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**Statement by Mr. Mojarrad on Seminar--Reserve Accumulation and International Monetary Stability
(Preliminary)
Executive Board Seminar 10/2
May 28, 2010**

1. We thank staff for a thought-provoking paper that touches on wide-ranging issues. While the lengthy bibliography confirms that most of the proposals are not new, staff analysis suggests that many of them seem unlikely to attract consensus in the near term let alone be ready for implementation. As such, the discussion in a seminar format is appropriate.
2. The paper analyzes the **trend in reserve accumulation**, and considers that high demand is expected to continue in the long-term, particularly in view of rising trade and financial openness and the mitigating role played by large reserves in the recent crisis. It would be useful to explore if some policy-induced factors underway, including rebalancing growth toward domestic demand, could alter this trend. *Staff is invited to comment.*
3. **Causes of the reserve accumulation.** In addition to the traditional causes of reserve accumulation, including for consumption smoothing, the paper highlights the role played by “systemic imperfections” in the IMS, including uncertainty on availability of international liquidity in a crisis situation, large and volatile capital flows, absence of an automatic adjustment of global imbalances, and the lack of a substitute to the U.S. dollar. Uncertainty on availability of liquidity could be reduced through more frequent SDR allocations and further progress in improving the toolkit of Fund financing, including by reducing the stigma. Moreover, while much of the reserve build up resulted from intervention to stem appreciation during episodes of large capital inflows, one wonders whether a well-designed prudential framework or capital controls to stem excessive volatility of flows would not have been more appropriate. *Staff may wish to comment.*
4. **The cost of reserve accumulation.** The opportunity cost of reserve accumulation is difficult to measure and varies according to country circumstances. Oil producing countries with considerable export revenue and limited domestic absorption have lower opportunity costs than other countries, with several of them saving oil revenue for future generations, including through Sovereign Wealth Funds. Also in countries that accumulate reserves to protect themselves against exogenous shocks, the opportunity cost must be assessed against

the cost (not only financial, but also economic and political) of potential exogenous shocks or other insurance mechanisms (including UFR). The current crisis and the Asian crisis before it have amply demonstrated that the choice is self-evident.

5. Views about the **vulnerability and potential instability of the IMS** vary. The paper concludes that the system has proven resilient and “is not on the verge of collapse”, notwithstanding the global crisis. Under the circumstances, while we appreciate staff’s attempt to explore potential avenues for improvement, we expect that the discussion of these issues will not be rushed.

6. **The role of the Fund.** One is struck by the seemingly limitless role suggested for the IMF, which goes beyond the Articles of Agreement and may exceed the Fund’s financial and human resources capabilities. In addition to managing a possible Substitution Account, the Fund would attempt to mitigate the demand for reserves, monitor capital flows and reduce their volatility, serve as a coordinating platform between key reserve issuers; encourage reserve holders to adjust currency composition only gradually, consider mechanisms to facilitate the use of emerging market assets to draw liquidity (para.38), help EMs pool reserve assets and guarantee the liquidity of the pool through a trust fund, and manage a repo window by lending to solvent countries against collateral in the form of high quality EM assets (Box IV.2). Moreover, the Fund would increase availability of alternatives to reserve accumulation within its toolkit.

Agreeing with members on the distinction between precautionary and non-precautionary demand for reserves and on the adequacy of reserves will be extremely difficult in view of the many subjective and judgmental factors involved. Furthermore, it is not clear that market participants, including investors and rating agencies would accept Fund guidance in this area. We are particularly skeptical about the suggestions to monitor capital flows and dampen volatility. Volatility is a symptom of underlying distortions and disequilibria, and policy makers have a hard time reducing volatility, notwithstanding the wide range of tools and the large resources at their disposal to deal with it. Moreover, giving the Fund a key role in monitoring these flows is highly unrealistic in terms of data collection needs, and would put exorbitant demands on country authorities and staff resources. We also remain skeptical about extending Fund jurisdiction to capital account transactions, and consider agreement on a multilateral framework for capital controls or the imposition of penalties on deficit and surplus countries—which would be inconsistent with the Fund’s cooperative character—as highly unlikely.

7. More promising suggestions relate to strengthening of the role of the SDR in the IMS. Five suggestions seem to be of particular interest.

- First, countries with sizable current account surpluses that peg to a single currency (mainly the US dollar) could switch to an SDR peg, which would facilitate an automatic adjustment process (par.41).
- Second, the composition of the SDR basket could be changed to reflect the relative importance of currencies in the world’s trading and financial system, including a major non-convertible currency. Further analysis could look into the

implications of exposure to non-convertible currencies through the SDR (par.47).

- Third, promoting invoicing of international trade in SDRs, including commodities and oil, could enhance the role of the SDR as reserve asset while providing some price stability to commodity markets. This would require, however, the establishment of clearance systems in SDRs.
- Fourth, promoting issuance of sovereign debt in SDRs, which would reduce exchange rate risk and the need for hedging instruments.
- Finally, agreeing on large and regular SDR allocations of the equivalent of SDR 200 billion annually, as suggested in the paper, to reduce the demand for non-precautionary reserves.