2

Foundations of Accountability

How should the quality of accountability in exchange rate policy be assessed? What litmus tests should be administered? What standards apply?

Definition and Prerequisites

"Accountability," as Ruth Grant and Robert Keohane (2005, 29) define the term, "implies that some actors have the right to hold other actors to a set of standards, to judge whether they have fulfilled their responsibilities in light of these standards, and to impose sanctions if they determine that these responsibilities have not been met." Accountability has several prerequisites: (1) general acceptance (legitimacy) of the right of one actor (the US Treasury in the case of exchange rate policy) to exercise particular authorities and the right of the other (Congress) to hold it to account; (2) standards for assessing whether the power wielder has properly discharged its responsibilities; and (3) sufficient transparency and information to assess whether standards have been fulfilled.

The first prerequisite is satisfied in the United States. The US Constitution gives Congress the power "[t]o coin money, regulate the value thereof, and of foreign coin . . ." (Article I, section 8). Congress delegates the authorities of both the Federal Reserve and Treasury on monetary and exchange rate policies,[1] and both entities are formally accountable to the

1. Originally through the Federal Reserve Act of 1913 and the Gold Reserve Act of 1934, respectively. The legislative history of the latter and subsequent amendments to it are discussed by Henning (1999), among others.

Peterson Institute for International Economics | www.petersoninstitute.org

legislature across the full range of their responsibilities. The Treasury and Federal Reserve prefer to make and administer exchange rate policy in confidence. Together they constitute the core of a policymaking system that historically has been closed to outside purview and remains veiled relative to many other policy areas (see Destler and Henning 1989).

Treasuries and central banks dominate this policy domain in most other countries as well. Some analysts would prefer that legislatures recuse themselves from currency matters (discussed below). But confidentiality with respect to market operations, which should be preserved, can be distinguished from oversight of these agencies with respect to the basic objectives of policy. Congress's constitutional responsibility to oversee the Treasury and Federal Reserve in the US system is beyond dispute. Its oversight powers are reinforced by its control over grants of authority, appropriations, and appointments to key posts in these agencies—although it has not always used these tools.

The second and third prerequisites in the United States are less complete.

Consider the standards for assessment. In most countries, national legislation that establishes the authorities of the finance ministry and central bank focuses largely on their domestic tasks; their roles in exchange rate policy are usually not completely defined. Under the Bretton Woods regime, the Treasury was directed to maintain the par value for the dollar. After the shift to flexible exchange rates, Treasury was enjoined to use its Exchange Stabilization Fund (ESF) in ways that were simply "[c]onsistent with the obligations of the Government in the International Monetary Fund on orderly exchange arrangements and a stable system of exchange rates" (31 USC 5302b). The Exchange Rates and International Economic Policy Coordination Act of 1988 mandated Treasury to pursue "international economic coordination" where possible and to review the currency practices of trading partners, identify instances of exchange rate manipulation, and pursue negotiations to halt manipulation (discussed in chapter 3). No general statement in legislation sets overall objectives for exchange rate policy and its relationship to domestic monetary and fiscal policies. Therefore, while these mandates set down some specific markers by which Congress can judge Treasury's performance, they are partial, vague in come critical cases, and collectively incomplete.

The reporting provisions of the 1988 Act addressed the third prerequisite—sufficient transparency to hold the authorized officials to account. In the Act, Treasury is required to discuss exchange rate policy in the context of the broader macroeconomic environment and in light of global current account balances and capital movements. The department is directed to provide information and analysis on a formidable list of policy and financial topics. Its reports are evaluated in chapter 4. Congress is by no means limited to information provided by the Treasury; it can of course also draw on the plentiful information available from private-sector

Peterson Institute for International Economics | www.petersoninstitute.org

financial analysts, independent policy analysts, and private-sector lobbying groups, among other sources. Information regarding policy, policy intentions, and international negotiations, however, is more closely held within the official sector. On this dimension in particular, Congress has not always had sufficient information to exercise effective oversight.

Debate over the Role of Congress

A normative debate exists over the appropriate degree of "democratization" of exchange rate policy despite the legislature's constitutional standing in this area. Several economists are deeply skeptical that Congress can play a constructive role in this policy domain. For example, Kathryn Dominguez and Jeffrey Frankel (1993, 50–53, 137–38), while advocating broader consultation within the executive, oppose a broader role for Congress and more generally a "democratized" exchange rate policy. A broadening of the exchange rate policy process, they fear, could some day induce policymakers to push the exchange rate away from equilibrium rather than toward it. More recently, Jeffrey Frankel and Shang-jin Wei (2007) also are implicitly skeptical of Congress—which they portray as preoccupied with the bilateral trade effects of currency values as opposed to "legitimate economic variables." They absolve the Treasury of protectionism when it has cited countries for manipulation in the past, on the proposition that it was acting under pressure from Congress. Frankel and Wei note with approval that the White House considers a broader set of effects when making policy than does Congress.

I. M. Destler and I (Destler and Henning 1989), by contrast, argue that Congress played a constructive role during the mid-1980s, intermediating between private-sector activism and executive neglect, and helping to produce a needed shift in exchange rate policy by the second Reagan administration. We recommended broadening intra-executive deliberations over the exchange rate, strengthening the role of Congress in setting broad international economic objectives, and institutionalizing and legitimating private-sector advice to the Treasury. The present analysis extends these recommendations, arguing that the experience since the mid-1980s reinforces the case for strengthening the role of Congress in setting objectives and overseeing executive performance in light of these objectives.

Congress has not always behaved consistently in this policy domain. It has sometimes resisted quota increases for the IMF and has imposed multiple, particularistic mandates for the US executive director—but later regretted that the institution was not more aggressive against countries that manipulate currencies. Congress also placed temporary restrictions on Treasury's use of the ESF during fiscal years 1996 and 1997 that were counterproductive. Nonetheless, by and large, Congress has been circumspect on exchange rate policy, limiting its own role in this domain to

Peterson Institute for International Economics | www.petersoninstitute.org

defining reasonable (though incomplete) objectives, requiring some degree of transparency, and avoiding encroachment on Treasury's operational responsibilities.

To some extent, this disagreement over the role of Congress might reflect differences between the preoccupation of economists with policy optimization, and sometimes a professional preference for technocratic management, and the preoccupation of political scientists with institutional governance, democracy, and accountability. These contrasting approaches will color the debate about delegation, accountability, and oversight as the reform discussion evolves.

Executive Discretion and Congressional Oversight

Treasury holds the "lead" among executive agencies and the Federal Reserve in the exchange rate policy domain. The secretary is the chief financial officer of the US government and represents it on the governing boards of international financial institutions such as the IMF and World Bank. The secretary holds sole discretion over the use of the ESF and is typically the only cabinet member allowed to make public pronouncements on the exchange rate. Senior Treasury officials conduct delicate confidential negotiations with foreign counterparts, such as within the Group of Seven (G-7), in concert with Federal Reserve officials. The Treasury rightly reserves these tasks and should retain a good deal of discretion in carrying them out. Advancing US interests in international monetary policy and cooperation requires a strong Treasury.

The department reports to the Congress, and to the public, on international financial matters through several channels in addition to the biannual exchange rate reports. The Treasury and Federal Reserve issue a joint report quarterly on exchange rates, foreign exchange intervention, and their international reserve holdings.[2] The annual financial statement and monthly balance sheets of the ESF are published with a short lag.[3] Treasury posts the US international reserve position weekly.[4] Any loan agreement involving the ESF is notified within 60 days to the international relations committees of both chambers, as required by the Case Act.

2. See, for example, Federal Reserve Bank of New York, "Treasury and Federal Reserve Foreign Exchange Operations," November 8, 2007, available at www.newyorkfed.org (accessed March 19, 2008).

3. See, for example, Department of Treasury, Office of the Inspector General, "Audit Report," available at www.treas.gov (accessed March 19, 2008).

4. See, for example, US International Reserve Position, released December 17, 2007, available at www.treas.gov (accessed March 19, 2008).

Peterson Institute for International Economics | www.petersoninstitute.org

This list is not exhaustive.[5] Some of these reports, particularly the quarterly joint report with the Federal Reserve, overlap the coverage of those mandated by the 1988 Act. However, none of the reports just listed offer statements of policy or substantial analysis, which are mandated by the exchange rate provisions of that Act.

Congress's treatment of these reports and indeed its oversight more broadly sustain a list of criticisms by the executive and independent agencies and advocates of accountability generally. First of all, Congress sometimes mandates and then ignores reports by executive agencies; its attention to certain issues can be cyclical or episodic. Second, Congress is fragmented by its separation into two chambers and by the committee structure within each. The division of labor by committee leads to questions of jurisdiction and serious problems of intercommittee coordination. Committees can compete with one another on oversight—leading, for example, to excessive demands for testimony on salient policy issues—and on legislation. The Congress was not designed primarily to be an efficient institution, and dysfunctionalities in accountability can arise from its weaknesses. The answer to these criticisms is not to weaken congressional oversight, but rather to address its flaws in order to strengthen the accountability process.

It is nonetheless worth specifying the pitfalls that Congress should avoid in delegating to the Treasury in the area of exchange rate policy. First, it would be inappropriate for Congress to mandate to Treasury objectives that were not possible to meet, either because they were conflicting or because the department did not possess the relevant instruments. Given that exchange rates and international monetary policy are subject to multiple pressures, private and official, the injunction against unrealistic mandates is important. It would be inappropriate, for example, for Congress to mandate pursuit of an exchange rate or current account target that was inconsistent with the legislature's own fiscal choices or the Federal Reserve's monetary policy. Second, while Congress can mandate objectives, it would be inappropriate for the legislature to mandate an outcome to international negotiations that depended in turn on the willingness of foreign governments to cooperate. Third, deflecting politically unpopular decisions to executive agencies and then criticizing them—scapegoating—may be common, but it is also inappropriate.

Potential conflict between maintaining room for maneuver for Treasury and the accountability mechanism arises in two ways. First, accountability sometimes deliberately restricts the agent's discretion, as the 1988 Act sought to do with respect to currency manipulation. Second, disclosure of information necessary to conduct oversight can potentially undercut

5. Congress also mandated a set of separate reports from Treasury after the Mexican peso crisis of 1994–95 and the Asian financial crisis of 1997–98.

Peterson Institute for International Economics | www.petersoninstitute.org

Treasury's effectiveness if, for example, foreign interlocutors wish to preserve confidentiality. However, international norms have evolved toward substantially increased transparency since the 1988 Act was drafted, and accountability mechanisms can be designed to minimize (though perhaps not eliminate) the tradeoff with policy effectiveness.

As a matter of principle, the more authority and autonomy is delegated to an agency, the more important are reporting, disclosure, and oversight. Delegation and accountability go hand in hand. It is appropriate for Congress to set broad policy goals, and some specific ones, and to insist that Treasury provide information and defend its use of discretion. Rather than inhibiting good performance by the Treasury, disclosure requirements and other mechanisms that give Congress continuing influence over the policy agenda can best be seen as preconditions for extensive prior delegation to the department.[6]

---

6. This argument is developed generally in Epstein and O'Halloran (1994).

Peterson Institute for International Economics | www.petersoninstitute.org