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Statement by Mr. Perez-Verdia and Mr. Jiménez on Seminar--Reserve Accumulation and International Monetary Stability
(Preliminary)
Executive Board Seminar 10/2
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We welcome the opportunity to discuss the ambitious and far-ranging papers prepared by staff. We agree that there are imperfections in the International Monetary System that could have negative implications to financial and economic stability. However, like staff points out, we also acknowledge that the IMS has functioned well over several decades so that any potential adjustments have to be well thought-out and justified.

The first thing that stands out –and this is, of course, not a new development– is the failure of market forces to produce a stable equilibrium between the demand and supply of reserves. We should indeed be concerned about what excessive reserve accumulation may imply for the stability of the international monetary system. The fact that reserve accumulation has been regarded in recent years as a form of relative insurance between countries has given place to a no-end race to accumulate disproportionate levels of reserves –such irrational race entails substantial costs and distortions– for example, as mentioned in the paper, *a larger* deflationary impact in the system.

The potential instability to the financial system warrants the Fund's involvement. A comprehensive solution is probably in the hands of the larger surplus-and-deficit countries. But the Fund must remain engaged because this is part of its core mission, because it can promote collaboration between countries and because it cannot afford to be perceived as absent from these developments.

We support further work on reserve level adequacy while recognizing that the outcome will need to be monitored for some time before it can be considered as a guideline for the membership.

Moreover, the composition of reserves in the global system is also a concern, with the excessive dependence on a few currencies –and in particular, the U.S. dollar signifying a higher exposure of the world to domestic developments in reserve-issuing countries. One particular concern in this regard is the fact that uncertainty about long-term fiscal sustainability in the reserve currency issuer may imply higher real interest rates for the rest of the world. A different system may be more beneficial in terms of relative interest rates, as well as regarding the quality of reserves as a store of value.

We believe a diversification of reserves could improve the stability of the monetary system. This would be better achieved if official reserve issuers pursue sound domestic policies and official reserve holders diversify their reserve portfolios carefully and with appropriate communication policies. Transparency regarding the composition of reserve holdings should be pursued.

We are less convinced at this moment on the desirability of establishing a multilateral framework for managing capital flows. The approach seems to rely on a degree of intervention and micromanagement beyond what we are capable of optimally providing.

We actually see as more feasible and worthy of further study the increased diversification of reserve assets, leading to a greater role played by the SDR. This deals more directly with the demand for reserves, which in our view has a higher chance of success through a coordinated approach.

In the longer run, a transition to an SDR-based system could be the coherent outcome from a multi-polar system, as expressed in the paper, or, under certain circumstances, it could be achieved more easily. For example, multilateral reserve diversification targets that mirror the composition of the SDR could form the initial steps towards this transition. We encourage staff to further work on this area.

One last point on this respect, we do not fully share the view that the success of an SDR-based system would need a significant increase in SDR allocations through the mechanisms described. The way this increase is presented in the paper (paragraph 44) resembles more the issuance of a new fiat currency, which the SDR is not.