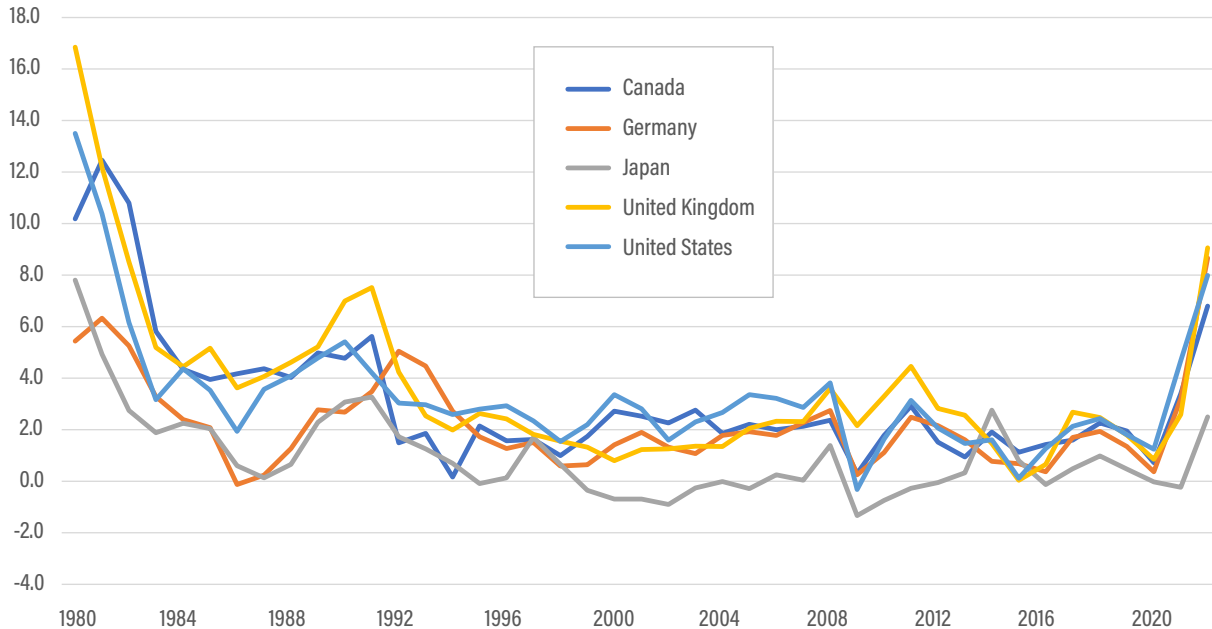
Source: International Monetary Fund

Other jurisdictions without an explicit inflation target also strengthened their governance of monetary policy by making central banks more independent, thereby contributing to increased transparency. Indeed, the 20-year period leading up to the Global Financial Crisis and Great Recession was known as "the Great Moderation," as both inflation and economic growth in most countries were relatively steady. While several factors likely contributed to this solid economic performance, the improved conduct of monetary policy was widely viewed as one of them (Bean, 2009; Bernanke, 2004). Some commentators went so far as to argue that inflation targeting coupled with improved central bank governance and transparency represented the "end of monetary history."

The Great Recession, the protracted recovery of the 2010s, and the COVID-19 pandemic all represented profound shocks in their own way, and caused material departures in the behaviour of inflation relative to what had occurred during the Great Moderation. In particular, the global pandemic and policy responses—including health measures adopted to limit the spread of the virus and fiscal and monetary policies taken to mitigate the loss of income and the decline in economic activity—had massive impacts on both sectoral demand and the sectoral supply of goods and services. The resulting demand-supply imbalances at the global level triggered dramatic increases in the prices of traded goods, including for finished goods as well as for intermediate inputs such as semi-conductors, energy, and other commodities. These increases in goods prices were exacerbated

by the unprovoked Russian invasion of Ukraine, and the total effect was to cause inflation to approach or exceed double-digit rates in many countries. These inflationary effects proved to be more persistent than expected for two reasons. First, the input-cost pressures were large and pervasive and were quickly passed through into prices and, eventually, wages. Aggregate demand for goods and services and labour remained robust owing to fiscal and monetary policy support, which, in hindsight, proved to be too expansionary, especially in the United States. Second, services prices rose as health restrictions were eased and pent-up demand was unleashed, while supply recovered slowly due to the scarcity of workers, lack of investment, and persistent cost pressures.[13]

During the pandemic, expectations for central bank transparency increased, for a number of reasons. First, the increase in inflation was substantial and the factors behind it, as just described, were complex and unusual, as both supply and demand forces were at play. The inflation experience was further complicated by major shocks—most notably, the economic fallout from the pandemic and the Russian invasion of Ukraine. Second, the monetary policy response was also complex, as it entailed the use of several unconventional or non-traditional tools, including large-scale asset purchases (quantitative easing), exceptional forward guidance, and, in some cases, negative interest rates and yield curve control. While some central banks had resorted to these tools to support recovery from the Global Recession of 2008–09, they were more widely used during the pandemic because, at its outset, core financial markets froze and the policy rate was quickly cut to its zero lower bound or to below zero. Moreover, these tools sparked some controversy because their effectiveness was uncertain and large-scale asset purchases had important consequences for the government's deficit position and balance sheet (Fortin, 2022). Central banks refocused their research and analysis to provide more information on the impact of the pandemic and related public health measures on economic activity and inflation and to explain the use of unconventional monetary policy tools, including their implementation and effectiveness. This increased transparency was helpful because it reaffirmed the commitment of central banks to price stability and to supporting sustainable full employment, and thus kept long-run inflation expectations reasonably well anchored at their inflation targets. While increased transparency could not, by itself, prevent inflation from rising, given the unprecedented nature of the shocks to prices, the commitment to the inflation target and the anchoring of inflation expectations helped to prevent a wage-price spiral similar to what had occurred in the 1970s.

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13 For a recent insightful explanation of the evolution of inflation during the pandemic, see Bernanke and Blanchard (2023). Although their analysis focuses on the US experience, the forces were similar in other major economies. Chen and Tombe (2023) provide a recent review of the Canadian experience.

Measuring Central Bank Transparency and Identifying Best Practices

There is an extended literature on assessing and measuring central bank transparency. A key contribution is that of Petra Geraats (2002), who provides a useful taxonomy of five distinct elements of monetary policy transparency that created a basis for constructing indices of transparency used by other authors, including the International Monetary Fund (IMF) (see box 1):

- *Political transparency* concerns the relationship between the government (i.e., the executive branch) and the central bank and whether their respective roles and responsibilities in the conduct of monetary policy are clearly specified and transparently codified, including whether the central bank has a quantitative policy target(s) and its degree of independence.

- *Economic transparency* is about the release of economic information relevant to monetary policy decision making—namely, an assessment of the starting point of the economy and the economic outlook or projection, as well as any monitoring or projection models.

- *Procedural transparency* focuses on the way decisions are made, including monetary policy strategy or rules linking the tools to the policy goal(s), as well as minutes, the voting record, or a summary of the policy deliberations.

- *Policy transparency* entails a prompt announcement of the decision regarding the policy tool, with an explanation of the decision. The provision of some form of forward guidance is also included, whether it is a weak form such as a policy inclination or an indication of future policy actions, or a stronger form such as a projected policy rate path. The strongest form would be a policy interest rate commitment, either time or state (outcome) dependent. [14]

- *Operational transparency* concerns the implementation of monetary policy, including any factors that affect attaining the desired monetary conditions and the transmission of those conditions to inflation and economic activity, including ex-post analysis of the impact and outcomes of past policy actions.

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14 The form of forward guidance is often divided into two categories: Delphic and Odyssean (Campbell et al., 2012). Delphic provides information about the likely future path of the policy interest rate or other monetary tools, whereas Odyssean incorporates a time- or outcome-based commitment. Odyssean seems to have been almost exclusively used in the context of holding the policy rate at the effective lower bound. This commitment is generally viewed as a distinct unconventional or non-traditional policy tool. See Jain and Sutherland (2020) and Sutherland (2020).

**Box 1: The International Monetary Fund's Central Bank Transparency Code**

In 2020 the IMF developed a Central Bank Transparency Code to provide best practice standards for central bank transparency, not only for monetary policy, but also for its governance, operations, outcomes, and official relations. This code updates and replaces the earlier Monetary and Financial Policies Transparency Code that was established in 1999 in the wake of the Asian financial crisis. The lack of policy transparency in the region contributed importantly to the crisis, as implicit guarantees that had been made by government bodies, including central banks, were not well known.

A central bank's transparency practices are assessed against the new code on a voluntary basis. A self-assessment questionnaire is completed, followed by an onsite IMF review mission. A final report is then prepared, with recommendations. No attempt is made to assess transparency practices across central banks.

To date, seven reviews have been conducted; the Bank of Canada was the first central bank in an advanced economy to be reviewed. The final report (International Monetary Fund, 2022b) recommends that the Bank document its deliberations, publish a summary, and provide risk scenarios. The Bank responded to the report in Bank of Canada (2022) and recently published its first summary and agreed to provide risk scenarios on an as-needed basis.

Several studies have used this taxonomy to construct indices of central bank transparency for the conduct of monetary policy. The most recent and comprehensive is by Dincer, Eichengreen, and Geraats (2022), who apply their constructed index to a large set of 112 central banks from 1998 to 2019. They divide this sample of central banks into four country groups: high income, upper-middle income, lower-middle income, and low income. Their main finding, which is corroborated in other studies, is that monetary policy transparency has increased over time across all four groups for the reasons explained earlier (figure 2). Although no comprehensive study starts with a sample before 1998, one would expect that this upward trend began earlier, especially in high-income countries. The increase in transparency is most pronounced for central banks in the three upper-income groups, while transparency in the low-income group has lagged.

**Figure 2: Monetary Policy Transparency Index,
by Level of Economic Development, 1998–2019**
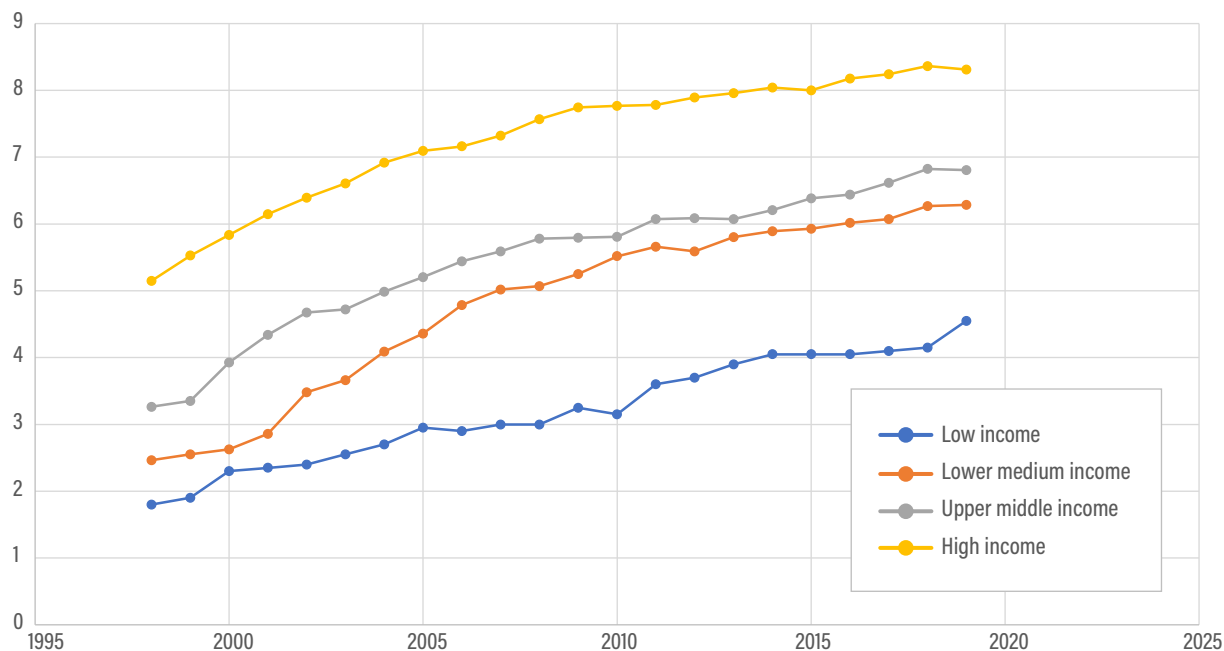
Source: Dincer, Eichengreen, and Geraats (2022)

To understand these trends better, the authors recut their sample of central banks by their monetary policy framework, again into four groups: inflation targeters, exchange-rate targeters, monetary aggregate targeters, and others (figure 3). Inflation targeters show by far and away the largest increase in monetary policy transparency over the sample, in contrast to exchange-rate targeters, which show the least increase in transparency. Certain factors help explain the difference.

The first is the high degree of secrecy concerning monetary policy when countries operated under a fixed exchange rate system such as Bretton Woods. Under such a system, central banks and other authorities had a strong incentive to withhold information to pre-empt market speculation against a devaluation of the exchange rate, which the central bank might not have been able to lean against and thus could become self-fulfilling. This reasoning will have carried over largely to exchange-rate targeters in recent decades, but the extent likely depended on the hardness of the fixed exchange rate. For jurisdictions such as Hong Kong and Denmark, with very hard fixed exchange rates, the primary aim of their macro-economic policies was to maintain the fixed rate. Other economies, however, typically an emerging market or developing economy, might not have had the policy discipline to maintain a fixed rate (e.g., Mexico prior to 1995), and thus would have been more vulnerable to speculative pressure. In contrast, countries with an inflation-targeting framework normally would also have had a flexible market-determined exchange rate, so that the incentive to be opaque would have been

Figure 3: Transparency Index, by Monetary Policy Framework, 1998–2019

Legend:
- Exchange rate targeters
- Monetary aggregate targeters
- Inflation targeters
- Other
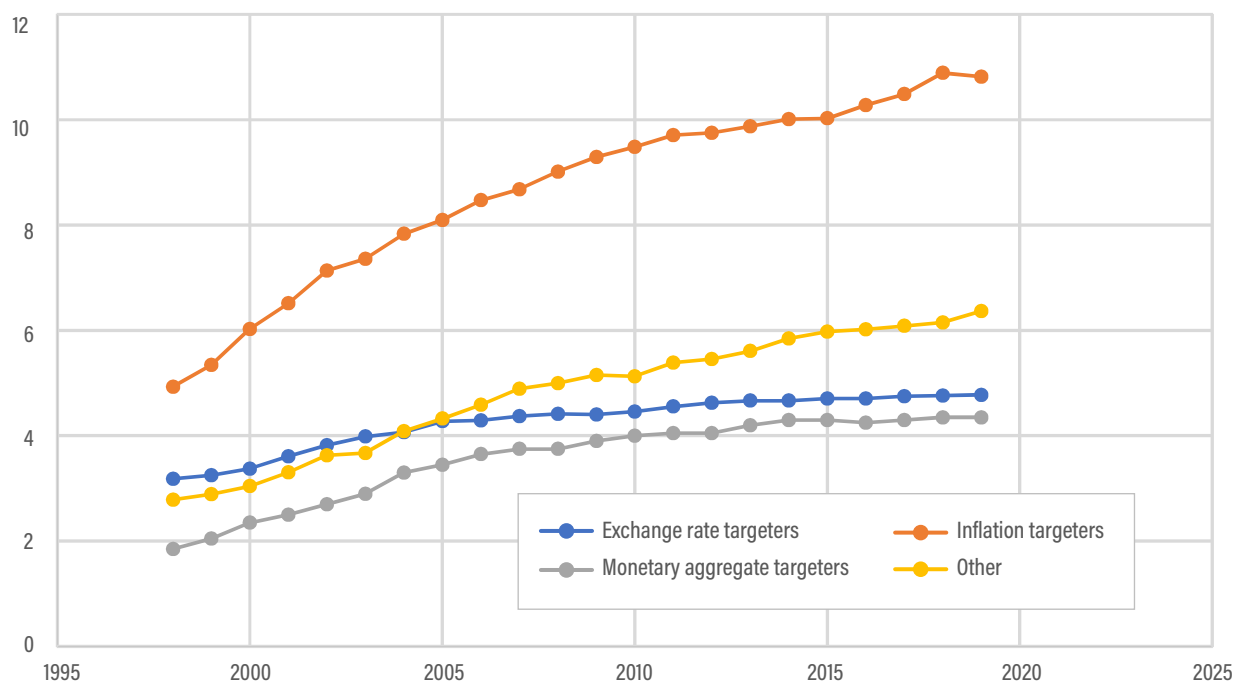
Source: Dincer, Eichengreen, and Geraats (2022)

less, as the there was no opportunity for self-fulfilling one-sided bets to attract market speculation.

The second important consideration is that the adoption of an inflation target facilitated central bank accountability and communications. The monetary policy objective was clear and quantitative, with a specific inflation-rate target, and the narrative was straightforward, as deviations from the target needed to be explained. This increased accountability to the public, in turn, spurred reforms to monetary policy governance, chiefly more central bank independence.

The difference in transparency between central banks in higher-income versus those in lower-income jurisdictions reflects the fact that many more high- and upper-middle-income countries were inflation targeters, while central banks in lower-income countries were not. Indeed, the twelve most transparent central banks in the Dincer, Eichengreen, and Geraats (2022) sample from 2019 were all inflation targeters.[15] The study also finds that, while all aspects of transparency

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15 The Dincer, Eichengreen, and Geraats transparency index ranks countries on a scale of 1 to 15, with 15 representing high transparency. The top 2019 rankings are Sweden (14.5); Czech Republic, United Kingdom, Chile, Norway, Hungary, European Monetary Union, Iceland, Japan, South Korea, and South Africa (all at 12). This index builds on work by Al-Mashat et al. (2018), Haworth et al. (2020), and Fornero et al. (2020), which applied such an index to the central banks of the Czech Republic, New Zealand, and Chile, respectively.

improved over the sample on average, economic transparency (provision of information about data, models, and forecasts) and policy transparency (the explanation of policy strategies and decisions and of the use of monetary policy instruments) increased the most. Clearly this was the consequence of central banks' releasing more information to the public to answer questions about the conduct of monetary policy.

A study by Kostanyan, Laxton, and Romero (2022) also starts with the Geraats taxonomy to construct an index tailored specifically for a sample of 16 inflation-targeting central banks. This index, however, is much more granular than that used by Dincer, Eichengreen, and Geraats to highlight important differences in communications practices and transparency across this group of central banks. Because the Dincer, Eichengreen, and Geraats index was constructed for a large sample of countries, inflation-targeting central banks normally received almost full marks; hence, there is very little differentiation among them and less identification of best practices within this group. Kostanyan, Laxton, and Romero, in contrast, divide their sample of 16 central banks into groups: those that practice a rigorous systematic approach to forecasting and policy analysis (FPAS) and those that use a more discretionary approach. While both groups of central banks have an explicit inflation target, the key difference is *how* they achieve this objective. A critical aspect is that FPAS central banks incorporate an endogenous path for their policy instruments into their economic forecasts for output growth and inflation, and the most transparent in this group publish this projected policy rate path.

The Kostanyan, Laxton, and Romero approach streamlines the Geraats (2002) taxonomy into three core categories:

- Transparency of monetary policy objectives, with inflation being the primary objective and if specified as a numerical point target.
- Transparency of the forecasting and policy analysis system through the publication of all inputs (data, the quarterly projection model),[16] and all outputs, including the projections of output growth, inflation, and the policy rate path, the regular use and release of alternative risk scenarios in addition to the base case to highlight the degree of uncertainty, and explanations of revisions to the quarterly projections.

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16 Typically, these projection models are those used by central bank staff to provide economic scenarios and policy recommendations to the monetary policy committee. They would also include an estimate of the central bank's reaction function based on historical data that relate the policy rate to target variables, such as the deviation of current inflation from the target and the output gap and the deviation of actual output from potential output. Such reaction functions are similar in spirit to monetary policy rules such as those developed by Taylor (1993).

- Transparency of the policy process through the publication of the policy decision and a press conference to explain the decision and the key developments behind it; regular meetings with market participants and policy analysts to explain the outlook and related risks and scenarios; the publication of detailed minutes and voting records to explain the thought process, debates, and deliberations; and a regular assessment of forecast performance and the policy framework itself.

The main finding of this approach is that central banks that follow the FPAS approach are more transparent than non-FPAS central banks (figure 4, panels A and B). The top four FPAS central banks are those of Chile, the Czech Republic, Sweden, and New Zealand, while the top four non-FPAS central banks are those of the United Kingdom, the United States, the European Monetary Union, and Australia. The Bank of Canada is not in the top four FPAS central banks because it does not publish the projected policy rate path, minutes or voting records.[17] The Bank of England and the US Federal Reserve are considered non-FPAS central banks primarily because they do not publish economic projections based on an endogenous policy rate path.

In summary, central banks have made significant progress in improving communications and increasing the transparency of their monetary policy—some more than others. Still, there is room to enhance transparency further. Moreover, the frontier for transparency continues to expand as new communications and software technologies allow for even more public access. For example, the use of new social media and layered approaches to monetary policy communications permit central banks to reach a wider audience. In addition, the use of open-source software allows the public to extract data more easily from central bank reports and websites and also to access and use economic projection models. Consequently, central bank analysts and other interested members of the general public can replicate central bank findings and run alternative scenarios to deepen their understanding of the extent of uncertainty and the likely reaction of monetary policy to different outcomes.

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17 A recent study by Jain et al. (2023) compares the content of the summaries of central bank deliberations across nine major central banks to assess their overall transparency. The top three central banks were the Swedish Riksbank, the Bank of England, and the US Federal Reserve: their summaries consisted of detailed minutes that captured different views and included voting records. Central banks that followed a consensus-based approach to decision making all scored much lower.

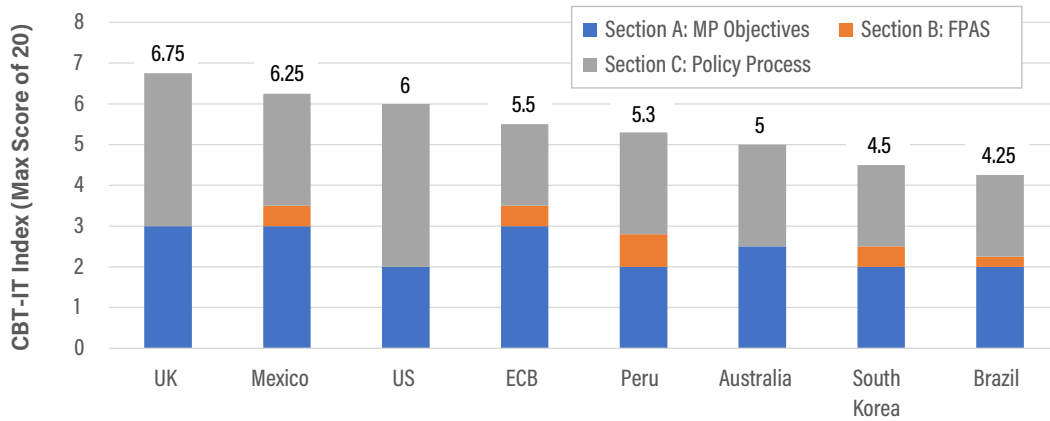**Figure 4a: Monetary Policy Transparency Index, 2021**

Inflation-targeting FPAS central banks
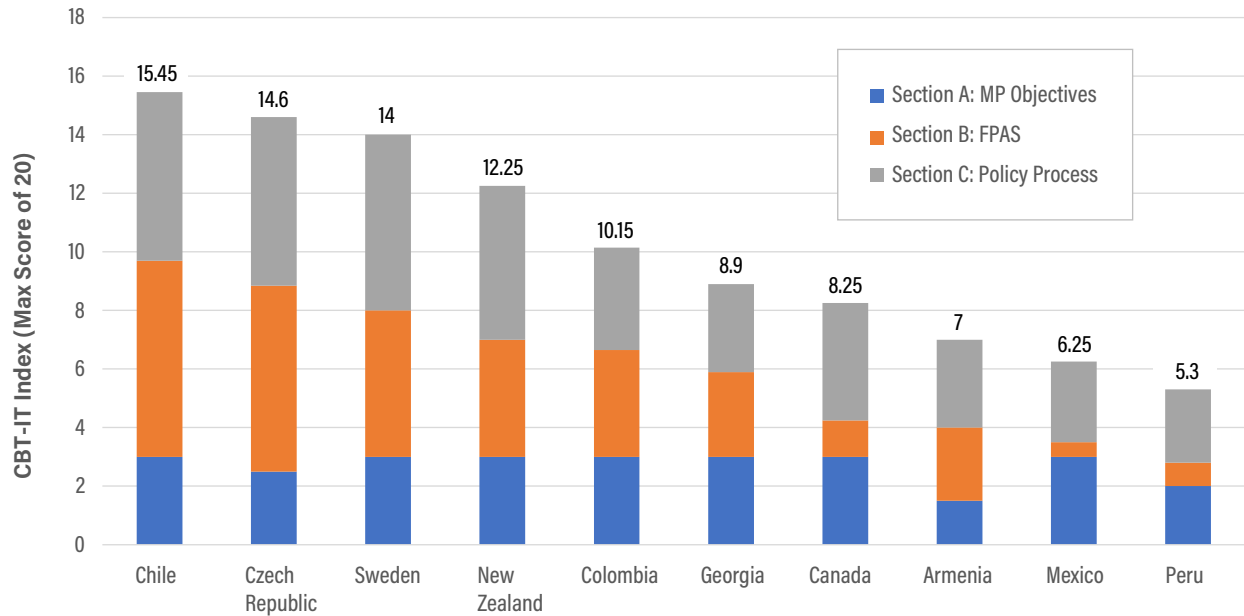
Source: Kostanyan, Laxton, and Romero (2022)

Figure 4b: Monetary Policy Transparency Index, 2021

Inflation-targeting non-FPAS central banks

Source: Kostanyan, Laxton, and Romero (2022)

Limits to Transparency: How Binding?

Increased monetary policy transparency is generally seen as beneficial. This is consistent with the evidence that all central banks have become more transparent over time, and this trend has received broad support from the general public and central bank watchers alike. There are, however, those who argue that there are limits to monetary policy transparency and that, in some instances, central banks might already have gone too far.

Several factors can constrain the extent of transparency or limit the benefits from it. The most important is how monetary policy is governed. Good governance of monetary policy generally works to enhance transparency and its benefits.

Some observers (e.g., Blinder, 2009) feel that best practice is for monetary policy decisions to be taken by a small committee consisting of approximately six to eight members. Some of the members should be full-time senior employees of the central bank (including the governor as committee chair) and some should be external members, with shorter, part-time appointments. All should have individual accountability, and detailed minutes and voting records should be taken and published. Such a structure is seen as most likely to provide diverse, independent thinking that would help counterbalance the influence of the governor and help prevent "group think" and "free riding." Such a governance structure, it is argued, would lead to better decisions and improved communications. It could also offer different perspectives about the economic outlook and monetary policy decisions that would provide a useful sense of the degree of uncertainty surrounding both.

Two caveats to this perspective are worth noting. First, if the committee became very large and many members expressed different views in public speeches or in the minutes, this cacophony of voices could create confusion among market participants and the general public, thereby lessening the benefit of this transparency. Examples of large committees and many voices are the US Federal Reserve's Federal Open Market Committee (19 members, only 12 voting) and the European Central Bank's Governing Council (26 members; only 21 voting). A recent paper by Lustenberger and Rossi (2020) finds that too much communication about monetary policy, measured by the number of central bank speeches, reduces the accuracy of professional forecasts. Larger monetary policy committees typically give more speeches.

Some critics have pointed to the Federal Reserve's policy interest rate "dot plot" as an example of transparency gone too far because the range of policy rate paths can be relatively wide. Thus, it does not add much reliable information, and it could be detrimental by creating noise and confusion, especially since the dots are not based on a single economic projection. This lack of consistency is problematic, but it reflects the governance structure of US monetary policy.

In addition, even if the committee were small, it could become fractious and divided, impairing the decision-making process—as is the case for Sweden's Riksbank, for example, as discussed by Goodfriend and King, 2016). Because of these two concerns, some central banks prefer a consensus-based decision-making process so that all members know that they might have to compromise to achieve a consensus and ultimately speak with one voice.[18] Although such an approach might lead to more efficient decision making and coherent messaging, it generally precludes voting, discourages individual accountability, and limits the provision of different perspectives that would highlight the degree of uncertainty, all of which result in less transparency.[19] Hence, there is an important trade-off between transparency and individual accountability, on the one hand, versus collegial and perhaps more efficient decision making and consistent communications, on the other.

The benefits of transparency can also be influenced by how the information is communicated. In particular, if projections for output growth, inflation, and other important economic variables are presented in a manner that does not convey the degree of uncertainty surrounding the projections, especially given that they are conditional on many maintained assumptions, they could provide false precision and false comfort, leading to undue reliance on them (Morris and Shin, 2002). Various means can be used to convey the uncertainty around such projections: providing ranges around point estimates, including confidence bands, using "thick" paths rather than narrow lines, or presenting alternative scenarios. As Kostanyan, Laxton, and Romero (2022) note, presenting alternative scenarios is seen as a best transparency practice because not only does it highlight the conditionality of the projection and the uncertainty surrounding it; it can also help deepen understanding of the central bank policy response under different circumstances and the nature of its reaction function.

There has been active debate about publishing the projected path of the policy rate that is incorporated into the outlook for economic growth and inflation underlying the policy rate decision. Some observers have argued that such a path could be misunderstood by market participants and the general public, as it would be perceived as a commitment (Goodhart, 2001). Another criticism is that it would be difficult for monetary policy committee members to come to agreement on such a path (Goodfriend and King, 2016; Mishkin, 2004). Consequently, while some central banks publish the projected path for the policy rate, others

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18 The Reserve Bank of Australia and the Reserve Bank of New Zealand have monetary policy committees with consensus-based decision making. At the Bank of Canada, while the governor is still legally responsible for monetary policy, its Governing Council also operates on a consensus basis.

19 Warsh (2014) argues that too much transparency about the deliberations of the monetary policy committee could hinder frank and open dialogue and result in poor policy decisions. Most central banks do not release verbatim transcripts and those that do, such as the US Federal Reserve, only do so with a long lag of five years.

project an economic outlook using a flat profile for the policy rate at the current level, while still others use the market interest rate or simply do not reveal the path.

Although these criticisms have some validity, they can be managed in different ways. For example, the Reserve Bank of New Zealand and Sweden's Riksbank, among the first to publish the projected policy rate path, make an extra effort to explain the path's conditionality. Their experience was that market participants quickly adjust to the release of the projected path and have learned not to treat it as a central bank commitment.

The advantage of publishing the projected path of the central bank policy rate is that it is a transparent means of communicating the overall stance of monetary policy because it depends not only on the policy rate today, but also on the future path, since both will influence market short- and medium-term rates. Such a path is also consistent with the economic outlook that drives the bank's decision because monetary policy operates with an estimated lag of six to eight quarters.

Publishing the projected policy rate path also forces the central bank to explain changes in the path based on new data and economic analysis. It is an important accountability device that demands rigorous, clear thinking and communications. If done well, this accountability exercise boosts the public's understanding of monetary policy decisions, as well as the credibility of the central bank.

To realize more fully the benefits of transparency, new technologies can be used to communicate the key aspects of the central bank's economic outlook and its policy decision to different audiences. To this end, central banks have adopted a variety of communications vehicles to increase accessibility. Some, such as the Bank of England, have adopted layered approaches to their published materials that go from simple graphics and narratives to more technical analysis. Many central banks, such as the Bank of Canada (2021c) and the Federal Reserve Bank of New York (2023), use surveys, focus groups, or targeted conferences to reach out to underserved communities. Some also use various forms of social media to communicate to a broader audience, and are taking advantage of open-source technologies to provide access to their projection models and economic data.

Another important aspect of transparency is the source of the information. Typically, information provided for the conduct of monetary policy is seen as carrying more weight if it comes from the decision-making body, the monetary policy committee, rather than from central bank staff. The division of labour in most central banks, however, is that staff provides the projections for the base case and risk scenarios under the supervision of the monetary policy committee, while the committee makes and explains the policy decision. Logistically, it is challenging for the committee to take full responsibility for all the information provided, especially given the strict confidentiality of the decision-making process. How this logistical issue is managed varies greatly across central banks, and even the most transparent central banks, such as the Czech National Bank, designate some of the

relevant information—namely, the projected economic outlook and the policy rate trajectory—as coming from staff rather than from the committee.

In summary, monetary policy transparency has proven to be beneficial in deepening the public's understanding and expectations of monetary policy decision making, thereby rendering monetary policy more effective in achieving low and stable inflation. Nonetheless, the benefits of transparency can be limited or reduced by how monetary policy is governed and how it is communicated. Governance reforms, where possible, and new approaches to communications can reduce these constraints and take better advantage of the benefits of increased monetary policy transparency.

Lessons for Fiscal Transparency

Although to this point the paper has focused on central bank transparency—specifically, the transparency of monetary policy—useful lessons from this experience can be drawn for fiscal authorities and other public agencies. In particular, enhanced transparency about policy objectives, strategy, and tools would deepen the public's understanding and increase the credibility of fiscal policy, leading to better policy outcomes.

For this purpose, the IMF developed a *Fiscal Transparency Code* and undertakes regular assessments of countries' compliance with the code.[20] The code is based on four pillars: fiscal reporting, fiscal forecasting and budgeting, fiscal risk analysis and management, and resource revenue management. An IMF study of its 186 member countries over the period 2003–13 (Wang et al., 2015) finds some evidence of gradual improvement in transparency, but most countries' reporting remained far from comprehensive. Similarly, the International Budget Partnership conducts an annual *Open Budget Survey* of 120 countries, and its most recent report (2021) concludes that no country has adequate systems in place across all three of the fundamental metrics of accountability: public participation, oversight, and transparency.

These findings suggest that fiscal authorities have much room to improve and are, perhaps, where central banks were decades ago in terms of the opaqueness surrounding objectives, instruments, and their effectiveness, the process of formulating and implementing policy, and their economic and budget projections and risk management. A prominent issue is the adoption and implementation of fiscal rules, which would provide greater clarity about overall fiscal strategy. Fiscal rules constrain fiscal policy through numerical limits on broad-based budget aggregates such as government spending, government deficits, and the ratio of government debt to GDP. Most countries have multiple fiscal rules covering different budget components to achieve fiscal objectives. The most common combinations are a debt ceiling or debt anchor supported by other rules, such as targeting a balanced budget over the economic cycle (see Davoodi et al., 2022).

A key trend and a source of weakness in the effectiveness of fiscal rules, however, has been that fiscal authorities often deviate markedly from their own rules. This rising use of discretion includes the invocation of so-called escape clauses after significant economic shocks such as the Global Financial Crisis and the COVID-19 pandemic. These shocks led many fiscal authorities to suspend fiscal rules, which, in turn, allowed them to undertake different forms of extraordinary

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20 Based on the 2014 version of the Fiscal Transparency Code, the IMF has not evaluated Canada.

fiscal stimulus. Persistent deviations from fiscal rules, however, undermine their credibility. In comparison, the central banks of the major economies had achieved a long period of low and stable inflation, which enhanced the credibility of their transparent inflation targets and contributed positively to overall economic performance.

It might be argued that escape clauses and other discretionary measures enable fiscal authorities to manage economic cycles more effectively and, in particular, to respond more vigorously to demand-side shocks. Mintz (2020) disputes this assertion, however, and argues that the expansionary effect of deficit spending typically is offset by households and businesses consuming less and saving more to pay for future taxes. He further argues that statutory fiscal rules—whether embedded in the Constitution or in legislation—would improve long-run economic growth, whereas fiscal rules relying only on political commitment do not positively influence economic growth. Weak commitment to specific fiscal rules contrasts with the commitment of central banks to enduring inflation-targeting rules.

Mintz (2020) notes that Canada has only had fiscal rules that rely on economic growth. For example, Justin Trudeau 's government was elected in 2015 on a promise to hold federal government deficits to $10 billion per year. But as government spending grew, this fiscal target was abandoned in favour of reducing debt as a proportion of GDP. This target has also proved elusive, as the federal government debt-to-GDP ratio rose from 31.2 percent before the pandemic to 45.2 percent in fiscal year 2021/22 and is projected to slow gradually to 38.1 percent by fiscal year 2027/28 (Office of the Parliamentary Budget Officer, 2022). In terms of transparency, the Parliamentary Budget Officer wrote: "Canada continues to fall short of the standard for advanced practice in the International Monetary Fund's financial reporting guidelines" (2022: 1). The IMF, in its Article IV review of Canada, said "the fiscal framework could be better anchored with a specific debt target supported by an operational rule. Separately, rules-based fiscal stimulus could be a useful addition to the toolkit for dealing with future downturns" (International Monetary Fund, 2022a: 6). In contrast, having a simple and clear inflation target for monetary policy has helped the Bank of Canada achieve low and stable consumer price index inflation, which has averaged just below 2 percent over the thirty years prior to the pandemic (Bank of Canada, 2021b).

Given that well-managed fiscal policy is critical and likely more important than monetary policy for maintaining strong and sustainable economic growth, weak fiscal transparency creates significant uncertainty about the economic outlook, along with substantial economic costs. In particular, concern about the sustainability of the government's fiscal position generates uncertainty about future tax rates and hinders investment decisions by firms and households, thereby reducing productivity and economic growth and causing living standards to be lower than would otherwise be the case.

In Canada, fiscal uncertainty has increased owing to large and persistent government deficits. The fiscal position has gone from a balanced budget in fiscal year 2014/15 to a deficit of 3.6 percent of GDP in 2021/22, which is projected to decline gradually to 0.3 percent of GDP in 2027/28. This represents more than a decade of non-stop deficit spending over at least two complete business cycles. Because investment decisions are forward looking, the elevated fiscal uncertainty arguably has discouraged capital investment, thereby contributing to weak labour productivity growth and stagnant income per capita levels over the past decade.

A fiscal position that is potentially unsustainable can also undermine the independence of the central bank and the credibility of its inflation target. Such a situation increases the likelihood of fiscal dominance, whereby government expenditures are financed by money creation, with the resulting inflation reducing the real value of outstanding public debt. Public expectations of fiscal dominance can themselves contribute to or exacerbate inflation. Brunnermeier (2023) explains that the likelihood of fiscal dominance has increased because the rapid rise in interest rates has raised the cost of servicing the public debt that was incurred during the pandemic. For this reason, Mintz (2020) recommends the use of a statutory fiscal rule along with monitoring by an independent agency.

Dahlby and Ferede (2023) note that, prior to the pandemic, the federal government's fiscal anchor was to maintain the debt-to-GDP ratio at 30 percent. But with federal borrowing to finance the massive increase in pandemic-related spending, the ratio shot up to 47.5 percent in 2021. Rather than adopt the fiscal restraint necessary to restore the debt-to-GDP ratio to its 30 percent target, the federal government embraced a new fiscal anchor: reduce the debt-to-GDP ratio over the medium term with no explicit target ratio or timetable. Although the federal government has projected a steadily declining debt-to-GDP ratio over the next 45 years, the projection assumes a constant real economic growth rate of 1.6 percent per year. Dahlby and Ferede question the reasonableness of the growth assumption, given historical experience—particularly the likelihood that the Canadian economy will experience one or more recessions in the coming decades. They also criticize the federal government's failure to report in a transparent manner how significant economic downturns might affect the projected debt-to-GDP path. In short, the absence of a credible fiscal anchor and the failure to report the economic contingencies surrounding fiscal projections add unneeded uncertainty to the government's macroeconomic outlook, making financial planning by Canadian businesses and households even more difficult.

In addition, countercyclical fiscal policy—for example, increasing transfers and spending during an economic downturn—is typically conducted in Canada on a discretionary basis. As we noted, however, the International Monetary Fund (2022b) has argued that Canada should instead adopt a rules-based approach, which would rely more heavily on automatic fiscal stabilisers, such as unemployment insurance. A number of economists have made the case that the effectiveness

of such automatic stabilizers should be strengthened so that governments could rely less on discretionary policy that is relatively non-transparent and more difficult to predict.[21] In Canada, the Employment Insurance Program is under review to render it simpler, more responsive to economic conditions, and more effective (IRPP, 2022).

In summary, economic outcomes would improve if fiscal policy followed the experience of monetary policy in Canada and in other major economies and became more transparent. In this regard, fiscal policy would benefit from having clearer objectives, explicit targets, well-understood operational rules or strategies, and a deeper understanding of the effectiveness of various fiscal policy tools.

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21 See for example Blanchard et al. (2010), Fuss and Palacios (2019), and Maravalle and Rawdanowicz (2020).

Concluding Remarks

The dramatic increase in the transparency of central banks' monetary policy over the past half-century has not only transformed these institutions by making them more open and accountable; more important, it has also improved the effectiveness of monetary policy and contributed directly to the achievement of the primary goal of price stability. The gains in transparency have been led by jurisdictions that adopted inflation targeting, which also entailed important governance changes, including a clearer specification of the objectives of monetary policy—namely, an explicit inflation target—and the operational independence of the central bank. These reforms have constrained discretion, increased accountability, and rendered monetary policy more credible. Consequently, the multifaceted improvements in transparency and governance have had far-reaching effects. In particular, they have strengthened the effectiveness of monetary policy and contributed to the achievement of low and stable inflation over the three decades prior to the COVID-19 pandemic. While there are valid criticisms of monetary policy transparency, they largely stem from the monetary policy governance structures of individual central banks, and do not come close to offsetting the large benefits in terms of the low-inflation outcomes that have been achieved.

Although the transparency of monetary policy has generally increased over time, there are still opportunities for many central banks to go further and adopt widely accepted best practices. Moreover, the frontier of transparency is continuing to expand with innovations in technology and communications. So, even central banks that are seen as leaders in monetary policy transparency cannot simply rest on their laurels, but must continue to do research and to innovate to take advantage of these new technologies. Moreover, the experience of the pandemic has posed new challenges for central banks and the transparency of monetary policy. Quantitative easing was one tool widely used during the pandemic to provide additional monetary stimulus at the effective lower bound. This not only created the perception that monetary policy was helping to finance government spending, but it also increased financial vulnerabilities and financial stability risks. The scope of monetary policy transparency should expand to address these new considerations. In particular, central banks need to be more forthcoming about the efficacy of their new tools and the potential consequences for fiscal outcomes and for financial stability.

In response to the pandemic shock, fiscal authorities in Canada and in other major economies implemented immense fiscal spending programs to support businesses and households, thereby driving levels of public debt to post–World War II highs. At the same time, central banks have responded to high inflation by dramatically raising interest rates, thereby greatly increasing the cost of servicing

the higher levels of public debt and raising the spectre of fiscal dominance. To combat this perception, fiscal authorities should draw important lessons from the experience of central banks. Fiscal policy should become more transparent by adopting more explicit objectives, statutory fiscal rules, and independent reviews of fiscal outlooks. Moreover, if both central banks and fiscal authorities were to become more transparent about their objectives and policies, policy conflicts could be better avoided and improved economic outcomes achieved.

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