



# Introduction

1. Global international reserves grew rapidly over the last decade, mainly in emerging market economies (Figure 1).<sup>1</sup> In some countries reserves were accumulated for precautionary reasons to insure against shocks, including those from volatile international capital flows, and to preserve financial stability. In other countries, reserves grew as a by-product of the pursuit of policy objectives related to the exchange rate and competitiveness, or from a desire to save the windfall from rising commodity prices and to foster intergenerational equity. Since the global financial crisis, reserve accumulation has continued, and is now evident in some economies that have traditionally not emphasized the need for international reserves.

2. In its communiqué of October 2009 (IMF, 2009d), the International Monetary and Financial Committee (IMFC) instructed the IMF to help its members reduce the perceived need for excessive reserve accumulation. Earlier in the same year, IMF Management, supported by some staff analysis, had warned about the risks to the stability of the international monetary system that were posed by what it saw as excessive reserve accumulation. These warnings continued in Management speeches in 2010, and the IMFC in its communiqué of that year (IMF, 2010b) repeated its concerns about the growth of international reserves.

3. In parallel, IMF staff explored several key policy initiatives to enhance the stability of the international monetary system and national economies. New IMF financing facilities were introduced following the onset of the global crisis and were presented in part as an

alternative to reserves being held for precautionary purposes (IMF, 2009f). Staff discussed mechanisms to limit countries' precautionary demand for reserves and enhance the supply of international reserve assets (IMF, 2010g), and a new indicator of reserve adequacy for emerging market economies was presented to the IMF's Executive Board for consideration (IMF, 2011b).

4. Management's warnings about excessive reserve accumulation as a threat to the international monetary system appeared at a time when authorities in many countries felt that the reserves they had accumulated before the crisis had served them well. Authorities in several countries, including some advanced economies, had started focusing anew on the role of reserves in crisis mitigation and management. Amid persistent uncertainties in global financial markets, these authorities were re-evaluating the costs and benefits of holding reserves. Thus the authorities in a number of member countries were skeptical about IMF Management concerns and the proposals and initiatives to slow reserve accumulation.

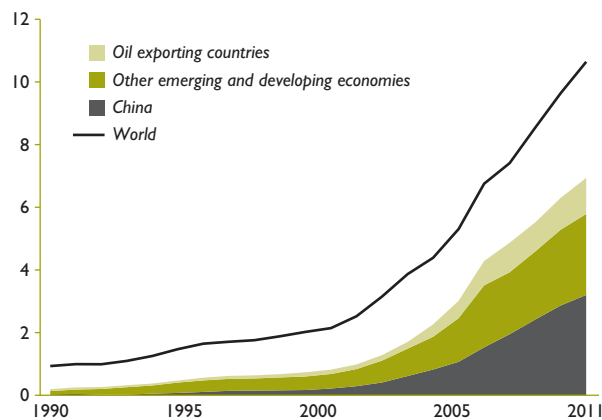
5. The analytical underpinnings of IMF Management's emphasis on the dangers of excessive reserves for the international monetary system were not persuasive. The arguments that were brought forward related mainly to current account imbalances and not to reserves per se. In addition, when seen in the context of the evolution of global financial markets, the size of official international reserves did not appear excessive. Hence, many authorities believe that in analyzing the international monetary system the IMF should have placed greater emphasis on more pressing issues than reserves, for example the growth in global liquidity and capital flow volatility.

6. Concerns have also been raised that the new reserve adequacy indicator ("reserve metric" hereafter), which defined upper and lower bounds for precautionary reserves, would be used to pressure countries to reduce reserves at a time of heightened global uncertainty, and

<sup>1</sup>International reserves are defined as "those external assets that are readily available to and controlled by monetary authorities for meeting balance of payments financing needs, for intervention in exchange markets to affect the currency exchange rate, and for other related purposes (such as maintaining confidence in the currency and the economy, and serving as a basis for foreign borrowing)." IMF (2009b), paragraph 6.64.

**Figure 1. Global Reserves<sup>1</sup>**

(In trillions of U.S. dollars)

Source: IMF, *International Financial Statistics*.<sup>1</sup>Total reserves minus gold.

could influence how the IMF would approach its bilateral policy advice to members on reserves.

7. Against this background the evaluation focuses on two aspects of the IMF's concerns and advice related to international reserves. First, it examines the origin, rationale, and robustness of the concerns about the effects of excessive reserve accumulation on the stability of the international monetary system. Second, it assesses the conceptual underpinnings, nature, and quality of the Fund's advice on reserve adequacy in the context of bilateral surveillance.

8. Because the evaluation focuses on the possible implications of excessive reserves and not on the problems facing economies with insufficient reserves, the sample of countries covered in the evaluation consists principally of those that have accumulated large reserves. The period covered extends from 2000 to 2011.

9. The evaluation addresses the following questions:

(a) What was the nature of the IMF's concerns about reserve accumulation in the context of the international monetary system? What factors brought about these concerns, and were they well grounded from an analytical perspective?

(b) What were the conceptual underpinnings for the IMF's advice to its members on reserve adequacy? What was the nature of the advice provided, and how useful has it been for country authorities?

10. The remainder of this report is organized as follows. Chapter 2 describes the scope of the evaluation and the methods and sources used. Chapter 3 discusses the nature and evolution of IMF concerns about the relationship between excessive reserve accumulation and the international monetary system, and the role of the IMF's new reserve adequacy metric in this context. Chapter 4 describes and assesses the quality of the Fund's analysis and advice on reserves in the bilateral context. Chapter 5 summarizes the evaluation's main conclusions, provides recommendations on how to strengthen the Fund's work in this area, and draws some broader lessons of operational interest to the Fund.