

# **Hoarding of International Reserves: Mrs Machlup's Wardrobe and the Joneses**

**Yin-wong Cheung**

University of California, Santa Cruz  
Hong Kong Institute for Monetary Research

and

**XingWang Qian**

University of California, Santa Cruz

July 2007

## **Summary**

After the 1997 East Asian financial crisis, some economies have experienced a steep increase in their holdings of international reserves. In this exercise, we explore a motive for hoarding international reserves that was advocated by Fritz Machlup in the 1960s. Specifically, we consider the Mrs Machlup's wardrobe hypothesis and the related keeping up with the Joneses argument. We suggest that, in addition to psychological reasons, there may be economic reasons underlying the keeping up with the Joneses behavior. For instance, if an economy is holding a level of international reserves that is relatively lower than the Joneses, it is more vulnerable to speculative attacks. Further, for developing economies, international reserves can have a positive impact on their growth prospects, which, in turn can reduce their vulnerability to crises. We use a stylized model to illustrate these effects on the hoarding of international reserves.

A canonical empirical international reserve demand equation is used to investigate the presence of the Joneses effect in a group of East Asian economies. Both linear and panel-based regression results are suggestive of the presence of the Joneses effect, especially in the post-1997 crisis period. Individual economy estimation results, however, show that the Joneses effect is not uniform across economies.