Speech

Reflections on Reserve Management and International Monetary Cooperation

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Today, the management of a country's international reserve assets, as well as the international assets of any sovereign wealth funds (SWF), is a central financial responsibility of governments. At the end of 2011, international reserve assets alone amounted to 17 percent of world GDP and an average of 29 percent of the national GDP of emerging market and developing countries. See the attached table. Including the international assets of SWFs and similar entities would boost those percentages substantially above 20 percent and close to 40 percent respectively. At a 5 percent total return, those assets yield 1 to 2 percent of GDP per year. Consequently, the wise management of these assets is in the strong interests of the citizens of the home countries. However, equally important are accountability, transparency, and the interests of the global economy and financial system in the management of these assets: the focus of my remarks. They are drawn from my experience with issues of reserve management and international monetary cooperation over the past 50 years.

I have four central points.

First, managers of international assets should be held accountable to their stakeholders, foreign as well as domestic.

Second, transparency aids in establishing this accountability.

Third, international cooperation is also essential if the management of international assets is to contribute to global economic and financial stability.

Fourth, over the years, progress has been made on some aspects of international cooperation on managing international assets, but that progress has not kept pace with the increased need for cooperation. That need derives from increases in the size of official holdings, and in the number of substantial holders, as well as the evolution of the multicurrency system.

The 1960s

During the 1960s, the principal reserve asset was gold and the major holders of those reserves were the advanced countries, essentially the Group of Ten (G-10) group consisting of eight countries in Western Europe, the United States, Japan, and Canada. The central issue in reserve management was whether to hold a country's reserves in gold, yielding a zero but very safe nominal return, or in claims on the dominant reserve currency country (the United States) and earn a positive nominal, and generally real, return. Some countries held their reserves in sterling, but that was not particularly attractive given UK restrictions that were imposed on the use of some of those reserves by some holders.

The Bretton Woods system was based on gold, the US dollar, and fixed exchange rates, and the system came under increasing stress. The principal reserve holders, the G-10 countries, responded to this stress with a number of cooperative steps; many of their efforts were organized at, and sometimes conducted by, the Bank for International Settlements (BIS). The objective was to limit destabilizing movements from gold to dollars of the type that helped to undermine the gold standard system in the inter-war period.

What was done then and how do those measures relate to institutional arrangements today?

First was the gold pool, which was established informally in late 1960 and later institutionalized. Participants, a subset of the G-10 countries, cooperated in feeding gold into the London gold market to help keep the price close to $35 an ounce. The modern counterpart of the gold pool is the agreement among the central banks of some of these same countries to limit their market sales of gold. But that agreement, which currently runs through 2014, does not extend beyond a small group of countries.

Second was the establishment at the BIS in 1962 of the Gold and Foreign Exchange Committee of the G-10 central banks. At regular monthly meetings, participants exchanged views on conditions in gold and foreign exchange markets as well as their own operations. These discussions involved extensive sharing of confidential information. Later on, these same central banks began regularly to participate in daily telephone calls in which they discussed, and exchanged information on, financial market developments including the size, currency, and nature of their foreign exchange market operations.

The BIS committee exists today as the Markets Committee. Its membership includes the original 11 countries and representatives of three other advanced countries or institutions, including the European Central Bank. Representatives of seven emerging market economies (including China, Brazil, India, and Mexico) also are now members. I understand that the volume of confidential information that is shared at these meetings is substantially less than it was 15 years ago. This, in part, reflects the fact that more data are now available to the public. Conference calls exchanging information now focus more on conditions in domestic money markets than on foreign exchange operations. They typically involve only a subset of the central banks on the Committee, and always have been organized outside the Committee context.

Third was the establishment by the G-10 in 1964 of a multilateral surveillance exercise. Information was collected monthly and compiled by the BIS on the financing of external imbalances including the size and composition of changes in international reserves. This information was kept confidential; access was limited to only a few officials in each reporting country. This exercise continues to this day. A few other countries have joined the group, but my understanding is that the principal emerging market economies have declined to share this type of information on their activities even on a confidential basis.

Fourth was the agreement to create a supplementary reserve asset—special drawing rights (SDR)—and to decide on the first allocation of SDR in 1970. This agreement involved all members of the IMF, but the negotiations were driven, and some would say were held back, by the G-10 countries.

Of course, the SDR is still with us today. The post-Bretton Woods system, enshrined in the second amendment to the IMF Articles of Agreement, called for the SDR to become the principal reserve asset. As you can see from the attached table, the SDR has not become the principal reserve asset, even with the small blip shown for 2011, which was associated with the 2009 allocations of $283 billion in SDR.

Thus, the 1960s saw a great deal of shared accountability in the management of international reserves—substantially more than today—and considerable transparency about operations at least within official circles. That cooperation was driven by a shared concern for global economic and financial stability—preserving the sysem. The cooperation was not enough to save the Bretton Woods system, but it was, nonetheless, impressive by today's standards.

The 1970s

In 1971, the United States closed its official gold window, and the Bretton Woods system collapsed. During the 1970s, the value of total official reserve holdings increased by 10 times. The increase in the reserves of emerging market and developing countries was even larger, but the bulk of reserves continued to be held by the advanced countries.

Although the physical volume of official gold holdings, including by the IMF and BIS, declined by about 10 percent from the mid-1970s until 2007, and has only inched up since then, their market price rose to $490 an ounce as of the end of 1980, which boosted gold's share in total reserves. Among the cooperative steps by the advanced countries during this decade was the de facto demonetization of gold through a series of agreements. Gold remains a minor part of reserves, generally at the bottom of the pile.

In the 1970s, the advanced countries continued to drive policies and cooperative action on reserve management. Those policies generally focused on exchange rates, such as the revision of Article IV of the IMF Articles of Agreement, which formally legalized floating exchange rates. The 1977 principles for guidance of exchange rate policies under the new Article IV, which remain in effect today in the wake of revisions in 2007 and earlier this year, included (A) the avoidance of manipulating exchange rates to prevent balance-of-payments adjustment, (B) the authorization of discretionary intervention in exchange markets to counter disorderly conditions, and (C) an exhortation that IMF member countries "should take into account in their intervention policies the interests of other members, including those of the countries in whose currencies they intervene."

Much of the subsequent focus on exchange rate and reserve management policies has focused on the first principle and the associated test of protracted large-scale intervention in one direction in the exchange market. However, the third principle—principle C—deserves attention. It provides potential leverage for countries, such as the United States, to remonstrate with other countries about their accumulation of US dollar assets and thereby limiting the appreciation of their currencies against the dollar and otherwise distorting financial markets.

In 1977, the United States insisted upon the inclusion of this principle, but has never invoked it. My colleagues Fred Bergsten and Joe Gagnon, who are concerned about the massive accumulation of dollar reserves by other countries that impede the adjustment of the US current account position and recovery of the US economy, advocate that the United States should invoke this principle. Bergsten and Gagnon would go further and have the United States

support a requirement that all countries must consult with the countries issuing currencies in which they are accumulating reserve assets and, in the extreme, require that they receive advance permission for their actions. These were the implicit ground rules under which the G-10 countries operated in the 1960s and 1970s and under which those countries continue to cooperate today.

International cooperation on reserve management in the 1970s also saw a set of arrangements to support the unwinding of reserve balances held in sterling, which again was centered in the BIS. The decade also saw two discussions of the possible creation of an account in the IMF through which holdings of reserve currencies, principally US dollars, would be substituted for SDR-denominated claims on the IMF. One of the objectives of these proposals was to limit the scope for destabilizing movements in the currency composition of international reserves. However, the discussions did not reach fruition.

With respect to transparency, the Federal Reserve in the 1970s adopted a policy of marking its foreign exchange holdings to market in its own currency and publishing the data in this form. That practice today is more common, at least marking reserves to one of the reserve currencies as a numeraire, but at the time the United States was a path breaker.

In summary, the 1970s was a continuation of more of the same at a lower level of intensity than during the 1960s.

The 1980s

By 1980, scaled by trade, reserves were at the same level as in 1960. The 1980s saw a reduced pace of overall reserve accumulation, slower than the growth of world GDP and in particular world trade. Gold reserves declined in value by almost 40 percent. A second round of SDR allocations extended to 1981, but the SDR's share continued to be minuscule. Reserve positions in the IMF increased by about 50 percent. But the bulk of reserve accumulation was in foreign exchange. Of course, the 1980s was the decade of the global debt crisis; the combined total reserves of emerging market and developing countries barely increased on balance, and shrank by about half relative to world (and combined) national GDP and trade.

Cooperation on reserve management primarily consisted of bridge loans, often arranged through the BIS, in support of the reserve positions of emerging market countries. In addition, foreign exchange operations by the advanced countries consisted of efforts first to restrain the dollar's appreciation, second to encourage the dollar's decline, third to prevent an excessive

dollar decline, and finally to limit renewed dollar appreciation. One of the motivations of the post-Plaza effort to encourage the dollar's decline was to prevent an outbreak of trade protectionism. In this sense, international cooperation on exchange rates, and implicitly reserve management, was directed at global economic and financial stability.

The 1990s

The 1990s saw an almost 50 percent increase in the reserves of advanced countries, but more than a tripling of the reserves of emerging market and developing countries. The latter group of countries became more important players of international reserve management. Their reserves rose relative to global and national GDP and trade. Moreover, the external financial crises of the mid and late 1990s led to a number of innovations in accountability and transparency.

First, in the wake of the Tequila crisis, IMF members agreed to establish the General and Special Data Dissemination Standards (GDDS and SDDS). These standards not only promote closer attention to the quality of national economic and financial statistics, but also introduce more transparency in the timing of their release and increase the accountability of the relevant national authorities vis-à-vis their own citizens and the rest of the world, in particular the investor community. Those standards contained guidelines on the presentation of data on international reserves. Seventy-one economies currently subscribe to the SDDS, a slight increase from the number of initial subscribers, and include Hong Kong and the West Bank and Gaza. Conspicuous among the non-participants are two G-20 members, China and Saudi Arabia.

Second, following the Asian financial crises which revealed serious issues in the accountability and transparency of several countries in published information on their international reserves, the IMF, working with the BIS and G-10 countries, adopted the Data Template on International Reserves and Foreign Currency Liquidity (Reserves Data Template). Countries subscribing to the SDDS, in principle, are required to report on their reserves using the Template. (Curiously, Ecuador and the West Bank and Gaza subscribe to the SDDS, but currently do not satisfy this requirement.) However, countries can adhere to the Reserves Template while not subscribing to the SDDS, and five countries fall in this category, New Zealand, three Central American countries, and the Seychelles. Thus, there are 76 reporters on the Reserves Data Template, including the European Central Bank and the European System of Central Banks, a modest increase from 64 reporters in 2008. But, again, the participants do not include China and Saudi Arabia.

The focus of the Reserves Data Template is on the quality of countries' reserves and their availability to meet forward commitments or other potential short-term claims, or drains, on those reserves. In the late 1990s, there was little concern about how or where countries invested their reserves with the exception of claims on domestic banks, which might not be readily available. The problem that the Template addressed was the tendency of some countries to overstate the effective level of their reserves. The result was the introduction of accountability (at home and abroad) and transparency about the credibility of countries' reserves.

Today, we face a different challenge. Levels of reserves in some countries are in excess of their needs. The accumulation of those reserves over a long period distorts the international adjustment process. And changes in the asset or currency composition of foreign exchange reserves have the potential to destabilize exchange rates and financial markets of countries that issue the reserves. Equally important, rumors of changes in official asset preferences disturb markets. Greater transparency—the availability of more facts—would help to counter this tendency. This will become an ever bigger problem as the multicurrency system expands further. What is needed is more accountability and transparency in reserve management in the interests of the stability of the international economy and financial system.

The Reserves Data Template so far has made only a modest contribution in this direction. Countries, at least once year, must indicate the amount of their foreign exchange reserves held in assets denominated in the four currencies in the SDR basket (the US dollar, euro, pound sterling, and Japanese yen) and in assets denominated in other currencies. Sixty-four of the reporters provide this aggregate information more than once a year; among the conspicuous exceptions are Indonesia, India, Japan, Mexico, Malaysia, Norway, Singapore, and both the ECB and the European System of Central Banks. (The Reserve Bank of Norway publishes detailed information quarterly on the assets and currencies in its foreign exchange holdings, but apparently has chosen not to provide the SDR-non-SDR break in its Reserve Template submission.) Based on research I conducted several years ago, but have not updated, about two dozen countries, at least annually, voluntarily provide detailed information on the currency composition of their foreign exchange reserves.

The IMF has recently conducted a review of the Reserves Data Template, and slightly tweaked some of the reporting instructions. In my view, a thorough overhaul is needed.

The major reserve holders, those with combined assets, say, in excess of $50 billion, 25 or 30 countries, should agree to publish regularly, with an appropriate lag of perhaps a quarter, detailed information on the types of assets in their portfolios, the countries on which those claims are held, and their currency composition.

Third, of course, the IMF does collect information on the currency composition of foreign exchange reserve (COFER) holdings and publishes the data for all reporters as well as separately for reporters among the advanced and emerging market and developing countries as separate. Unfortunately the coverage of this confidential survey has declined from 77 percent of all foreign exchange holdings in 2001 to less than 55 percent today. (Non-participation by emerging market and developing countries accounts for most of the decline. As their share of total reserves has increased over the period since 2001, coverage has declined from 56 percent to 39 percent. Taiwan is the only advanced economy that does not report the currency composition of its reserves.) Moreover, the IMF recently reported that a request in April 2011 to the five largest non-reporters produced no positive responses although a more generalized request later in the year produced a positive response from five current non–reporters, but implicitly none of the major non-reporters.

The IMF is also considering adding two currencies to the current list of five used in COFER reporting—the SDR currencies plus the Swiss franc—but press reports from the two countries (Australia and Canada) suggest that the authorities are not enthused by this prospect. The risk they see is that increased prominence of their currencies will increase demand for assets denominated in their currencies and complicate macroeconomic policy formulation and execution.

However, this is precisely the point: All the burdens should not be placed on the issuers of assets in a few currencies when demand is so heavy. On the other hand, greater accountability and transparency about the reserve management practices would help to flesh out the global picture as well as to flush out reluctant participants in the system.

In this connection it is noteworthy that the US Treasury on November 27, in its semi-annual report on International Economic and Exchange Rate Policies, commented on China's accountability and transparency policies in this area:

> Although reserve accumulation provides some indication of the degree of intervention, China does not publish intervention data, in contrast to most large

> economies. Even when reported with a lag, such data provide valuable information to market participants and promote more transparent and effective functioning of international currency and financial markets. It is important that the Chinese government move toward greater disclosure of its activities in the currency market, which also would be consistent with China's commitment through the G-20 Los Cabos Summit to increase the transparency of its exchange rate policy. In addition, China should commit to participation in the IMF's COFER database and the SDDS befitting its status as a systemically important and the world's second-largest economy.

This comment is significant, in my view, because it illustrates the connection between accountability and transparency and other aspects of international cooperation.

A final example from the 1990s, in which I was personally involved, is that the Federal Reserve and Treasury decided to elaborate on the quarterly information they already provided, with a one month lag, to the US Congress and the public on US foreign currency holdings. Those holdings are divided approximately equally between the Federal Reserve and the Treasury and consist of euro- and yen-denominated assets. Two steps were taken. The holdings as of the end of the previous quarter were reconciled with holdings as of the end of the current quarter, taking account of intervention operations, earnings, and unrealized gains and losses; each component is shown in the published reports. In addition, more detailed information began to be provided on the assets held. Today, that information covers which euro area countries' debt obligations are eligible collateral for reverse repurchase operations as well which countries' securities are held outright. The report also provides the duration of the yen and euro portfolios. This evolution of US practice illustrates two key points: Pressure for greater accountability and transparency can come from domestic sources; the Federal Reserve and Treasury were responding to requests for information from the Congress and the general public. In addition, it is possible to go quite far in the detailed information that national authorities release without jeopardizing the efficient and effective management of a country's foreign exchange reserves.

In summary, the 1990s saw a number of changes in practices with respect to reserve management and transparency and accountability. Many but not all of them were the result of

cooperative international efforts in the interests of the system as a whole as well as to benefit participating countries.

The 21st Century

Over its first 11 years, the 21st century saw an explosion of reserve holdings, which is expected to continue. Relative to world GDP and trade, reserves have risen dramatically. Total reserves increased more than five times, reserves of emerging market and developing countries increased almost 10 times, while those of advanced countries merely tripled. (Note: by 2011, the advanced countries included Hong Kong, Korea, Singapore, and Taiwan.) Over the same period assets under management by SWFs increased an estimated 10 times.

The world has changed. More countries are major players. Many of those countries had little or no role in formulating the written and unwritten rules of the game. They may resent this fact except that those rules were adopted in the collective interests of all countries not to the narrow advantage of a small group of advanced countries. Whatever the cause, participation in collective action on reserve management has been in relative decline.

The increased wealth in the hands of more and more governments has raised new concerns about the motivations, accountability, and transparency of the managers of that wealth. Those concerns have focused primarily on SWFs, but you know and I know that it is often impossible to distinguish the investment priorities of reserve managers and mangers of SWFs. One positive step, which I find personally gratifying, was the 2008 formulation of the Santiago Principles (Generally Accepted Principles and Practices). The promulgation of the Santiago Principles is a prime example of how a quantum change in accountability and transparency can help to demystify the operations of investment managers.

However, the International Forum of SWFs (IFSWF), the successor body to the group that drew up the Santiago Principles, has its work cut out for it. Accountability and transparency of many SWFs has improved over the past four years, in particular among the IFSWF group, but there are laggards. Moreover, the IFSWF has a problem with the SWFs of the three countries (Equatorial Guinea, Iran, and Libya) that are members of the IFSWF but have not been active participants. Inactive memberships are a problem for self-regulatory bodies such as the IFSWF because such behavior reflects adversely on the other members and on the credibility of the forum as an institution. In addition, the IFSWF so far has been unable to attract any new-member adherents to the Santiago Principles though the communique issued after the most

recent IFSWF meeting in September in Mexico City indicated that discussions of expansion are continuing.

SWF investors and reserve managers are concerned about the rise in financial protectionism. Those concerns are real and legitimate, but there are also legitimate concerns on the side of the recipients of investments from reserves and SWFs. This suggests potential scope for international monetary cooperation: increased accountability and transparency on the part of public investors in return for more open access to investment opportunities.

One area of public investor concern today is the availability of so-called safe assets. This development has contributed to a renewed attention on the SDR and a possible substitution account type of arrangement. In contrast with broader concerns about access to assets and markets, this focus on safe assets is misguided in my view.

First, excessive reserve accumulation, in the form of safe or near-safe assets, distorts the international financial system and the adjustment process. If public investors want to continue their relatively rapid accumulation of assets, they should adopt a more balanced investment approach.

Second, why should the world as a whole in effect provide cover for those investors via a substitution arrangement? The asset side of that arrangement would be faced with the same issues that confront public investors today.

It is imperative, in my view, that further progress is made on the accountability and transparency of public investors around the world. As I noted earlier, even with respect to small steps like participation in the COFER database and revising the Reserves Data Template, progress has been slow or non-existent. This is troubling. It is a manifestation of the fact that the enhancement of cooperative arrangements in this area is falling behind the need for them in the face of the explosion of the size and number of significant public investors, bringing in many non-traditional investors. This is a global issue. The notion that a country's public investments are the exclusive concern of the country itself is analytically wrong and fundamentally dangerous. Two countries (at least) share an exchange rate. Similarly, two countries (at least) share the effects of cross-border public investments.

These concerns are not limited to the emerging market and developing countries. Switzerland's recent very heavy intervention to prevent the appreciation of the Swiss franc against the euro and the subsequent reallocation away from euro-denominated assets raise

concerns. The Swiss are a paragon of transparency about their operations. I understand that they have consulted with at least some of the interested official parties. However, rumors about, for example, Swiss purchases of Swedish krone swirled over the summer and proved to be unfounded. I conclude that more transparency is needed not only by other countries but even by Switzerland.

The alternative to increased cooperation on public sector investment policies is a currency war. A currency war might start with more active use of principle C in the IMF guidelines on exchange market policies in which investors formally take account of the interests of the country in whose currency they are investing, an approach advocated by my colleagues Fred Bergsten and Joe Gagnon. However, such proactive use of principle C would be merely a skirmish in a currency war. The greater risk is that restrictions and barriers will increase affecting not only cross-border official investments, but all cross-border financial transactions. Once we start down that path, a trade war would not be difficult to envisage, and the consequences for global growth and stability could be severe.

Concluding Remarks

I conclude as I began:

First, managers of international assets should be held accountable to their stakeholders, foreign as well as domestic.

Second, transparency aids in establishing this accountability.

Third, international cooperation is also essential if the management of international assets is to contribute to global economic and financial stability.

Fourth, over the years, progress has been made on some aspects of international cooperation on managing international assets, but that progress has not kept pace with the increased need for cooperation. That need derives from increases in the size of official holdings, and in the number of substantial holders, as well as the evolution of the multicurrency system.

The Evolution of International Reserves, 1960 to 2011

Reserves and Components	1960	1970	1980	1990	2000	2011
World						
Total reserves (US dollars, billions)	62	95	997	1,293	2,282	12,103
Percent of:						
World GDP	n.a.	n.a.	9	6	7	17
World trade	48	30	50	37	35	67
Composition (percent)						
Foreign exchange	30	48	38	67	85	84
Gold	65	41	59	28	12	12
Special drawing rights	0	3	1	2	1	2
Reserve position in the IMF	6	8	2	3	3	1
Advanced Countries						
Total reserves (US dollars, billions)	50	77	756	1,049	1,515	4,845
Percent of:						
World reserves	81	81	76	81	66	40
World GDP	n.a.	n.a.	7	5	5	7
World trade	39	24	38	30	23	27
National GDP	n.a.	n.a.	9	6	6	11
National trade	56	32	53	37	31	44
Composition (percent)						
Foreign exchange	24	43	30	65	80	70
Gold	70	44	66	30	15	23
Special drawing rights	0	3	2	2	1	4
Reserve position in the IMF	7	9	2	3	4	2
Emerging and Developing Countries						
Total Reserves (US dollars, billions)	12	18	240	244	767	7,258
Percent of :						
World reserves	19	19	24	19	34	60
World GDP	n.a.	n.a.	2	1	2	10
World trade	9	6	12	7	12	40
National GDP	n.a.	n.a.	10	6	12	29
National trade	30	24	47	36	50	104
Composition (percent)						
Foreign exchange	54	67	61	76	94	94
Gold	44	25	35	20	5	4
Special drawing rights	0	3	1	1	1	1
Reserve position in the IMF	2	5	3	2	1	1

n.a. = comparable data are not available.

IMF = International Monetary Fund

Notes: (1) Trade is measured as the sum of exports and imports divided by two. (2) Gold is valued at its market price.

Source: IMF, *International Financial Statistics*, CD-ROM, June 2012 and November 2012