

CURRENCY UNION TECHNICAL EXPERT GROUP

DRAFT FOLLOW-UP PAPER (CUTEG) # 10

CONCEPTS OF CONTROL AND READY AVAILABILITY OF RESERVES IN A CURRENCY UNION

1. Current international standards for the statistical treatment of the issue

1. *BPM5* recommends that the reserve assets of a currency union (CU) be attributed to member countries. There are no specific guidelines on what should comprise the reserve assets of a currency union.

2. Concerns/shortcomings of the present treatment

2. A set of principles is needed, common to all currency unions, that defines what should comprise the reserve assets of the currency union regardless of the institutional arrangements. An initial attempt to provide such a set of principles is presented in CUTEG issues paper # 10. In the list of actions for the next meeting, CUTEG outcome paper # 10 proposed the following action: “*When NCBs hold reserve assets of the currency union, Fund staff to consider how the concepts of control and ready availability might be applied to determine whether such assets could be classified as reserves assets in the national data, and possible alternative treatments if the criteria are not met.*” This paper addresses part of this question—how should the concepts of effective control and ready availability be applied to reserve assets held with national entities.

3. Proposed treatments

3. The CUTEG has to determine whether it is to confirm its provisional view that for national data, reserve assets should not include any assets not included in reserve assets at the currency union level.

4. Further, this paper looks more closely at how the concepts of control and ready availability of reserve assets should be applied in a currency union, taking into account the centralized and decentralized models of a currency union that are elaborated in issues paper #10. The starting point is that, regardless of the institutional arrangements, reserve assets must comprise the monetary authorities’ foreign currency claims on nonresidents of the CU that meet a test of liquidity and availability for use. So references to “foreign assets” below means foreign currency claims on nonresidents of the CU. The issues for consideration are: (i) how to define the monetary authorities; and (ii) how to apply a concept of effective control over assets not owned by the monetary authorities.

5. In *BPM5*, the monetary authorities are said to comprise the institutional units responsible for the management of reserves and the issuance of currency (paragraph 514). The *SNA93* says that the monetary authorities may issue banknotes and may hold all or part of the international reserves of a country (paragraph 4.86). The *MFSM (2000)* defines the

monetary authorities account as a consolidation of those institutional units responsible for currency issue and transactions in international reserve assets (paragraph 477). In a currency union, account has to be taken of institutional arrangements by which policy on reserve management and currency issue are determined and implemented.

6. In the centralized model, these functions are undertaken by the CUCB or its agents in member countries. In this model, the term agent (rather than branch) could be used to indicate that the agent may only hold reserve assets on behalf its parent organization, the CUCB. Based on these definitions, the Eastern Caribbean Currency Union (ECCU), the Union Monétaire Ouest Africaine (UMOA), and the Communauté Economique et Monétaire de l'Afrique Centrale (CEMAC) may be characterized as centralized models of a currency union. In line with their characterization as centralized models, the reserve assets of the ECCU, UMOA, and CEMAC are held exclusively by the CUCB. It also follows that in each of these monetary unions the CUCB comprises the monetary authorities of the currency union. In both UMOA and CEMAC, reserve assets held by so-called branches in member countries are treated as reserves owned by the CUCB and managed by its agents in member countries. There is a presumption in these institutional arrangements that member countries do not have any particular expertise in reserves management.

7. In the decentralized model, reserve management and currency issue policies are set at the currency union level, while the implementation of these policies is undertaken at the national level. The European Monetary Union (EMU) may be characterized as a decentralized model of a currency union. The question then arises as to whether, in the decentralized model, the monetary authorities should comprise only the agencies that set reserve management and currency issue policy, or also include those agencies responsible for currency issue and reserve management at the national level. In the decentralized model, part of reserves are owned (not just managed) by member countries of the currency union.

8. There are two approaches to characterizing the resulting institutional arrangements in the decentralized model. The first approach is to recognize that reserve management policy can only be set at the currency union level and therefore *define the monetary authority as the CUCB* (and/or any other monetary authorities at the CU level); the NCBs would not be considered as monetary authorities. In this approach, the critical test of whether foreign assets owned by NCBs comprise reserves of the currency union is whether these NCBs foreign assets are under the effective control of the CUCB. This approach is the tighter one as it recognizes that NCBs may hold foreign assets for purposes other than reserves management. In this regard, for consideration is whether this approach should exclude from reserve assets at the CU and NCB levels NCB foreign assets that the NCB can buy and sell without requiring approval by the CUCB, that is, assets not controlled in any way by the CUCB.

9. The second approach is to define the monetary authority as the CUCB (and/or any other monetary authorities at the CU level) and all national institutions *which are members of the central decision making body and implement reserve management policy decisions of a CU*. In that sense, any CUNCB would be considered as a unit of the monetary authority at

the national level. In other words, the monetary authority would comprise both the CUCB (and/or any other monetary authorities at the CU level), and the institutional units that own reserves and issue currency at the national level (e.g., the NCBs) and are members of the central CU decision making body. The Manual could recommend that what constitutes a reserve asset at the CU level should be consistent with the criteria as set out international methodology with borderline cases best determined as a collective task among the CUCB (and/or any other monetary authorities at the CU level) and CUNCBs (and/or any other monetary authorities at the national level). In this instance, as the NCB is part of the monetary authorities, all NCB foreign assets that meet the criteria of reserve assets should be included in CU reserve assets, even assets over which the CUCB did not have any form of control.

10. A more extreme version of the decentralized model is a currency union in which there are no institutional arrangements along the lines of a CUCB for holding and managing reserves at the currency union level. There are no practical examples of such currency unions, but the prospective Gulf Cooperation Council Currency Union (GCCU) may envisage the devolution of the reserve management function to member countries and not establish a CUCB. In such instances, the proposal as set out in paragraph 9 could be adopted: *members of the central decision making body and implement reserve management policy decisions of a CU*. It remains to be determined whether such arrangements qualify as a currency union as defined by CUTEG.

11. There remains the treatment of foreign assets held by domestic banks but “controlled” by monetary authorities (at the national level)—should they be classified as reserve assets. This issue is not simply a CUTEG issue but one with more general interest. However, one issue for the CU data arises: what happens if a CUNCB considers that some foreign assets held outside the monetary authorities meet the criterion of effective control, while the CUCB disagrees? Who will have the last say? As noted in paragraph 9, a collective approach to determining such borderline issues could be encouraged.

4. Points for discussion

- *Does CUTEG confirm its provisional view that for national data, reserve assets should not include any assets not included in reserve assets at the currency union level?*
- *Should the monetary authority in a currency union comprise only those agencies responsible for setting reserve management and currency issue policy or also include the CUCB (and/or any other monetary authorities at the CU level) and all national institutions that are members of the central decision making body and implement reserve management policy decisions of a CU? According to the answer, which are the institutional units comprising the monetary authorities in the ECCU, UMOA, CEMAC, GCCU, and EMU?*

- *Should the Manual recommend that what constitutes a reserve asset at the CU level should be consistent with the criteria as set out international methodology with borderline cases best determined as a collective task among the CUCB (and/or any other monetary authorities at the CU level) and all national institutions that are members of the central decision making body and implement reserve management policy decisions of a CU?*
- *Should the elaboration of the concept of effective control by the monetary authority (with monetary authority as defined above) over foreign assets held by other resident entities, be decided in the wider discussion of the methodology for reserve assets (e.g., as in the Annotated Outline, paragraph 5.54) and then applied as appropriate for the purposes of a currency union?*
- *In the GCCU, are there institutional arrangements, such as a standing committee, that can set reserves management and currency issue policy in the absence of a CUCB?*