More transparency needed
Making official holdings more open

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Lack of clarity on the scope and activity of many types of government investment bodies is holding back better understanding of the world economy. Changes in the asset or currency composition of foreign exchange reserves have the potential to destabilise exchange rates and financial markets. Greater transparency would help to counter this tendency.

One of any government’s major responsibilities is managing the country’s international assets. How well it discharges this role has profound economic and political implications. Reforms are urgently needed to enhance the domestic and international transparency and accountability for this activity – in the interests of a better-functioning world economy.

Total end-2013 cross-border investments can be conservatively estimated at about $130tn. However, the share of government-owned or government-controlled cross-border investments in that total is unknown. These investments include those of government pension funds, government-owned banks, development banks and state-owned enterprises as well as international reserves and sovereign wealth funds (SWFs). We know little about the location, asset categories, instruments, and currency composition of these investments.

A conservative guess for the total volume of the assets of or controlled by governments is $35tn, about 25% of total cross-border assets, close to 50% of global gross domestic product at current prices and exchange rates. Most analysis is concentrated on an important but narrower category of official asset managers – central banks and SWFs. As of end-2013, international reserves were $13.4tn, including gold at the market price. Adding the international assets of SWFs, about $4.0tn, and adjusting for double counting, produces a total for these two broad categories of institutions of $16.2tn or 22% of global GDP. On a conservative estimate, this figure accounts for less than half of all assets held by Global Public Investors.

In the wake of the 1994-95 Mexican financial crisis, International Monetary Fund members agreed to establish the General and Special Data Dissemination Standards (GDDS and SDDS). These standards promote the quality of national economic and financial statistics. This initiative introduced more transparency and accountability in national authorities’ practices vis-à-vis their own citizens as well as the rest of the world, in particular the investor community.

The number of SDDS subscribers has increased slightly over this period to 71. Conspicuous non-participants are two G20 members, China and Saudi Arabia. To reflect the great increase in complexity and interconnectedness of the world economy during the past 20 years, the number of SDDS subscribers should significantly increase.

The Asian financial crisis in 1997-98 revealed serious deficiencies in some countries’ accountability and transparency about their international reserves. The IMF, working with the Bank for International Settlements (BIS) and G10 countries, adopted the Data Template on International Reserves and Foreign Currency Liquidity (Reserves Template).

Countries subscribing to the SDDS, in principle, are required to report on their reserves using the Template. (Ecuador subscribes to the SDDS, but does not report on reserves. Five countries – New Zealand, three Central American countries, and the Seychelles – adhere to the Reserves Template, but do not subscribe to the SDDS.)

The Reserves Template encompasses 79 countries and institutions, including the European Central Bank (ECB) and the European System of Central Banks, up from 64 in 2008. China and Saudi Arabia, again, do not participate. The Reserves Template was designed to focus attention on the quality of countries’ reserves and their availability to meet forward commitments or other potential short-term claims (or drains) on those reserves.

The Reserves Template addressed some countries’ problematic tendency to overstate the effective level of their reserves. However, its contribution to transparency is modest with respect to where and in what assets reserves are invested.
Global interest in how or where countries invest their reserves has grown over the past two decades, as reserve holdings have expanded from 6% of world GDP in 1990 to 17% today (more than 20% including SWFs).

At least once a year, countries are expected to indicate in their Reserves Template the amount of their foreign exchange reserves held in assets denominated in the four currencies in the Special Drawing Right basket (the dollar, euro, sterling, and yen) and in other currencies. But that does not take us very far.

The IMF collects confidential information on the currency composition of foreign exchange reserve (COFER) holdings. It publishes the aggregated data for all reporting countries, separating reporters into advanced and emerging market and developing countries. However, the coverage of total reported foreign exchange reserves declined from 77% in early 1999 to 53% as of December 2013. Non-participation by emerging market countries accounts for most of the decline. Their share of total reserves has increased from 38% to 67% since 1999; overall COFER participation of these countries has declined from 56% to 36%.

Mainland China, with $3.8tn in foreign exchange reserves at end-2013, accounts for 67% of the non-reporting by emerging market countries. But China is not alone. Among these countries, another $1.2tn in reserves is unreported; after China, the biggest non-reporter is believed to be India. Taiwan, with $421bn in reserves, is the only advanced economy that does not report the currency composition of its reserves. In April 2011, the IMF asked the five largest non-reporters to participate, but received no positive responses.
In early 1999, only 1.6% of international reserves of all reporting countries were held in currencies other than the traditional list of five used in COFER reporting – the SDR currencies (dollar, euro, sterling and yen) plus the Swiss franc. At end-2007, the percentage had risen only to 1.8%.

But as of end-2013, the figure was 6.2%, reflecting the increasingly multicurrency nature of the international monetary system. In response to this trend, the IMF in 2013 was able to add the Australian and Canadian dollars to the list. Their combined share in December 2013 was 3.4%.

The challenges surrounding transparency and accountability in the management of governments’ international assets are at several levels. Reserves in a number of countries are well in excess of their needs. The accumulation of those reserves over a long period distorts the international adjustment process. All the burdens should not be placed on the issuers of assets in a few major currencies.

Changes, real or rumoured, in the asset or currency composition of foreign exchange reserves have the potential to destabilise exchange rates and financial markets. Greater transparency would help to counter this tendency. This will become an even bigger problem as the multicurrency system expands further.

In the interests of the stability of the international economy and financial system, I advocate five major reforms. First, international statisticians should agree that data on international investment positions for government-owned and -controlled entities should include separate tabulations in each major institutional category, such as SWFs. Implementing such an agreement will take time, but it would pay dividends. The Santiago Principles for SWFs have contributed substantially to the accountability and transparency of SWFs. But progress by SWFs has been uneven and incomplete.

Second, participation in the SDDS and the associated Reserves Data Template should include, at a minimum, all countries with a GDP of $200bn or more, at market prices and exchange rates. This criterion would encompass 50 countries as of 2013. Compared with the current list, 10 additional countries would become participants: Algeria, China, Iran, Iraq, Nigeria, Pakistan, Qatar, Saudi Arabia, the United Arab Emirates, and Venezuela. The rationale is that the reserves of these countries are large enough for their policies to affect the global economy or those of their immediate neighbours.

Third, the Reserves Data Template itself should be revised to provide more information on the assets held. The current template was relevant to the problems and issues of the 20th century but not to those of the 21st century.

Fourth, major reserve holders should publish more detailed information on the investments. Those with combined assets of more than $50bn (26 countries on end-2013 figures) should publish regularly, with an appropriate lag of perhaps a quarter, detailed information on the types and currency of assets in their portfolios and the countries on which those claims are held.

Fifth, these major reserve holders should report confidentially their intervention and investment operations to the seven, and potentially more, countries that issue assets in international currencies under the COFER system. The G10 industrialised countries that have traditionally been at the heart of the reserves system have exchanged this type of information for more than 50 years.

Transparency and accountability are important not just for recipient countries and for the financial markets, but also for the citizens of the countries that own the assets. The reserves and SWF assets of emerging market and developing countries are about 35% of their combined GDP.

A one percentage point increase or decrease in the rate of return on those assets changes these countries’ average annual growth rate by 0.35 points. More information about the management of these assets is in the strong interest of the home countries, as well as, more generally, the global economy and financial system. ■