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Staff Memo

Comparing monetary policy transparency. The Eijffinger and Geraats index - a comment

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Comparing Monetary Policy Transparency The Eijffinger and Geraats Index – a Comment

By Carl Andreas Claussen¹

Introduction

There is by now a large volume of literature on central bank transparency and communication. One branch of this literature compares transparency across central banks and over time. Recent contributions in this vein are Eijffinger and Geraats (2006), Dincer and Eichengreen (2007), and Geraats (2008), who all use an index developed by Eijffinger and Geraats (2006).²

In this note I argue that the index can be very misleading. The argument is illustrated by the case of Norway, which has received a relatively low score on the index.

The Index

The Eijffinger and Geraats index is based on Geraats' (2002) conceptual framework for transparency. Her framework reflects the different stages of the decision-making process and distinguishes five *aspects* of transparency:

1. *Political transparency*: Transparency regarding objectives for monetary policy.
2. *Economic transparency*: Transparency regarding the economic information used for monetary policy.
3. *Procedural transparency*: Transparency regarding the way monetary policy decisions are made.
4. *Policy transparency*: Transparency regarding policy decisions.
5. *Operational transparency*: Transparency regarding the effects of monetary policy and unanticipated disturbances.

In the index, there are three explicit questions for each aspect. For each question countries receive a score of 0 or 1 (6 questions), or 0, ½, or 1 (9 questions), depending on whether they satisfy certain criteria. Box 1 gives the questions, criteria and scores under aspects 2 and 4. For all questions, see the appendix in Dincer and Eichengreen (2007). The total index score is the unweighted sum of the five sub indexes. Thus, the index has a maximum score of 15.

Why the index can be (very) misleading

Crude scores. Consider question 4c. Here a country that discloses an explicit policy inclination every quarter scores 1, while a country that does so 3 times a year scores 0. This blows up the difference between countries that release policy inclinations 3 and countries that do so 4 times a year. Similarly, it reduces the difference between countries that never release policy inclinations and countries that do so 3 times a year. The same problem arises for other questions, for instance questions 2a and 2c. Since many countries publish policy inclinations and forecasts for key economic variables in monetary policy reports or inflation reports, the overall score will depend very much on whether the report is published 3 or 4 times a year (see the example of Norway below). It is clearly arguable whether publishing the report 3 or 4 times a year matters much for transparency.

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² For an overview of earlier contributions and contributions using different frameworks and different indexes, see Dincer and Eichengreen (2007).

In the same manner, the crude scale has the effect that major changes in transparency for a country are not captured or are exaggerated. For instance, if a central bank that says nothing about its policy inclinations starts publishing interest rate forecasts three times a year, this change will not be captured by the index. If a central bank that publishes its policy inclinations three times a year starts publishing policy inclinations each quarter, the index will measure this as a major change.

No weighting. Assigning equal weight to all the questions does not take into account that some aspects are more important for transparency than others. For instance, having a formal statement of the objective(s) for monetary policy is in the index considered equally important as making the model(s) public. The same problem arises for other aspects and questions. Thus, two countries that have the same score may in fact not be equally transparent, and a country with a lower score may in fact be more transparent than a country with a higher score. The same problem could potentially arise when comparing developments in one country over time. The problem may be limited by the fact that countries tend to implement the most important transparency reforms first, however.

An example: Norway

If we look at the overall index score in Dincer and Eichengreen (2007), Norway receives a total score of 8 in 2005, with Norway ranking fifteenth in the index.

Table 1. EG index score 2005
for countries with highest scores
and for Japan, the US and Norway.

Country	Score
New Zealand	13.5
Sweden	13
UK	12
Czech Republic	11.5
Canada	10.5
Euro area	10.5
Philippines	10
Japan	9.5
US	7.5
Norway	8

Source: Dincer and Eichengren (2007)

The authors have kindly provided us with the scores on the different questions for Norway for 2005. These reveal that Norway falls behind in transparency because

- (i) Norges Bank did not have quarterly releases of capacity utilization, inflation and GDP forecasts, and its assessment of macroeconomic disturbances,
- (ii) because there were no minutes and voting records from the monetary policy meetings of the executive board of Norges Bank, and
- (iii) because the bank's formal models for policy analysis were not publically available.

In 2005 Norges Bank published its inflation report 3 times a year. The report contained the bank's measure of capacity utilization, inflation and GDP forecasts, and the bank's

assessment of macroeconomic disturbances. Furthermore, it contained a forecast for the interest rate (policy inclination). If the report instead of being published three times a year was published each quarter Norway would receive an additional 2.5 points and receive a total score of 10.5, giving Norway a ranking of fifth in the index (see Table 1).

It is not correct that Norges Bank's formal models for policy analysis were not publically available in 2005. Norges Bank's main model was disclosed on the web already in 2004. Correcting for this, Norway receive an additional point and receive a total score of 11.5, with Norway ranking joint fourth with the Czech Republic.

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