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IEO Releases Evaluation of International Reserves: IMF Concerns and Country Perspectives

The Independent Evaluation Office (IEO) of the International Monetary Fund (IMF) released today its evaluation of International Reserves: IMF Concerns and Country Perspectives, which focuses on the role of international reserves in IMF's bilateral and multilateral surveillance activities. This evaluation was discussed by the IMF's Executive Board on December 7, 2012.

Global international reserves grew rapidly over the last decade. 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 the desire to save the windfall from rising commodity prices and to foster intergenerational equity.

In 2009–10, IMF Management advanced the argument that excessive reserve accumulation was jeopardizing the stability of the international monetary system. This evaluation traces the evolution of this thinking, in particular how it relates to the Fund's longer-standing concern about the risks from global imbalances, and discusses reasons for the shift towards stressing the risks posed by excessive reserve accumulation. It assesses the conceptual framework behind this approach, presents views of country authorities and academics, and discusses why the Fund's arguments have not resonated with much of the IMF's membership. The evaluation also assesses the conceptual underpinnings and quality of the advice on reserve adequacy in the context of bilateral surveillance. Its findings are based on a sample of economies whose combined reserves account for about 90 percent of total global international reserves at end-2011.

The report argues that the IMF's emphasis on reserve accumulation as a risk for the international monetary system was not helpful in that it stressed the symptom of problems rather than the underlying causes, and thus led to a loss of clarity in discussing options to reduce such risks. The report also notes that the new reserve adequacy metric which was introduced in 2011 and that defines upper and lower bounds for precautionary reserves was received with skepticism by country officials, who worried that it could become a rigid benchmark to limit reserve accumulation at a time of heightened uncertainty in the global economy.

In the context of bilateral surveillance, the evaluation argues that the IMF's assessments of reserve adequacy were often pro forma, emphasizing a few traditional indicators and insufficiently incorporating country-specific circumstances. It also identifies cases where the Fund's analysis and advice could have been improved, notably by embedding the assessment of reserve adequacy in a broader analysis of countries' internal and external stability.

Based on its analysis, the evaluation recommends that:

- Policy initiatives should target distortions and their causes rather than symptoms such as excessive reserves;

- Discussion of reserve accumulation in the multilateral context should be imbedded in a comprehensive treatment of threats to global financial stability, one that is informed by developments in global liquidity and financial markets;
- Policy initiatives that are meant to deal with systemic externalities must take into account the relative size of countries' contributions to the externality;
- Reserve adequacy indicators should be applied flexibly and reflect country-specific circumstances; and
- The multiple tradeoffs involved in decisions on reserve accumulation and reserve adequacy at the country level need to be recognized, and advice on reserves should be integrated with advice in related policy areas. Advice should not be directed only to emerging markets but, when necessary, take into account the concerns in advanced economies that have arisen since the financial crisis.

The report, IMF Management and staff responses, and the Summing Up of the Executive Board meeting are available at <http://www.imo-imf.org>.

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