TRANSPARENCY AND U.S. DOLLAR POLICY

Vice Chairman Jim Saxton (R-NJ)

Joint Economic Committee
United States Congress

July 1999

Executive Summary

The case for a more transparent U.S. dollar policy is compelling. In addition to producing a number of economic benefits, a more transparent policy would complement a growing consensus on the desirability of transparency in the conduct of government policy in general and monetary policy in particular. More open disclosure in dollar policy is long overdue for a number of important reasons. Further, improved transparency would parallel Treasury's requirement to comply with the letter and spirit of the *Government Performance and Results Act*, which mandates a clarification of objectives and clear explanation of operations.

Transparency has multiple dimensions, involving not only the clarification of dollar policy objectives, but also the timely and complete disclosure of policy decisions and their underlying rationale.

Current dollar policy violates conventional transparency guidelines or parameters in a number of ways. Policy objectives are unclear, intervention policy is non-transparent from several perspectives, Treasury and Federal Reserve dollar relations are ambiguous, and Exchange Stabilization Fund (ESF) financing methods are obscure. Further, the ESF is overly secretive and current informational reporting is not nearly as transparent as it could be.

A number of specific recommendations for improving dollar policy transparency include the following:

- Establish clear, understandable dollar policy objectives that are consistent with monetary policy goals.
- Promote clear, understandable procedures for intervention activity.
- Require more transparent dollar policy reporting from institutions charged with foreign exchange management responsibilities.
- Clarify dollar policy responsibilities of Treasury vis-à-vis the Federal Reserve.
- Insist on a more transparent and reformed ESF.
- Establish rigorous oversight procedures for these reforms.

Joint Economic Committee
1537 Longworth House Office Building
Washington, DC 20515
Phone: 202-226-3234
Fax: 202-226-3950

Internet Address:
http://www.house.gov/jec/

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INTRODUCTION

This paper makes the case for a more transparent Treasury Department foreign exchange (dollar) policy. More transparent dollar policy would complement a growing consensus on the desirability for transparency in the conduct of governmental policies in general, and (international) monetary policy in particular. Convincing cases for more transparency on the part of Federal Reserve monetary policy and in IMF operations have already been made.[1]

More transparency in Treasury Department dollar policy dealings is long overdue for a number of reasons:

- It has long been recognized that Treasury dollar policy is overly secretive and non-transparent from a wide variety of perspectives.[2] Some of the rationale for secrecy in foreign exchange dealings is no longer relevant.

- There are a number of important economic benefits to improved transparency in dollar policy.

- With ever-increasing global integration and capital mobility, dollar movements become more important as a factor impacting the open macroeconomy. The foreign exchange rate has become one of the key channels in the transmission of monetary policy and therefore is increasingly integral to the transparency of overall monetary policy.

- The *1993 Government Performance and Results Act* mandates that agencies of the government clarify their objectives and explain their operations. The Treasury Department is subject to the letter and spirit of this law.

- Improved transparency complements congressional oversight. Congressional oversight of dollar policy could be enhanced with more transparent Treasury Department foreign exchange operations. Since Congress delegated authority for dollar policy to the Treasury Department, and because taxpayer funds are

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[1] See, for example, Robert Keleher, "Transparency and Federal Reserve Monetary Policy," Joint Economic Committee, November 1997, and Christopher Frenze and Robert Keleher, "IMF Financing: A Review of the Issues," Joint Economic Committee, March 1998.

[2] See, for example, Anna J. Schwartz, "From Obscurity to Notoriety: A Biography of the Exchange Stabilization Fund," *Journal of Money Credit and Banking*, Volume 29, Number 2, May 1997, pp.135-153. Even Treasury officials themselves have recognized this secrecy. See the testimony of David Mulford, "Review of Treasury Department's Conduct of International Financial Policy," Hearing before the Committee on Banking, Finance and Urban Affairs, U.S. House of Representatives, One Hundred First Congress, Second Session, August 14, 1990, p.62.

involved, Congress has a responsibility and duty to monitor such activity. Improved transparency would help in this effort to promote more accountability.

After delineating both the meaning and importance of transparency, this paper examines various aspects of Treasury international financial or dollar policy from the perspective of transparency. The case is made that there is a good deal of room for more transparent dollar policy. A number of recommendations are made to improve the transparency of such policy.

MEANING OF TRANSPARENCY

Transparency is defined in dictionaries as "easily seen through or detected; obvious, candid or open, clear; free from guile." Transparent dollar policy, therefore, is characterized by a lack of secrecy, obfuscation, or ambiguity, and should be clear, simple, and understandable to those outside the policy process including both ordinary citizens as well as legislators responsible for policy oversight.

The transparency of dollar policy, however, has multiple dimensions. Transparency is relevant for clarifying policy goals as well as identifying policy procedures undertaken to achieve stated goals. Goal clarification can be a most important component of transparent dollar policy since such clarification itself can help to ferret out or identify those procedures best suited to achieve given objectives.

Clear reporting is another important aspect of transparency that also takes on different dimensions. Prompt "real-time" reporting provides visibility of policy action at the time such policy occurs. "Ex ante" transparency occurs when policymakers announce ahead of time what action will be taken under given circumstances (i.e., policy rules are established). "Ex post" transparency explains afterward what policymakers have done.[3]

In short, prompt disclosure of policy objectives, rules, procedures and rationale used in implementing policy, as well as any progress in achieving stated objectives are all important elements of an open dollar policy. Transparent dollar policy, therefore, necessarily involves not only the clarification of dollar objectives, but also the timely and more complete disclosure of policy decisions and their underlying rationale.

NON-TRANSPARENT TREASURY DOLLAR POLICY

The dollar policy of the U.S. Treasury Department violates the above-described transparency guidelines or parameters in a variety of ways. A number of questions, uncertainties, or ambiguities remain in most areas of the Treasury's foreign exchange policy. Problems of non-transparency, for example, characterize the following aspects of dollar policy:

[3] See Charles Enoch, "Transparency in Central Bank Operations in the Foreign Exchange Market," Paper on Policy Analysis and Assessment of the International Monetary Fund, PPAA/98/2 March 1998, p.2.

- ***Ambiguous Policy Objectives.*** One fundamentally important aspect of any transparent policy is an unambiguous, clear, and understandable statement of policy objectives. Yet Treasury's dollar policy objectives remain ambiguous, unclear, and confused, as pointed out by Bordo and Schwartz:

> The principles that guide central bank governors and finance ministers in their choice of exchange rates to support have never been explained.[4]

There are a number of reasons for this ambiguity. For example, over the years there have been significant differences of opinion as to the proper objectives of foreign exchange policy. At times, some Treasury officials have suggested that dollar policy should have trade or current account balance objectives as guidelines to policy. At other times, goals related to economic growth or inflation have found support. A most important barrier to goal transparency has been the propensity to frame foreign exchange policy goals as if they were fully independent of monetary policy. More specifically, given (revealed) preferences for both capital mobility and domestic goals for Federal Reserve monetary policy, the "trilemma" choice facing the U.S. necessarily implies that Treasury Department-influenced exchange rate objectives be subordinate to capital mobility and Federal Reserve objectives such as price stability.[5] Despite this stark reality, such a proper hierarchy of policy objectives involving both Treasury and the Federal Reserve has never been explicitly delineated since the demise of Bretton Woods. A reluctance to clarify these objectives is understandable. In part, it stems from Congress' delegation of separate foreign exchange and monetary policy powers to two distinct, powerful, and turf-conscious organizations, each with differing agendas. The reluctance also stems from the widely held expectation that reform of the international monetary system was inevitable so that any formal policy structure under one regime would have to be disassembled and constructed anew under an alternative regime.

Accordingly, Treasury officials currently go through the motion of voicing a dollar policy as if it were independent of monetary policy. Since dollar policy cannot be independent in this way, such non-transparent posturing results in unnecessary uncertainty, confusion, and market volatility.

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[4] Michael Bordo and Anna J. Schwartz, "What Has Foreign Exchange Market Intervention Since the Plaza Agreement Accomplished?", NBER Working Paper No. 3562, December 1990, p.21.

[5] The limitations that capital mobility impose on monetary policy and exchange rate management are sometimes summarized in the concept of an "inconsistent trinity" or "open-economy trilemma." As Obstfeld explains: "…a country cannot simultaneously maintain fixed exchange rates and an open capital market while pursuing a monetary policy oriented toward domestic goals. Governments may choose only two of the above. If monetary policy is geared toward domestic considerations, either capital mobility or the exchange rate target must go. If fixed exchange rates and integration into the global capital market are the primary desiderata, monetary policy must be subjected to those ends… (In practice), the greater the attention given to the exchange rate, the more constrained monetary policy is in pursuing other objectives." Maurice Obstfeld, "The Global Capital Market: Benefactor of Menace?", Journal of Economic Perspectives, volume 12, Number 4, Fall 1998, pp.14-15.

- ***Non-Transparent Treasury Foreign Exchange Intervention Policy.*** Another non-transparent dimension of Treasury dollar policy relates to foreign exchange intervention procedures or conventions of the Exchange Stabilization Fund (ESF).[6] These foreign exchange operations are non-transparent in a number of ways.

"Appropriate" intervention has not been defined.

"Appropriate" intervention, for example, has never been defined or consistently pursued during the post-1973 floating rate regime. As Broaddus and Goodfriend have argued:

> Officially, the objective of foreign exchange rate operations is to counter "disorderly market conditions," but that phrase has never been defined operationally.[7]

Because objectives have not been defined operationally, it is understandable that intervention has been inconsistently implemented and non-transparent. Nonetheless, this inconsistent intervention results in unnecessary confusion and heightens uncertainties as to when, why, or under what conditions intervention will take place.

Intervention is often secret.

Further, foreign exchange intervention itself is often secret and is sometimes referred to as "unannounced," "stealth," or "discreet" intervention. These operations are not publicly announced so traders can only guess at the size of an official action.[8] This type of intervention is non-transparent by definition. While there may be peculiar situations when secrecy may be called for, such non-transparent activity nonetheless also creates uncertainties and confusion, therefore promoting market volatility.[9,10]

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[6] The Treasury Department has authority for, and normally takes the lead on, deciding when to intervene in the foreign exchange market. While the Federal Reserve participates equally on a financial basis and implements (as an agent) Treasury Department decisions, this paper assumes that ultimate responsibility for decisions relating to foreign exchange operations rests with the Treasury.

[7] J. Alfred Broaddus Jr., and Marvin Goodfriend, "Foreign Exchange Operations and the Federal Reserve," Federal Reserve Bank of Richmond Annual Report 1995, p.12.

[8] Most intervention operations are anonymous. More specifically, as explained in Dominguez and Frankel, "There is no central trading floor and brokers are not obliged to reveal the identity of counterparties." See Kathryn M. Dominguez and Jeffrey A. Frankel, *Does Foreign Exchange Intervention Work?* Institute for International Economies, Washington, D.C., September 1993, p.60.

[9] For an enumeration of the rationale for such secrecy, see Dominguez and Frankel, pp.60-62.

[10] Dominguez showed that secret intervention by both the Federal Reserve and the Bundesbank generally increased exchange rate volatility in the 1980s. See *ibid.*, p.108 and references cited therein.

Intervention is sterilized.

Additionally, U.S. foreign exchange intervention is routinely sterilized by the Federal Reserve. This means, for example, that any money-expanding purchases of foreign exchange is offset ("sterilized") by an equivalent amount of money-contracting (dollar-denominated) security sales so that no net change in reserves, money, or short-term interest rates occurs. Thus, policy fundamentals do not change. Since sterilized intervention does not change fundamentals or the stance of policy, professional economists for the most part believe that sterilized intervention has little lasting effect on foreign exchange markets. A good deal of empirical research supports this position. In other words, sterilized intervention is not the separate policy tool that many purport it to be.

From the perspective of policy openness, therefore, sterilized intervention is certainly not transparent since it promotes the erroneous impression that intervention is an independent policy tool. It appears to identify a goal for policy that policymakers cannot genuinely achieve, thereby misleading the public. This misleading perception promotes further confusion, unnecessary uncertainties, and associated market volatility. It also can undermine the credibility of policymakers.[11]

Any "Signaling Channel" Depends on Non-Transparency.

Recent research in this area suggests that sterilized intervention may work to impact exchange rates through a "signaling" channel. This mechanism works when policymakers convey information about their future policy intentions by intervening in the foreign exchange market.

According to Dominguez and Frankel:

> Through the signaling channel, sterilized intervention can have an effect on exchange rates if it provides the market with relevant information, not known or not fully incorporated in determining the current exchange rate. This channel… relies on the existence of a difference between what is known by the (policy) authority and what is known by market participants.[12]

In short, for this mechanism to work, intervention authorities are assumed to have more (inside) information about future policy moves than the market; they have information that they have withheld from the market. This information about future policy moves is conveyed to the market via foreign exchange intervention. Such

[11] As Broaddus and Goodfriend put it, the spectacle of "failed (sterilized) foreign exchange operations are costly because they give the impression that the authorities are either unable or unwilling to achieve a prominent objective that they appear to be pursuing… Widely publicized policy failures undermine (policymakers) credibility." Broaddus and Goodfriend, *ibid.*, p.17 (parentheses added).

[12] See Dominguez and Frankel, *op. cit*, p.59 (parentheses added).

signaling, then, depends on secrecy or non-transparency on the part of the policy authority. But, as Bordo and Schwartz contend, intervention authorities "need not engage in such a devious way of informing the public of its objectives and the policies it favors to achieve them."[13] This signaling view also means that sterilized intervention is not an independent tool to control foreign exchange rates; it needs the supporting change in policy to be effective.

Non-transparency of Intervention is Revealed in Reporting Discrepancies.

The secrecy or non-transparency of U.S. intervention policy is also revealed in research that documents a significant, systematic difference between actual intervention activity and market-reported intervention activity. This difference -- which is corroborated in a number of research studies -- demonstrates that official reporting of intervention activity is non-transparent: i.e., the market is not receiving all pertinent information about intervention at the time it occurs.[14] In short, this divergence of reported versus actual intervention activity is prima facie evidence of non-transparent intervention policy. It relates not only to reporting delays and secrecy of intervention, but to the vagueness, the poor quality and substance of disclosure that often occurs.

G7 (coordinated) Intervention Activity is also Non-transparent.

Not only is U.S. foreign exchange intervention itself non-transparent, but U.S. participation in G7 or coordinated intervention activity suffers from non-transparency as well. G7 meetings are normally surrounded by an enormous amount of publicity and fanfare that serves to "heighten uncertainty whether the Federal Reserve will support sterilized operations with monetary policy action."[15] Since G7 meetings are dominated by finance ministers, however, discussions tend to be conducted as if foreign exchange intervention policy is independent of monetary policy. G7 discussions are routinely secret and G7 decisions are often informal and vague. G7 communiqués are well-known for their lack of clarity, ambiguity, and obfuscatory language: i.e., these communiqués are not transparent. All of this exacerbates confusion and uncertainty and raises further questions about the objectives of intervention policy.

- ***Ambiguous Treasury and Federal Reserve Dollar Relations.*** In addition to ambiguous policy objectives and non-transparent intervention practices, institutional relations between the Treasury and the Federal Reserve regarding foreign exchange responsibilities are unclear and contradictory in a number of ways. In short, these

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[13] See Bordo and Schwartz, *op. cit*, p.21.

[14] See, for example, William P. Osterberg and Rebecca Wetmore Humes, "The Inaccuracy of Newspaper Reports of U.S. Foreign Exchange Intervention," Economic Review, Federal Reserve Bank of Cleveland, Vol. 29, No. 4, 1993, pp.25-33; and William P. Osterberg and Rebecca Wetmore Humes, "More on the Differences Between Reported and Actual U.S. Central Bank Foreign Exchange Rate Intervention," Federal Reserve Bank of Cleveland," Working Paper 9501, May 1995 and citations therein.

[15] See Broaddus and Goodfriend, *op. cit.*, p.12.

relations are not transparent. This raises a number of questions about a subordinate role of Federal Reserve intervention activity as well as the obscure, non-transparent (and legally questionable) way in which Treasury foreign exchange operations can be financed.

The Division of Responsibility is Unclear and Ambiguous.

As Destler and Henning indicate, the "ambiguous statutory treatment of the prerogatives and responsibilities (of the Treasury and the Federal Reserve) in exchange rate management"[16] has provided wide latitude in interpreting the practical responsibilities of these two agencies. These authors go on to argue that:

> the law defines the exchange rate authorities of the Treasury and the Federal Reserve only ambiguously… the legal basis of the division of responsibility between the Treasury and the Federal Reserve with respect to exchange rates is unusually obscure.[17]

For example, both agencies have authority to intervene in the foreign exchange market but the law is ambiguous as to whether either can block intervention by the other. In effect, the institutions have shared responsibilities worked out after years of negotiation, compromise, and practice. Both agencies generally have found it in their self-interest to cooperate. But the Treasury maintains it is the first among equals in regard to intervention and the Federal Reserve has not challenged this view.[18] Nonetheless, the division of responsibilities is characterized by a sizable degree of non-transparency.

Warehousing and SDR Monetization are not Transparent Financing Methods.

Ambiguous intervention responsibilities are not the only non-transparent element of Treasury-Federal Reserve relations. Questionable, backdoor methods of financing the Treasury's Exchange Stabilization Fund (ESF) involving the Federal Reserve also merit attention. In particular, "warehousing" is a financing method that enables the Federal Reserve to make funds available to the Treasury's ESF without congressional appropriation.[19] Many analysts view this circumvention of congressional appropriation as questionable (perhaps even illegal) and possibly working to compromise the

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[16] I.M. Destler and C. Randall Henning, Dollar Politics: Exchange Rate Policymaking in the United States, Institute for International Economics, Washington DC, 1989, (emphasis and parenthesis added).

[17] Destler and Henning, *ibid.*, p.85 (emphasis added).

[18] *Ibid.*, pp.86-88. See Destler and Henning (pp.83-90) for a discussion on this ambiguous Treasury-Federal Reserve relationship.

[19] "Warehousing" is a transaction whereby the Federal Reserve lends dollars to the ESF in exchange for the ESF's foreign currency. By "warehousing" its foreign currency at the Federal Reserve, Treasury can obtain more dollars with which to intervene on its own account.

independence of the Federal Reserve. Similar arguments apply to Federal Reserve monetization of ESF's SDR holdings, an operation that is initiated at the option of the Treasury Secretary.[20]

Criticism and skepticism concerning these methods have come from numerous sources. Several analysts contend that these methods circumvent the budgetary prerogatives of the Congress, misuse Federal Reserve off-budget status, and compromise the independence of the Federal Reserve.[21] But the skepticism has reached within the Federal Reserve System itself. One Federal Reserve Bank President, for example, argued that:

> Fed financing of foreign exchange operations… by warehousing funds for the ESF sidesteps congressional authorization and obscures the funding.[22]

Further, at an FOMC meeting in March 1990, several FOMC members challenged the legality of these methods:

> Governors Angell and John LeWare and Cleveland Federal Reserve Bank President Lee Hoskins not only voted against the warehousing and foreign currency authorizations, but they openly challenged the legal basis for these facilities… In the public FOMC record, they stated that warehousing "could be viewed as avoiding the congressional appropriations process called for under the Constitution."[23]

In sum, the non-transparent nature of Treasury and Federal Reserve relations is well-known to experts.

- ***The Overly Secretive ESF.*** Non-transparency also characterizes Treasury's ESF, the institution through which Treasury dollar policy is implemented. Treasury officials themselves have on occasion acknowledged the culture of secrecy or non-transparency shrouding the ESF. In testimony before Congress in 1990, for example, Treasury Undersecretary David Mulford stated that the creators of the ESF wanted its

[20] Treasury's ESF can monetize its SDR holdings by issuing SDR certificates to the Federal Reserve in exchange for dollars. See Henning (1994), p.112 (footnote 101).

[21] See, for example, Schwartz, *op. cit.*, Walker F. Todd, "Disorderly Markets: The Law, History, and Economics of the Exchange Stabilization Fund and U.S. Foreign Exchange Market Intervention," Research in Financial Services Public and Private Policy, Volume 4. George Kaufman, ed. (Greenwich, CT: JAI Press, 1992) pp.111-179; and U.S. House of Representatives, Committee on Banking, Finance, and Urban Affairs, Review of Treasury Department's conduct of International Financial Policy, Hearing 14 August 1990, 101st Congress, 2nd Session (Washington, DC, GPO, 1990).

[22] See Broaddus and Goodfriend, *op. cit.*, p.18.

[23] See Henning (1994), p.296.

operations veiled "in the greatest secrecy."[24] This culture of secrecy is underscored by Schwartz:

> The (ESF) was conceived to operate <u>in secrecy</u> under the exclusive control of the Secretary of the Treasury, with the approval of the President, "whose decisions shall be final and not subject to review by any other officer of the United States."…The intention was to cloak foreign exchange market intervention… <u>The secrecy promoted two objectives</u>. One was to <u>conceal from the public and Congress</u> the exchange rates at which foreign currencies were bought and sold, particularly if they involved losses. A second objective was to permit the Treasury, if it so desired, <u>to conceal information about any other operations the ESF might undertake</u>… The ESF in its original design as a creature of the Executive Branch, immune to legislative oversight, breaches the separation of powers.[25]

Although some improvements have occurred over the years, this culture of secrecy persists. The ESF's non-transparency is embedded in its financing mechanisms, and is evident in both its "mission creep" and reporting. Since the ESF was originally set up to be self-financing, the Fund is not required to justify and explain its operations during the annual congressional appropriations process. Questions about operations, objectives, or procedures never have to be answered. Self-financing, therefore, has a very important implication: <u>it has significantly contributed to the secrecy of the ESF</u>.

Over the years, Treasury has managed to muster other sources of financing that have also ably served this same purpose: namely, to enable the ESF to operate in relative secrecy, without congressional oversight or scrutiny. This has been one of the key criticisms of Federal Reserve warehousing. Specifically, by removing the necessity to go before Congress for funding, warehousing contributed to the secrecy of the ESF.[26] Similar assessments of SDR monetizations by the Federal Reserve could also be made.

In addition to ESF's financing, non-transparency of the ESF is also evident in "mission creep:" its adoption of responsibilities for which it has no explicit mandate. The stated mission of the ESF, after all, was to stabilize the exchange rate of the dollar. There was no stated objective or mandate for the type of stabilization lending that has occurred over the years. In lending to various favored countries, therefore, the ESF has "assumed a role that had no mandate."[27]

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[24] Mulford, *op. cit.*, p.62.

[25] Schwartz, *op. cit.*, pp.137-38 (emphasis added).

[26] Schwartz, for example, notes that "the concern (regarding warehousing) was that warehousing removed from Congress the appropriation power, eliminating the necessity for Treasury to turn to Congress to obtain funds it did not have to acquire foreign currency." Schwartz, *op. cit.*, p.145.

[27] Schwartz, *op. cit.*, p.135.

Not only are clearly specified objectives of such lending difficult to find, but ESF reporting of these loan transactions as well as the terms and conditions of these loans are especially non-transparent. This is evident in the case of recent Brazilian loans, but it is also evident historically. In reviewing the ESF's historical documentation of these loans, for example, Schwartz observed the "notable omission (of) any reference to the interest rate that these countries were required to pay for dollar loans."[28]

- ***Reporting Non-transparencies***

A number of informational reporting improvements have occurred over the years; transparency of dollar policy is better than was earlier the case. The ESF, for example, currently issues a number of periodic reports regarding its operations.[29] And daily Treasury intervention data are now available, albeit with a one-year lag.[30] Despite various improvements, however, reporting of U.S. dollar policy cannot be considered highly or adequately transparent.

While dollar-related reports are issued periodically, these reports can be non-transparent in a number of important ways. Reports, for example, may not provide complete, comprehensive, or pertinent information. Reports may not delineate policy objectives for intervention or for stabilization loans. They may not provide adequate "real time," "ex ante," or even " ex post" transparency.

Reports may not be timely, clearly written, or contain adequate information to be understandable to policymakers, interested parties, or ordinary citizens. In short, the issuance of periodic reports does not, in and of itself, guarantee a high or adequate degree of transparency.

There are a number of ways in which existing Treasury dollar policy reports are not as transparent as they could be. As described above, research documenting significant discrepancies between actual intervention and news reports of intervention is prima facie evidence of such non-transparency. Some general examples of existing dollar-policy reporting non-transparencies include the following:

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[28] *Ibid.*, p.147.

[29] More specifically, the following periodic reports are issued by Treasury's ESF: (1) An ESF Annual Report, which includes a statement of financial position (a balance sheet), an income statement, and a statement of cash flows. (2) A bi-annual Treasury Interim Report to the Congress on International Economic and Exchange Rate Policy. (3) A Quarterly Report on Treasury and Federal Reserve Foreign Exchange Operations. (4) A Quarterly ESF balance sheet report published in the Treasury Bulletin with a six-month lag. (5) A monthly ESF financial statement report to the congressional Banking Committees along with a monthly report on foreign exchange operations, both of which are confidential. (6) A periodic report to Congress' Foreign and International Relations Committees citing credit arrangements with foreign governments, sixty days after they occur.

[30] Dominguez and Frankel, *op. cit.*, p.71; and Ostenberg, et al. (1995), *op. cit.*, p.5.

- The objectives of intervention policy and their relation to monetary policy have never been meaningfully clarified. Similarly, the objectives of ESF lending have not been carefully explained.

- Contemporaneous intervention activity is often secret with reporting delayed for months. Intervention activity often has to be inferred from various reports issued with a significant lag.

- Treasury's "risks of financial gains or losses are often not presented explicitly, or in a timely manner, to Congress or to the public."[31] Detailed specification of realized gains and losses is often incomplete.

- G7 foreign exchange discussions often remain secret and G7 communiques are notoriously vague, imprecise, and incomplete.

- The ESF does not adequately report on a timely basis the terms and conditions of its lending. Its balance sheet could be reported much more frequently on a non-confidential basis.

While several reports related to ESF operations are issued on a regular basis, these reports could be more transparent than is currently the case. Balance sheet information, to cite one example, could be issued more frequently, say monthly, and on a timelier basis.[32] Treasury's biannual report to Congress on International Economic and Exchange Rate Policy -- mostly a narrative on economic and exchange rate developments with a lag of several months -- generally is not policy specific. A small section of U.S. exchange rate policy is vague and imprecise.[33] Objectives of exchange rate policy and foreign exchange intervention guidelines and their relation to monetary policy objectives are seldom, if ever, discussed or clarified in a meaningful way.

Similarly, quarterly reports on Treasury and Federal Reserve Foreign Exchange Operations are mostly narratives on past exchange rate developments and reserve holdings, delayed several months. Dollar policy goals, purposes, and "ex ante" perspectives (explaining intended future policy under given circumstances) are not developed or clarified. Exchange rate policy is rarely meaningfully related to monetary policy. Reports to congressional committees are often confidential and therefore not readily available to interested parties or the general public. In sum, many of these reports could be substantially more informative and transparent than is currently the case.

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[31] Todd, *op. cit.*, p.115.

[32] ESF balance sheet data are currently issued both in the ESF Annual Report and in the quarterly Treasury Bulletin, lagged six months.

[33] The lack of any substantive explanation as to the June 17, 1998 foreign exchange intervention serves as an example. See Annual Report to Congress on International Economic and Exchange Rate Policy, January 22, 1999, p.10.

BENEFITS OF TRANSPARENT POLICY

Adopting a more transparent approach to dollar policy, as suggested here, would produce a number of economic benefits. More transparency and disclosure, for example, would reduce unnecessary uncertainties and minimize risk premiums, thereby working to stabilize foreign exchange markets. Exchange rates would be less volatile and more predictable. The more accurate information available to the market, after all, the better the market performs. Economic performance improves when policymakers provide a stable, less uncertain environment. As James Meigs argued decades ago:

> Whatever U.S. policies are, disclosing them promptly and fully to the world should reduce uncertainty and should make variations in exchange rates less than it would be in the absence of such disclosure. Disclosure would at least reduce that part of the variance in exchange rates that is attributable to uncertainty about U.S…. policies…[34]

In addition to promoting this stabilizing effect, more transparency would also help ensure the accountability of policymakers and constrain their discretionary powers.

RECOMMENDED ACTION

Adopting a less secretive, more open dollar policy should include changes in several dimensions of transparency: namely, (1) establishing clear, unambiguous policy objectives, (2) promoting understandable policy procedures, (3) insisting on accurate, timely, transparent reporting, (4) advancing a more transparent ESF, and (5) establishing rigorous oversight procedures.

Specific measures to achieve such dollar policy goals include the following:

- ***Establish clear, understandable dollar policy objectives that are consistent with monetary policy goals***. Delineate what constitute appropriate and inappropriate policy goals. Given capital mobility and price stability objectives, this implies that exchange rate objectives necessarily must be subordinate to these alternative goals.

- ***Promote clear, understandable procedures for intervention activity.*** Set up clear guidelines at to what constitutes "appropriate" intervention. Minimize (or eliminate) sterilized intervention. Should intervention be called for, employ non-sterilized intervention.

[34] James Meigs, "The Role of Information Disclosure in International Monetary Policy," in Federal Reserve Policies and Public Disclosure, edited by Richard Erb, American Enterprise Institute, Washington DC, 1978, p.70.

- ***Require more transparent dollar policy reporting from institutions charged with foreign exchange management responsibilities.*** Improve the timeliness, frequency, accuracy, policy content, and clarity of existing reports. Publicly announce most intervention activity. Work to improve the openness of G7 reporting, minutes of G7 meetings, and G7 communiqués. Remove confidential status of Treasury's reports to Congress.

- ***Clarify dollar policy responsibilities of Treasury vis-à-vis the Federal Reserve.*** Minimize (eliminate) obscure financing schemes involving warehousing or SDR monetization by the Federal Reserve. Consider Federal Reserve assumption of intervention responsibilities.

- ***Insist on a more transparent and reformed ESF.*** Clarify objectives for both ESF intervention and lending activities. Require more transparent ESF reporting including both monthly publication of the ESF balance sheet and public reporting of the terms and conditions of ESF lending. Require annual congressional appropriations for ESF loans in excess of $1 billion as detailed in H.R. 1540, the *ESF Transparency and Accountability Act*. Insist on an independent Federal Reserve; end SDR monetization by the Federal Reserve and consider cessation of warehousing practices by the Federal Reserve. Require congressional appropriations, should more funding of the ESF be essential.

- ***Establish rigorous oversight procedures for these reforms.*** Such oversight should not involve minute-to-minute foreign exchange management or decisionmaking but rather should establish objectives, procedures, accountability, and transparent reporting. Oversight should include thorough monitoring of the foreign exchange policies and operations of both Treasury and the Federal Reserve including intervention activities, ESF operations, Federal Reserve warehousing activities, as well as frequent and detailed testimony from Treasury and Federal Reserve officials. Oversight should include monitoring of U.S. participation in international organizations such as the G7, IMF, and others as they pertain to dollar policy and international monetary reform.

SUMMARY AND CONCLUSIONS

The case for a more transparent U.S. dollar policy is compelling. In addition to producing a number of economic benefits, a more transparent policy would complement a growing consensus on the desirability of transparency in the conduct of government policy in general and monetary policy in particular. More open disclosure in dollar policy is long overdue for a number of important reasons. Further, improved transparency would parallel Treasury's requirement to comply with the letter and spirit of the *Government Performance and Results Act*, which mandates a clarification of objectives and clear explanation of operations.

Transparency has multiple dimensions, involving not only the clarification of dollar policy objectives, but also the timely and complete disclosure of policy decisions and their underlying rationale.

Current dollar policy violates conventional transparency guidelines or parameters in a number of ways. Policy objectives are unclear, intervention policy is non-transparent from several perspectives, Treasury and Federal Reserve dollar relations are ambiguous, and ESF financing methods are obscure. Further, the ESF is overly secretive and current informational reporting is not nearly as transparent as it could be.

A number of specific recommendations for improving dollar policy transparency include the following:

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- Insist on a more transparent and reformed ESF.

- Establish rigorous oversight procedures for these reforms.

Dr. Robert E. Keleher
Chief Macroeconomist to the Vice Chairman