XII. Reserve Assets

610. Reserve assets are one of the four functional types of investment distinguished in the balance of payments. Reserve assets consist of financial instruments available to the central authorities for financing or absorbing an imbalance of payments or for regulating the size of such imbalances. (The authorities may regulate the size of imbalances by intervening in the market to influence the exchange rate of the national currency.) Reserve assets are distinctly different from other types of investments. The principal function of reserve assets is to provide or absorb the liquidity necessary to facilitate, by various means, the adjustment of an imbalance of payments between a country and the rest of the world. In addition, reserve assets may be held for other reasons. For example, reserve assets may be held to preserve confidence, to satisfy domestic legal requirements, or to serve as collateral for borrowing abroad.

611. Reserve assets determine some important aspects of the relationship between the International Monetary Fund and member countries. Reserve holdings are one of the factors on which a member country’s quota is based, and such assets also affect a member country’s eligibility to draw on its reserve tranche and to use Fund credit. Information on a country’s reserve holdings is used by the IMF in the designation of SDRs.

612. Because reserve assets play an important role in the adjustment process and in relations between the IMF and member countries, there is considerable interest in fully assessing changes in member countries’ stocks of reserves. (Such changes may be the result of transactions, the result of fluctuations in value, or the result of certain other occurrences unrelated to transactions.) Previous editions of the BPM addressed this interest through recommendations that supplementary information on total changes and valuation changes in reserve holdings be recorded in the BOP statement. However, in the fifth edition of the BPM, the conceptual framework was expanded to provide a means of assessing stocks (and changes in stocks) of reserves and all of an economy’s external financial assets and liabilities. Accordingly, information relating to stocks of reserves (as distinct from transactions) can be obtained by analyzing the reserve assets component of an economy’s international investment position.

Reserve Assets and the Adjustment Process

613. In theory, freely fluctuating exchange rates are sufficient to bring about continuous adjustments in imbalances of payments; it should not be necessary for reserve assets to play a significant role in the adjustment process. However, free-floating exchange rates may affect the established patterns of international trade and finance, existing legislation, the outlook for obligations under long-term international contracts, and similar circumstances of a structural nature. For many countries, the introduction of totally free-floating exchange rates would represent a disruptive and costly means of adjustment. Therefore, a broader range of adjustment measures, including a prominent role for reserves, is generally employed by these countries.

614. The monetary authorities of a country may adjust an imbalance of payments by a variety of means. In addition to expending or accumulating reserves, the authorities may finance imbalances directly through increases or reductions in net borrowing from official entities of other countries or from private financial markets. They may finance imbalances indirectly by encouraging other sectors of the economy to engage in financial transactions that are expected to offset imbalances. Moreover, a country’s authorities may take recourse to regulatory measures (such as controls on capital flows) or intervene in exchange markets to move the exchange rate of the national currency towards a level consistent with their adjustment objective. The monetary authorities of a country can also adjust domestic interest rates to influence the exchange rate. When confronted with a serious imbalance of payments, monetary authorities usually do not confine themselves to a single adjustment option.

615. However, factors such as limited access to financial markets, domestic political and economic
considerations, or regard for other countries’ concerns may constrain monetary authorities from exercising some options. Certain constraints (including those of exchange rate arrangements) arise directly from the obligations that member countries have under the Articles of Agreement of the International Monetary Fund.

616. The authorities of many countries cooperate with each other in numerous ways to facilitate adjustment of imbalances of payments. Cooperation may include exchanges of information, intervention in exchange markets as an agent of a partner country, ad hoc arrangements to avert developments of mutual concern, reciprocal swap agreements that can be activated on short notice between central banks, and permanent and formal monetary and exchange rate cooperation agreements between countries of a particular region. The most comprehensive cooperation occurs through IMF consultation procedures, which include input from the Fund’s surveillance of exchange rate practices.

617. The options available for dealing with imbalances of payments and the circumstances under which countries must deal with them make the adjustment process a complex one for individual countries and for the world. Because of this complexity, it is often difficult for anyone (other than the monetary authorities themselves) to determine which of the actions taken actually led to the achievement of the desired adjustment during a particular phase.

618. Nonetheless, reserve holdings are prominently and continuously involved in the adjustment process—through financing, or intervention operations, or both. An accumulation of reserve assets or a decline in holdings may be interpreted as an early indication of, and response to, the aggregate surplus or deficit resulting from autonomous transactions (those undertaken for their own sake) between residents of an economy and the rest of the world. While reserve assets are not the only resources available to manage aggregate surpluses or deficits, reserves usually finance or absorb a significant portion of the corresponding imbalances in the very short term. Consequently, reserve holdings fluctuate with the evolution of surpluses or deficits. Monetary authorities may or may not consider these fluctuations to be cause for concern.

619. For example, during short periods, surpluses and deficits can be minor enough to offset each other. Small holdings of reserves are usually sufficient for coping with these limited fluctuations. Seasonal fluctuations that exhibit no discernible trend of increasing deficits or surpluses may also occur. In these instances, a country’s monetary authorities determine—on the basis of observations concerning the effects, on the country’s balance of payments, of seasonality and related factors—the level of reserves necessary to finance or absorb such imbalances in the short to medium term. If there is reasonable expectation of a surplus in the near term, the authorities might consider borrowing from abroad on a short-term basis to augment the country’s reserves during deficit periods.

620. In the absence of factors with sufficient impact to effect relatively rapid self-adjustment in a country’s imbalance of payments, reserve holdings finance or absorb the initial impact of the imbalance. However, there are limitations on the time and the extent to which reserve assets are employed in this way. Whether reserves are used in financing or in intervention operations, a country’s monetary authorities normally do not permit reserve holdings to decrease below the level considered minimally appropriate or adequate for the country. A high priority objective of most adjustment policies is the maintenance of an adequate level of reserves and the restoration, in the course of the adjustment process, of depleted reserves. In view of the financial and psychological implications of permitting reserve holdings to decrease to critical levels, monetary authorities can be expected to implement alternative measures.

621. Monetary authorities often react rather cautiously to deviations, which could become cause for concern, from established BOP patterns. Although evolving imbalances are continuously monitored, decisions regarding the implementation of additional measures—and the determination of which measures are most appropriate—cannot be reached instantly. Time is required to assess the nature of developments, to implement corrective measures, and to permit corrective measures to take effect—especially as such measures are usually designed to avoid disruptive movements in exchange and financial markets and in other international transactions. Reserve assets are therefore continuously used (expended or accumulated, as the case may be) to finance or absorb rising imbalances and for intervention in exchange markets during transition.
phases in which adjustments to more stable positions take place. When deficits are increasing, substantial reserve holdings allow the authorities to extend adjustment policies over longer periods.

622. The level of reserve assets appropriate for a particular country (referred to as the country’s demand for reserves) depends upon factors such as the openness of the country’s economy, the magnitude of fluctuations in its imbalance of payments, and the cost of holding reserves. Each of these factors can be measured or otherwise evaluated to provide the authorities of the country with guidance in developing and implementing reserve policies. The openness of an economy, which is a reflection of a country’s interdependency with the world economy, can be determined by measures such as the ratio of the country’s exports (or imports) of goods and services to gross domestic product. The volatility of a country’s balance of payments can be measured by observations, which are made over time, of deviations from an average, and the cost of holding reserves can be measured by appropriate interest rate differentials.

623. A common measure of the adequacy of reserve holdings is the ratio of reserve assets to imports of goods. This ratio is sometimes expressed as the number of days’ or weeks’ or months’ worth of imports that could be paid for from a specific stock of reserve assets. Such a measure must not, of course, be taken as a rigid standard; ratios can vary considerably from country to country. For example, although U.S. participation in international trade is extremely significant, the United States requires only a limited level of nongold reserve assets because of the dominant role of the U.S. dollar as a reserve currency. However, in many cases, the ratio of reserve assets to imports is useful for analyzing the adequacy of reserve holdings because the ratio relates reserve assets to the predominant component in many countries’ external transactions. Moreover, trade statistics on goods are usually available sooner (and at more frequent intervals) than those for other current transactions.

624. In summary form, the principal attributes of reserve assets are:

(1) Reserve assets—the external assets available to the monetary authorities of an economy—are internationally recognized financial instruments that constitute the basis of a country’s ability to deal with continuous imbalances (surpluses or deficits) arising from the economy’s autonomous international transactions.

(2) Reserve assets are used to finance or absorb imbalances and to regulate the size of such imbalances through intervention, by a country’s monetary authorities, in exchange markets to influence the exchange rate of the national currency.

(3) Excessive use of reserves—that is, to an extent that reduces or increases reserve holdings beyond an appropriate range—does not usually occur. In the event of persisting imbalances, monetary authorities generally engage in alternative or additional policies of adjustment.

(4) The principal function of reserves is to provide or absorb liquidity during a limited period while decisions are made and alternative measures of adjustment aimed at correcting imbalances arising from international transactions are implemented.

(5) The use of reserve assets thereby permits countries to avoid recourse to totally free-floating exchange rates or to restrictive regulatory measures. Either of these two responses to an imbalance of payments could adversely affect the international transactions of other countries, and the latter action could well be inconsistent with provisions of the IMF Articles of Agreement.

The Relationship Between Reserve Assets and Liabilities

625. In the BPM, reserve assets are defined as monetary gold held by the authorities of a country, the authorities’ claims on nonresidents, holdings of IMF special drawing rights (SDRs), and a country’s reserve position in the Fund. These four components are commonly referred to as the gross external assets of the central authorities.

626. To conceive of reserve assets solely as external assets is to concentrate on limited aspects of international liquidity. A concept of reserve assets that includes selected liabilities (usually some or all of the external liabilities of a country’s monetary authorities) permits a more comprehensive view of BOP financing. Net reserves can, in fact, be considered a corollary of the analytic measure of an overall balance, which distinguishes autonomous transactions recorded “above the line” from accommodating transactions recorded “below the
line.” According to this measure, reserve assets and selected official liabilities are the financing (or accommodating) items of the net surplus or deficit resulting from above-the-line (or autonomous) transactions.

627. Official liabilities included in net reserves are generally those incurred to finance deficits or extinguished to absorb surpluses. For example, in the event a country experiences an overall surplus, the monetary authorities may, with the concurrence of the creditor, elect to reduce outstanding liabilities—sometimes before the due dates—instead of accumulating reserves. Conversely, in the event of a deficit, the authorities may incur liabilities instead of expending reserve assets, or they may borrow reserve assets outright from the authorities of another country. Transactions in such reserve-related liabilities can be netted against transactions in reserve assets, and outstanding liabilities can be netted against holdings of reserve assets because such liabilities can be regarded as direct claims on the reserve assets of a country. By defining net reserves as those that include liabilities substituting for reserve assets, it is possible to measure reserves that are actually available.

628. To the extent that all such reserve-related liabilities are considered liabilities to foreign monetary authorities and to the extent that holders of corresponding claims regard such claims as reserve assets, there is symmetry in the relationship between official reserve-related liabilities and reserve assets. Such symmetry permits meaningful comparisons—between countries—of official settlements or overall balances and net reserve positions between countries, and regional or world aggregates of net reserve positions can be calculated in a consistent way.

629. In practice, however, there will be divergence from country to country regarding the types of claims that are considered reserves and the types of liabilities that are considered reserve-related liabilities. Indeed, there is no compelling reason to consider the notional border of the official monetary sector as the essential factor for determining which claims are regarded as reserve assets and which liabilities as reserve liabilities.

630. The most obvious case is that of claims on countries (especially the United States) with currencies typically held as reserve assets. In 1971, the United States officially declared that gold (its principal reserve asset) would no longer be exchanged for U.S. dollars held by foreign authorities. Even before 1971, reserve assets consisting of U.S. dollar claims of monetary authorities of other countries were regarded as reserve-related liabilities by the United States only if such claims were held in official U.S. securities. However, a large portion of such claims were and are held in the form of liquid claims on private banks in the United States.

631. Likewise, reserve assets held in the form of claims denominated in other major currencies are not necessarily claims on the monetary authorities of the countries issuing those currencies or direct claims against the reserve assets of those countries. To a large extent, reserve assets denominated in major currencies represent claims on private banks in countries issuing such currencies. Some claims may be officially guaranteed, or the exchange values of the claims may be guaranteed by the authorities of the debtor countries. The existence of such guarantees can be a factor in determinations of whether or not certain financial instruments are considered reserve assets. The fact that some claims held as reserve assets are claims against international financial institutions (such as the World Bank) also adds to asymmetries because corresponding official liabilities are not incurred by any country. Fortunately, such claims are relatively small and easily identifiable and thus do not pose practical problems for analyses based on the net reserves concept.

632. Another source of asymmetry is use of the degree of liquidity as a criterion to determine whether or not a claim is considered a reserve asset. Although application of this standard normally involves little variation in judgment, the authorities of one country may apply the standard in an extremely rigid way and the authorities of another may apply it more leniently. On the basis of liquidity considerations, some claims of one country may be regarded as reserve assets but the corresponding liabilities of another may not be considered reserve-related liabilities—and vice versa. Consequently, there may be asymmetrical recordings of the same types of claims under equally defensible positions.

633. On the other hand, not all reserve-related liabilities are owed to foreign monetary authorities. To supplement reserve assets, a country may, for example, borrow from private banks located abroad.

634. For the foregoing reasons, items shown under reserve assets in the standard components of the
balance of payments are restricted to gross reserves. Liabilities related to an economy’s reserve assets are recorded under other BOP items.

635. Another type of liability related to reserve assets may be incurred through the use of Fund credit by member countries. In a sense, the availability of such resources makes them an extension of the reserve assets of these countries. If BOP problems arise, a member country may—after making a formal declaration of need—obtain the use of IMF resources through reserve tranche purchases or through various IMF facilities. In the case of reserve tranche drawings, conditionality is not an issue. To use Fund credit, however, the member country must propose and agree to implement reforms, which are reviewed and approved by the executive board, to ensure that the member’s BOP problem will be solved in a manner consistent with provisions of the IMF Articles of Agreement and that there are adequate safeguards for the return of IMF resources. This conditionality is an important factor for classification of a country’s transactions with the IMF. Transactions relating to a country’s reserve position in the Fund are treated as part of the country’s gross reserves. Transactions relating to the conditional use of IMF resources are treated as transactions in a liability related to reserves (rather than as transactions in reserves) and recorded as other investment—liabilities-use of Fund credit and loans from the Fund in the BOP financial account.

636. An analysis of overall balances and net reserves may be undertaken on the basis of items classified according to the BOP standard components. All of the liabilities identified as liabilities of the monetary authorities, or liabilities of the resident official sector, or some of these liabilities (such as short-term loan liabilities of the resident official sector) may—with some degree of flexibility—be selected as financing items for constructing official settlements or an overall balance suitable for a particular country.

637. To provide further assistance for analyzing the financing of imbalances of payments, a special category of exceptional financing transactions is included in the Selected Supplementary Information table that accompanies the listing of BOP standard components contained in chapter 3. (Transactions in this category are also published in the Balance of Payments Statistics Yearbook.) The exceptional financing category highlights transactions undertaken with the recognizable intent of financing an imbalance of payments by means other than gross reserves. The financial flows shown in this category reflect a wide variety of alternatives to the use of reserve assets for financing imbalances. The alternatives range from long-term borrowing through bond issues, certain grants received, and temporary accumulations of payments in arrears. Nevertheless, this category emphasizes the exceptional nature of such financing. Exceptional financing transactions, including grants received from IMF-administered subsidy accounts and loans from the Fund, are discussed in detail in chapter 8.

638. Liabilities constituting foreign authorities’ reserves (LCFAR) are also closely related to a country’s reserves. LCFARs may or may not be included in the liabilities of the official sector. For example, a portion of the reserves of an economy may be held in the form of deposits with nonresident commercial banks. In this case, the bank liabilities represent LCFARs of the economies in which the banks are residents.

639. It is difficult to develop criteria for identifying LCFARs, and the nature of their relationship to reserve assets is not always clear. Nevertheless, it is useful (for example, for bilateral and international comparisons of reserve asset data) for the compiling (debtor) economy to attempt identification of liabilities considered by other countries to be part of their reserve assets. LCFARs, which are not reflected in the listing of BOP standard components, are shown in the accompanying Selected Supplementary Information table on pages 34–35.

640. In certain analytic presentations (including those of the IMF) of the balance of payments, LCFARs are grouped together with reserve assets and exceptional financing as below-the-line items, that is, as a means of financing imbalances of payments. Interpretation of the behavior of LCFARs depends on the purpose of the analysis and the factors that brought about the changes recorded in the balance of payments. Moreover, interpretations are sometimes uncertain. For example, an increase in a central bank’s claims on a commercial bank may or may not indicate strength in the BOP position of the economy of the commercial bank. Nevertheless, changes in liabilities that are counterparts of another country’s reserve assets can be relevant in understanding the global process of reserve creation and neutralization.
Coverage of Reserve Assets

641. According to the BPM, reserve assets cannot be unambiguously identified through the application of objective criteria. The readily observable characteristics—legal ownership, original contractual maturity of a claim, marketability, currency of denomination, and the like—are not sufficient to establish whether an asset is actually available to central authorities to use for financing imbalances or for intervention operations in exchange markets. Reserve assets must actually exist; foreign exchange that could be obtained through swap agreements, other lines of credit, or credit from IMF stand-by arrangements does not constitute an existing claim. Conversely, assets that are pledged, committed, earmarked, set aside in sinking funds, blocked, sold forward or otherwise encumbered by the holders are nonetheless existing assets and are not precluded on those grounds alone from constituting part of reserve assets.

642. What assets, in addition to those actually owned by the central authorities, can be considered effectively at their disposal? Which of the assets controlled by the central authorities are available for use if the need arises? The test inherent in the first question is an entirely domestic one. The authorities may achieve effective control (which is tantamount to having the assets at their disposal) over external assets by holding legal title to such assets or by exercising their statutory powers. The test inherent in the second question concerns requirements determined outside the reporting economy. If a country’s central authorities consider specific external assets to be available for their use, such assets are usually considered by other countries to be at the disposal of the relevant central authorities.

Effective Control

643. As ownership of external assets is sufficient to establish control, the test of effective control can be confined to institutional arrangements that confer some measure of control on the central authorities when they do not legally hold title to the assets. Such arrangements exist in a number of countries. However, such arrangements often are not made for the exclusive purpose of placing external assets not owned by the central authorities at their disposal for use as reserves. Some countries maintain exchange controls primarily to forestall undesirable outflows of capital and thereby subject all dealings in external assets to explicit authorization. In many such countries, only official financial institutions and selected private banks may be authorized to hold and/or legally own external assets. In addition, effective control over these assets is maintained through terms specified by the authorities or through other forms of authorization under which such institutions are permitted to deal in external assets.

644. Controls of this type must actually be in force if the external assets are to be considered at the disposal of central authorities. For example, a statutory provision permitting the authorities of a country to introduce or to tighten (even on very short notice) regulations endowing them with control over external assets is not a sufficient indication that the relevant external assets are effectively controlled by the country’s authorities.

645. However, control of the authorities over external assets owned by the private sector should not be interpreted as extending beyond the assets of depository institutions. It is unlikely that a country’s authorities could obtain accurate and complete information about foreign exchange that is privately held outside the country’s depository institutions. As information is a prerequisite to effective control, the exercise of control cannot meaningfully be extended into areas for which information cannot be obtained.

646. There are some countries where arrangements unrelated to exchange regulations provide the central authorities with effective control over external assets that they do not legally own. By comparison with the size of the economies, the official sectors of some countries are very large, and external assets may be held and owned by a variety of agencies that are part of the general government or closely associated with it. External assets may be held by state governments, various public financial or nonfinancial institutions, marketing boards, and similar organizations. Some of these institutions may be rather independent from the central authorities. Although they are part of the public sector, it cannot be assumed that their external assets are effectively controlled by the central authorities. Arrangements existing between the central authorities and these agencies should be examined to determine which of the external assets are at the disposal of the central authorities.

647. Arrangements subjecting external assets not owned by the central authorities of a country to their effective control must be definite in intent as well as actually in force. Arrangements that merely provide incentives to the owners of foreign exchange to
transfer their holdings to the central authorities are not a form of effective control.

648. Temporary transfers made on the basis of repurchase agreements or swaps often take place between central banks and private deposit banks. Those transfers of foreign exchange assets from private banks to the central bank are frequently implemented as “window dressing,” and domestic liquidity is often the motive for transfers in the opposite direction. Effective control over such foreign exchange assets is, according to the BPM, exercised by a country’s authorities for the period during which they hold the foreign exchange transferred to them by the private banks. Control of foreign exchange temporarily transferred to private banks remains in the hands of the authorities.

649. For external assets to be considered reserve assets, arrangements conferring control of them to the authorities of a country must be definite and in force. In addition, the assets must actually exist. Many countries prepare for contingencies by making arrangements (often reciprocal) to obtain additional foreign exchange reserves through lines of credit or reciprocal swap agreements between central authorities and also through stand-by arrangements with the IMF. Such arrangements are an important component of an adjustment strategy, but available lines of credit do not constitute reserves at the disposal of a country’s authorities—unless, and to the extent that, drawings have actually been made on these facilities and reserve assets have thereby been created.

650. The issue of effective control pertains to all reserve assets, but only foreign exchange assets are actually subject to the procedures and criteria discussed in the preceding paragraphs. Unlike foreign exchange claims, monetary gold is, by definition, a reserve asset. While virtually all gold held as monetary gold is actually owned by various authorities, arrangements may sometimes exist under which gold is owned by others but effectively controlled by the central authorities. However, as monetary gold unambiguously constitutes reserves, it must be at the disposal of the authorities as it otherwise could not be classified as monetary gold.

651. The issue of effective control does not apply to reserve positions in the Fund. According to the terms of the Articles of Agreement of the International Monetary Fund, only the central authorities of member countries may hold reserve positions in the Fund. The articles, which constitute an international agreement, may be signed by sovereign countries only.

652. SDRs may be held only by the central authorities of IMF member countries and other holders designated by the IMF: SDRs owned by other holders are not subject to the effective control of national authorities, even if the national authorities are members of international and regional bodies consisting of other holders.

Availability for Use

653. BPM references to the availability of reserve assets for use in the event of need pertain to a variety of situations and do not specifically address a particular one. For most countries, the need to use reserve assets can arise in the course of any business day. To be available for use in daily market transactions, assets must be free of conditions restricting subsequent use by those who accept these assets. Therefore, two elements constitute the acceptability (or the availability for use) of external assets:

(1) the universal use, which is determined by convertibility, that can be made of a specific asset;

(2) the immediate usability, which is determined by liquidity, that a specific asset affords.

654. References to the liquidity of external assets, especially in a context of international or world liquidity, almost automatically imply the notion of convertibility. Any asset that is immediately available but not freely convertible is not, in an international context, regarded as liquid.

Foreign Exchange, SDRs, and Reserve Position in the Fund

655. Liquid balances in convertible currencies are commonly held to meet immediate needs (usually in relation to requirements determined by the volume of day-to-day transactions but often in excess of actual requirements) and to provide a margin for unforeseeable fluctuations. Such deposits are now

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held in a number of currencies—usually some or all of the major trading currencies such as the U.S. dollar, deutsche mark, Swiss franc, Japanese yen, pound sterling, French franc, and Netherlands guilder—and in other currencies in which significant settlements are regularly made. The medium for intervention in virtually all major exchange markets is the U.S. dollar—the currency in which a major portion of the foreign exchange holdings of other countries is often maintained. The composition of a country’s foreign exchange reserves is determined by considerations of a practical nature and, in more recent years, by the objective of protecting the value of foreign exchange reserves from changes in the values of individual currencies.

656. SDRs, which are reserve assets created by the IMF, are equivalent to liquid balances in convertible currencies in nearly every respect. SDRs are as liquid as demand deposits and, within the limits set by the IMF’s Articles of Agreement and By-Laws, unconditional in their convertibility. SDRs (the unit of account for all Fund accounting) can be used to settle financial obligations, to extend loans or make donations, and to obtain foreign exchange from other participants in the Fund’s Special Drawing Rights Department or from other holders designated by the IMF. While the amounts and most of the terms associated with SDRs are determined by agreement between the transactors, SDRs cannot be exchanged for gold. The exchange rate calculated by the IMF is binding for all settlements.

657. Reserve positions in the Fund can also be considered liquid. While a member country must present a declaration of BOP-related need to make a purchase in the reserve tranche (reduction in reserve position), the IMF does not challenge a member's statement of need. Convertible currencies from a reserve tranche purchase may be made available within days. Paragraphs 674–679 include a discussion of the transactions associated with a member country’s reserve position in the Fund.

658. In addition to liquid balances of foreign exchange, SDRs, and reserve positions in the Fund, most countries hold reserves in monetary gold and in the form of medium- or long-term claims. To minimize the costs of holding reserves, countries may invest assets in financial instruments that offer higher yields but less liquidity. In addition to holding external assets for reserve-related purposes, a country may also hold external assets (for example, investments in World Bank bonds, which provide development aid) for other reasons or purposes.

659. Although the presence of additional motives for holding external assets does not preclude such assets from qualifying as reserves, the test of availability for use in the event of need must, nonetheless, be passed. A judgment as to an asset’s potential availability for use would have to follow an assessment of constraints that might be encountered were it necessary to transform such an asset into immediately usable liquid foreign exchange.

660. Objective criteria alone are often insufficient for determining the availability of external assets to be used as reserves. The degree of marketability of an asset that has a relatively distant maturity or conditionalities attached to an asset considered for classification as a reserve asset must be evaluated in the context of a specific situation to determine the impact that these factors have on the transformation of such an asset into a liquid one. Usually, it will be possible to express the degree of marketability of an asset in terms of the cost that arises from liquidation prior to maturity. The amount that an asset represents, as well as other conditions such as yield and time remaining to maturity, may require that the price be negotiated if the asset cannot be absorbed by readily acceptable bids from the market. The cost and time involved in the liquidation of an asset may vary with changing market conditions, but a realistic assessment of the asset’s marketability in these terms is the only basis for judging the availability of an asset for use in the event of need.

661. Assets designated for specific uses cannot be excluded from reserves for this reason alone. On the other hand, assets redeemable only in inconvertible currencies or assets with uses restricted or blocked by the issuers are affected by conditions that the holders did not unilaterally impose and do not have the power to change. External assets held in the form of long-term loans extended to provide development assistance or to promote exports, deposits held in inconvertible currencies accumulated from export contracts at concessional terms, or repayments of loans extended under similar terms are among the more obvious examples of assets that could not, in virtually all conceivable circumstances, qualify as reserves.

Payments Agreements

662. In evaluations of the reserve character of foreign exchange assets, asset balances arising from
payments agreements are particularly difficult to
categorize. Such agreements have commonly been
used to facilitate exchanges of goods and services
between countries when one or both of the relevant
countries lack sufficient resources of convertible
currencies to sustain such exchanges under regular
market conditions. The terms of such agreements
vary. Settlements of outstanding balances may take
place at periodic intervals; or balances may be
permitted to increase (swing) to certain ceilings, and
amounts in excess of such ceilings must be settled
when due.

663. Limited convertibility is the primary factor that
leads to the exclusion (from reserve assets) of asset
balances held in connection with arrangements of
this kind. The very existence of payments
agreement arrangements appears to be sufficient
proof that assets (particularly those constrained by
bilateral arrangements) in this form are not available
for use in the event of imbalances of payments.
Moreover, the primary motivation for some of these
arrangements is not the absence of sufficient
resources in the form of convertible assets. Such
agreements may even require the settlement of
balances in convertible assets. The agreements
contained in the framework of the Latin American
Integration Association, for example, were primarily
motivated by the desire to provide a stronger
incentive for intra-regional exchange and an
institutional mechanism for corresponding
settlements. In presentations in the Balance of
Payments Statistics Yearbook, asset balances arising
from these agreements have therefore been
recognized as part of the reserves of participating
countries.

Monetary Gold

664. After a prolonged period of rapid growth in the
market price of gold and the development of a
significant gap between that price and the official
price (based on the Bretton Woods system) of
monetary gold, the official price of gold was
abolished, as of April 1978, by the second
amendment to the IMF Articles of Agreement. During
the period of increasing disparities between official
and market prices of gold, use of monetary gold as a
reserve asset was severely curtailed because of the
absence of a commonly accepted price.

665. Lack of common acceptance does not
necessarily imply that the price of gold should have
been a stable one; the prices of assets denominated
in major trading currencies and even those
denominated in SDRs also began to fluctuate as a
result of floating exchange rates. However, changes
in the value of this latter group of assets were
commonly accepted because the prices of such
foreign exchange assets were regarded as
representative. This acceptance reflects the fact that
the trading volume of such assets in relation to
holdings of them was far greater than the trading
volume of gold in relation to holdings of monetary
gold.

666. The volatility, which resulted in part from the
thin market, of the price of gold in turn imposed a
constraint on the potential availability of monetary
gold for use as a reserve asset. (Lack of availability is
not characteristic of liquid reserve assets.) The price
at which monetary gold was acceptable to the
parties of a potential settlement had to be negotiated
or otherwise determined before monetary gold could
be deemed available for use.

667. The long-range objective, which is stated in
the second amendment to the IMF Articles of
Agreement, of making the SDR the principal reserve
asset in the international monetary system also
affected the use of monetary gold. Although price
determination for monetary gold remains an open
issue, the continued inclusion of monetary gold in
the reserve assets category is unequivocal. Therefore,
monetary gold should unambiguously be treated as
part of reserve assets.

Other Claims

668. The other claims component of reserve assets
includes any claims—other than holdings of
monetary gold by monetary authorities, SDRs,
reserve position in the Fund, and foreign
exchange—that constitute reserve assets. For
example, the foreign exchange component may not
cover working balances of government nonmonetary
agencies or external financial assets held by private
banks and subject to control by a country’s
authorities.

669. In addition to these claims, the other claims
component is used to facilitate reconciliation of
presentations in the Balance of Payments Statistics
Yearbook. The series on foreign exchange in the
international liquidity section is published in
International Financial Statistics (IFS). As a publication presenting monthly data, IFS may not—for practical reasons—include minor asset positions for which it is sometimes difficult to obtain information on a current basis or at monthly intervals. Also, the data in IFS may occasionally pertain to the last workday—rather than the last calendar day—of a month, quarter, or year.

Transactions with the International Monetary Fund

Determination of Quotas

670. On joining the IMF, a country is assigned a quota. Quotas, which are stated in SDRs, are assessed on the basis of comparisons between the new member country’s economic characteristics and those of other member countries similar in size. A member country’s voting power, the quantity of IMF resources to which a country has potential access, and a country’s share in allocations of SDRs are determined by quota size.

671. Each member country is required to pay 25 percent of its quota in SDRs or in currencies that are issued by other IMF members and are acceptable to the Fund. (In all cases, the currencies must be fully convertible.) This 25 percent portion of the quota determines the initial value of the member’s reserve position in the Fund, which is a component of the member’s reserve assets. In the balance of payments, a transaction involving a reduction in foreign exchange reserves (credit) would be offset by an increase in the reserve position in the Fund (debit). The 25 percent portion of the quota (minus the Fund’s net use—if any—of the member’s currency; see paragraph 674) also comprises a member country’s reserve tranche. The other 75 percent of the quota is payable in the member’s own currency. However, no payments are actually made at the commencement of membership. Rather, the member agrees that the IMF may have access to this amount if and when it is required. The country therefore opens an account for the Fund (typically called the Number 1 Account) in its central bank or issues to the IMF a non-negotiable security that can be cashed at any time. In economic terms, the 75 percent portion of quota represents a contingent liability of the member country to the IMF. Consequently, no transaction is recorded in the member’s balance of payments. No interest is payable on either the deposit account or the security.

Change in Quotas

672. For two primary reasons, the IMF periodically reviews the size of member quotas. First, a general increase in quotas may be necessary so that the IMF can obtain additional capital to carry out operations. Second, it may be desirable to make adjustments in the relative sizes of quotas to reflect developments that take place in member countries’ economies after quotas are initially assigned. If, as a result of such reviews, it appears that changes in quotas are necessary or desirable, the membership votes on the proposed changes. When sufficient votes are received in favor, quota changes take effect.

673. Transactions reflecting a change in a member’s quota are similar to those that take place when the quota is initially paid. That is, 25 percent of the quota increase is normally paid in a currency acceptable to the IMF; the remaining 75 percent is payable in the member country’s currency and made available to the IMF if and when the amount is required. Only the 25 percent paid in foreign exchange is recorded in the balance of payments as an increase in the member country’s reserve position in the Fund (debit) and offset by a reduction in foreign exchange reserves (credit).

Other Transactions

674. A member country’s reserve position in the Fund constitutes part of that country’s reserve assets. Therefore, such reserves are available for use by member countries experiencing an imbalance of payments. To use its reserve position in the Fund to alleviate an imbalance, a country purchases foreign exchange from the IMF by “selling” its own currency to the Fund. In essence, there is an increase in the amount of the member country’s currency available to the IMF. The “sale” occurs through an increase in the Fund’s Number 1 Account with the member country’s central bank or through the country’s issuance, to the IMF, of a security with a value equal to the amount of currency “sold” to the IMF by the member country. The economic outcome of this transaction is a reduction in the member country’s reserve position in the Fund. The reduction is offset by an increase in the member country’s foreign exchange reserves. Both the reduction and the offset are recorded in the balance of payments.30

30In formal terms, a country’s reserve position in the Fund equals the country’s quota, minus the holdings in the Fund’s Number 1 Account, of the country’s national currency (or equivalent in securities), minus any outstanding purchases of Fund credit made by the country.
675. When a member country purchases foreign exchange from the IMF, the Fund often provides this foreign exchange from funds made available by another member country as part of that country’s contribution to its quota. In these cases, the first country’s reduction in its reserve position in the Fund is matched by an increase in the second country’s reserve position in the Fund. For the second country, this transaction is offset by an increase in liabilities, which are denominated in the country’s currency, to nonresidents.

676. A country that experiences BOP difficulties can “repurchase” its own currency with foreign currencies or SDRs when the situation improves. In such a case, the member country’s foreign exchange holdings decrease (credit), and the decrease is offset by an increase (debit) in the country’s reserve position in the Fund.

677. When a country exhausts its reserve tranche, it generally must make use of Fund credit to acquire additional foreign exchange from the IMF. As is required for use of a country’s reserve position in the Fund, the country must demonstrate that it is experiencing an imbalance of payments. However, when a country uses Fund credit, it must also agree to adopt and adhere to IMF-approved policies. There is, in addition, a formal agreement for the country to repurchase its own currency during a specified period. These conditions make the use of Fund credit a transaction in the user’s liabilities rather than in its assets. Accordingly, the use of Fund credit is classified as a loan liability under other investment in the financial account. Further discussion on this issue is contained in chapter 11.

678. When a country’s reserve position in the Fund exceeds a certain level, which is determined by application of a Fund-calculated ratio to the country’s quota, the IMF pays the country “remuneration” on a quarterly basis. This remuneration represents income and is typically recorded in the recipient country’s balance of payments as investment income—other investment-interest (credit) and offset by an increase in the foreign exchange component of reserve assets (debit).

679. As well as maintaining a Number 1 Account with a member country’s central banks, the IMF typically maintains a second account. The Number 2 Account is used by the IMF for operational purposes and, unlike the Number 1 Account, is reflected in the balance of payments of a member country as an explicit liability. Transactions involving the Number 2 Account are recorded as increases or decreases in this liability and are offset by the source of funds (in the case of an increase) or the use of funds (in the case of a decrease). For example, when the IMF transfers funds from the Number 1 Account to the Number 2 Account in a member country, the member’s balance of payments shows an increase in its reserve position in the Fund (debit). The increase reflects the reduction in IMF holdings of the country’s currency in the Number 1 Account and is offset by an increase in the country’s other investment liabilities relating to currency and deposits (credit). When the IMF uses funds from the Number 2 Account to pay for the acquisition of goods and services in a country in which the Fund maintains an office, the balance of payments of the member country shows a reduction in this account (debit) and an offset (credit) under government services n.i.e. in the current account.