

Let the Sun Shine In!

Policy Transparency Improves Economic Outcomes

The Experience of Monetary Policy with Lessons for Fiscal Policy

By Steven Globerman and Lawrence L. Schembri

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

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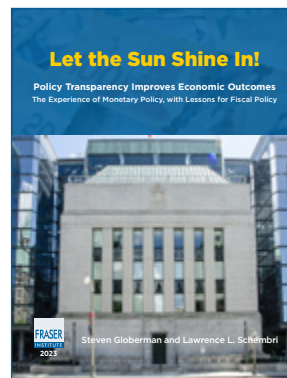
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in Canada and other major economies should draw important lessons from the experience of central banks for the conduct of fiscal policy, especially in light of the massive increase in government spending and public debt levels during the pandemic. 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.

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