

## RESEARCH BRIEF

# Effective Policy Communication: Targets versus Instruments

*Based on BFI Working Paper 2020-148, “[Effective Policy Communication: Targets versus Instruments](#),” by Francesco D’Acunto, Assistant Professor, Boston College; Daniel Hoang, Assistant Professor, Karlsruhe Institute of Technology; Maritta Paloviita, Senior Adviser, Bank of Finland; and Michael Weber, Associate Professor, Chicago Booth*

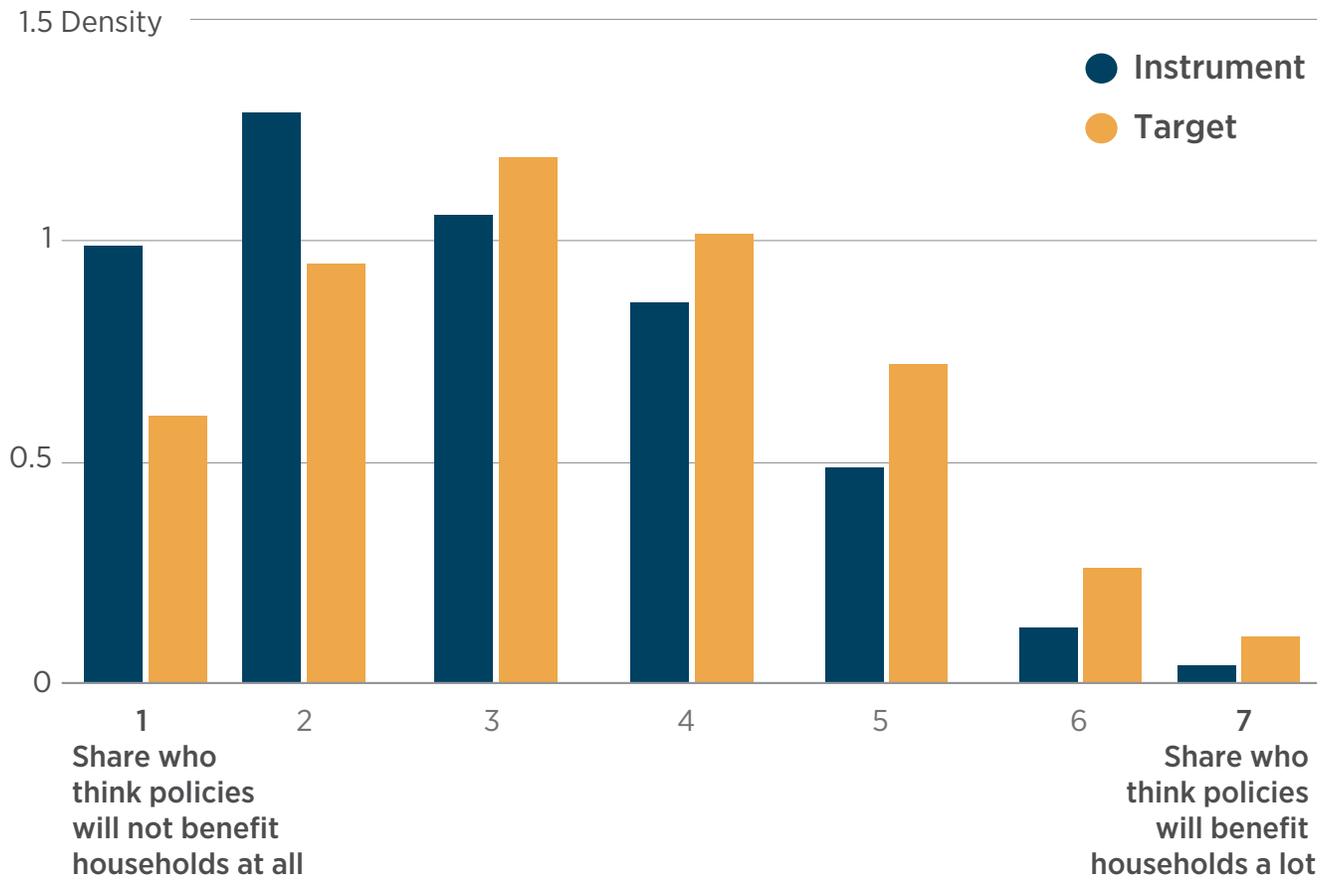
### KEY TAKEAWAYS

- ✓ With interest hovering near zero for lengthy periods, central bankers need other tools to influence economic activity.
- ✓ One way that central bankers hope to achieve their policy goals is through communication.
- ✓ New research reveals that target communications are more effective than instrument communications in effectively conveying policy goals.
- ✓ Importantly, these positive results hold for people regardless of cognitive ability.

In recent decades, and especially since the Great Recession, interest rates have remained very low, meaning that central banks have had to devise new ways to invigorate the economy in times of recession. In some cases, like quantitative easing, whereby central banks purchase long-term securities in the open market to increase the money supply and encourage lending and investment, these new tools are deemed unconventional.

However, one of the unconventional tools increasingly used by central banks sounds decidedly conventional to most people: communication. In other words, by stating its goals clearly and consistently to, for example, maintain monetary policy that is geared toward growth, central banks could convince households and businesses to invest, borrow, and spend. In this case, communication could have a similar effect as lowering interest rates.

**Figure 1** • How Much will Policies Benefit Households? Target versus Instrument Communication



Note: This figure plots the shares of respondents who think that policies will not benefit households at all (1), will benefit households a lot (7), or expectations in between these extremes, separately for respondents randomly exposed to target and instrument communications. Target communication was a tweet by Bank of Finland Governor Olli Rehn that the “The European Central Bank will do whatever is necessary to minimize the financial damage to citizens caused by the corona crisis.” Instrument communication was a tweet by Bank of Finland Governor Olli Rehn that the “New Euro 750 billion Pandemic Emergency Programme (PEPP) launched by the European Central Bank.” The authors measured normalized IQ using data from the official military entrance exam in Finland. The authors elicited whether policies benefit households on a seven-point Likert scale with 7 being policies benefit households extremely. The authors fielded the survey in June 2020.

It turns out, though, that communication is not as easy as it sounds. Central banks around the world have struggled to craft communication that is understood by investors and households alike, and that ultimately achieves the bank’s goals. In their new paper, “Effective Policy Communication: Targets versus Instruments,” Francesco D’Acunto, Daniel Hoang, Maritta Paloviita, and Michael Weber, investigate the effectiveness of central bank communication with households that have varying levels of financial and economic sophistication. The authors’ findings, which reveal that central bank communication is more effective when it focuses on policy targets rather than on the instruments that attain those targets, offer important insights for monetary policymakers.

### Whatever it takes to communicate clearly

Perhaps no better example of effective target communication is a 2012 speech by Mario Draghi in the wake of the Great Recession, when the then-president of the European Central Bank said that the ECB would do “whatever it takes to preserve the euro. And believe me, it will be enough.”<sup>1</sup> So popular was the “whatever it takes” refrain that it has been used by leaders around the world to address the COVID-19 pandemic. The message is clear while at the same time ambiguous on exactly what form the “it” of the policy will take. If the institution has the trust of the people to whom it is directed, such communication is presumably effective.

<sup>1</sup>[ecb.europa.eu/press/key/date/2012/html/sp120726.en.html](https://www.ecb.europa.eu/press/key/date/2012/html/sp120726.en.html)

The respondents were asked to consider to what degree their income would be impacted by each announced policy. The difference is striking. Target communication increases average monthly gross income expectations between EUR 70 and EUR 80 relative to a group that did not receive any relevant information.

For the authors, this is a testable hypothesis, and they designed a randomized experiment involving Finnish men with various demographic characteristics, including a test-based measure of cognitive abilities, to gauge the effectiveness of different types of communication. In their experiment, these men read policy statements from the same medium and the same source—the official twitter account of the Governor of the Bank of Finland, Dr. Olli Rehn. What varied was the tweets that the subjects read (which were actual tweets from Rehn’s account), and which consisted of target- or instrument-based policy communication. The target communication, which was tweeted on March 20, 2020, stated:

*“The European Central Bank will do whatever is necessary to minimize the financial damage to citizens caused by the corona crisis.”*

The instrument communication, which was tweeted two days earlier, said the following:

*“New EUR750 billion Pandemic Emergency Programme (PEPP) launched by the European Central Bank.”*

Survey respondents answered to what degree they thought the policy as described in the tweets would benefit the economy. As Figure 1 reveals, respondents exposed to target communication were more likely to believe that ECB policies would benefit households rather than those exposed to instrument communications.

To quantify this response vis a vis household income, the respondents were asked to consider to what degree their income would be impacted by each announced policy. The difference is striking. Target communication increases average monthly gross income expectations between EUR 70 and EUR 80 relative to a control group that did not receive any information. Instrument communication had no statistical effect on households’ income expectations. Target communication proved not only effective but efficient as such communication is essentially costless: It doesn’t take that much to tweet. Compare this effect with such fiscal policy measures as the “80-Euro tax bonus” introduced in Italy in 2014, which cost about EUR 9.5 billion per year.

However, are all households equal in their ability to understand central bank communications? This question matters because it makes little sense for central banks to carefully curate their messages if the same sophisticated households are the ones who benefit while the rest still have little understanding of policy. To probe this question, the authors employed data from the Finnish Defense Forces (FDF), which measure the cognitive abilities through entry-week tests during compulsory military service. The authors find that for men with below median levels of IQ, target communication increases income expectations by more than EUR 90 per month, which is 38 percent higher than the effect that they estimated for subjects with above median IQ. The effect increases to EUR 160 when conditioning on observables that plausibly correlate with IQ. In this case, the effect is about three times as large as the conditional treatment effect for high-IQ men.

Ultimately, target communication is not only more effective than instrument communication in managing the expectations of the average consumer, but it helps especially with managing the expectations of the least sophisticated groups in the population. The authors investigated a number of different questions relative to household cognition that are described in the full paper and that reaffirm value of target communication to reach lower-cognition households.

## Conclusion

Former Federal Reserve Chairman Alan Greenspan once gave a speech where he stated: "I spend a substantial amount of my time endeavoring to fend off questions and worry terribly that I might end up being too clear."<sup>2</sup> The line got a laugh, but it wasn't obvious to listeners that Greenspan was joking. For contemporary central bankers, communication is certainly no laughing matter as they have incorporated communication into their monetary policy toolkit.

This new research not only confirms the value of clear communication, but communication that describes policy targets (the "what" and "why" of policy) rather than policy instruments (the "what" and "how" of policy). The good news here for policymakers is that monetary policy communication can help central banks manage ordinary households' expectations, especially the expectations of the least sophisticated and unaware households, as long as such communication focuses on policy targets.

This isn't the last word on this line of research, according to the authors, as more work is needed to parse the effectiveness of certain communications on different groups, and on the effectiveness of various types of media, social and otherwise.

<sup>2</sup> [wsj.com/articles/SB112404192550712625](https://www.wsj.com/articles/SB112404192550712625)

## CLOSING TAKEAWAY

Ultimately, target communication is not only more effective than instrument communication in managing the expectations of the average consumer, but it helps especially with managing the expectations of the least sophisticated groups in the population.

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