

Russia sells foreign reserves

This Month in the Economy

Instructor's Guide

Introduction

These teaching packs are designed for 30-minute (online or offline) sessions that can be included within any lecture or tutorial class. They are designed to be suitable for undergraduate university students, but could easily be adapted for higher or lower levels. Every month, we will publish at least one exercise that you can use to engage your students with current events. The main aim of these exercises is to give students practice in relating economic ideas to the real world and their own lived experiences.

Newspaper articles or videos are used as the entry point to an economic topic, which the instructor expands upon before the students are broken into small groups to engage in an activity. Teaching more concrete knowledge about actual economies gives students motivation, helps them anchor theory to something in the real world, gives them a basis of knowledge to build on, and will help students to develop the skills required to work as economists in the real world. All the materials you need are provided for you. These teaching packs are published as creative commons (CC BY) and can be freely used and adapted.

The Economics and Geopolitics of Russia Selling Yuan and Gold Reserves

It is important for students to understand the workings of international and public finance and that the goal of governments and politicians is not always economic efficiency when making financial decisions. Normative goals other than efficiency can motivate economic decisions. A good economist is able to recognise, clearly name and take into account the values and goals behind economic behaviour, when making sense of the world.

The recent financial decisions of the Russian government provide a clear example of values and goals other than efficiency can affect economic activities, in this case how geopolitical goals (Putin's imperial ambitions) are affecting the accumulation and stocks of Russia's foreign exchange reserves. In January, Russia started selling some of its yuan as well as gold reserves. These decisions were a consequence of sanctions imposed by

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G7-countries on Russian oil and gas, which pushed Russia's government budget into a significant deficit, due to a drop in tax revenues from oil and gas.

While this is an extreme example, many economic decisions are more complicated than efficiency considerations and it is crucial for students to understand the multiplicity of factors involved in real-world economic decisions, including political goals and other value judgements. Sometimes decisionmakers prioritise other outcomes over efficiency, such as standing up against the West and financing a war, as in the Russian case.

Lesson Plan

Learning Objectives

- Recognise that efficiency is rarely the only consideration in economic decisions
- Connect economic decision making to geopolitics
- Understand why countries hold foreign exchange reserves and how they use them
- Understand why Russia is selling yuan and gold reserves

Transferable Skills Developed

- Understand and articulate written information
- Analyse and explain concrete economic realities

Prior to session

All students should read the two selected one-page articles about Russia selling yuan and gold reserves. In addition, students should read one out of three slightly longer articles..

The instructor should prepare the facilitation of the class discussion and the slides.

Plan of Activities

Duration	Teacher Activity	Student Activity
2 min	Introducing the topic (slides 1 to 3)	
18 min	Facilitating class discussion (slides 4 to 6)	Participating in class discussion
10 min	Bringing together and complementing insights from class discussion (7 to 10)	

Total: 30 min

Student preparation work (before class)

Before class, all students should read these one-page articles: [Russia is smashing open its \\$45 billion piggy bank of Chinese yuan as energy revenue crashes](#) and [Russia sells some gold as its budget deficit reaches \\$25 billion](#).

Guiding questions:

- What is the direct motivation for Russia to sell yuan and gold reserves?
- Why is Russia selling yuan and gold, but not other currencies?

In addition, the instructor subdivides students into three groups (e.g. alphabetically) and assigns one of the following three packages of background articles per group:

- I. [Foreign Exchange Reserves: What They Are, Why Countries Hold Them](#) & [Foreign Exchange Reserves and How They Work](#) (sections 'How Foreign Exchange Reserves Work' and 'Purpose')

Guiding questions:

- What are foreign exchange reserves?
- Why do countries hold foreign exchange reserves?
- What are the purposes of holding/using foreign reserves? Which (if any) of the described purposes using foreign reserves are Russia's sales serving?

- II. [Sanctions-Proof Yuan to Putin's Rescue After Oil Cap Hits Budget](#) & [Central banks are reassessing foreign exchange reserves](#)

Guiding questions:

- How are geopolitical decisions (by other countries) in the context of the war against Ukraine linked to Russia's public financial decision-making?
- How have geopolitical changes over the past two decades affected the composition and handling of foreign exchange reserves held by countries?

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III. [Russia's bright, shiny anti-sanctions weapon: Inside the billion-dollar business of 'blood gold'](#)

Guiding questions:

- What are the advantages and disadvantages of gold reserves?
- What geopolitical factors and considerations make gold reserves more advantageous than disadvantageous for Russia and other internationally ostracised countries?
- Why has Russia been stockpiling gold?

Introduction by the instructor (2 min)

Slide 2: Russia sells foreign exchange reserves

Slide 2 is to present the news about Russia selling yuan and gold reserves in January and February 2023.

Slide 3: Overview and learning objectives

Slide 3 is to give students an overview of the structure and learning objectives of the exercise.

Facilitated class discussion (18 min)

Students will have prepared by reading different background articles, which provided them with different perspectives and insights on Russia's foreign reserve sales.

The class discussion builds on these preparations. The purpose is to allow students to co-develop an understanding of the following topics:

- The role of foreign exchange reserves in the (international) economy
- Russia's use of foreign reserves and gold
- Geopolitics and economic decision-making/
- The role of values in economic processes

Instead of giving a lecture to provide the answers, the instructor prompts students to discuss and find answers together in dialogue. Groups that have read different articles before class will complement each other's insights on the topic.

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The subsequent questions can help the instructor to start and steer the discussion.

Discussion questions:

- Why do countries generally hold foreign exchange reserves and what do they usually use them for? (slide 4)
- To which extent do these common purposes and usages of foreign exchange reserves explain Russia's foreign reserve sales? (slide 5)
- What has directly and indirectly motivated Russia's reserve sales? (slide 5)
- Which goals is Russia pursuing internationally and how are they affecting the composition and handling of its reserves? (slide 6)

Presentation by the instructor (10 min)

The purpose of the final presentation by the instructor is to bring together the most important take-aways from the class discussion. Ideally, the students will have already co-developed most of the answers themselves, and the instructor only needs to connect the dots and fill some gaps here and there.

Slide 7: Foreign exchange reserves in the (international) economy

First, the instructor recaps the definition of foreign exchange reserves.

Subsequently, they explain the general purposes of holding or using foreign exchange reserves, according to mainstream economic theory. Students may have mentioned most, if not all, reasons during the discussion. There is no need to re-explain those points in detail. The emphasis should be on clarifying and explaining those that have not been covered or sufficiently understood:

- 1. To help keep the value of their domestic currency at a fixed rate.**

For example, China pegs the value of its currency (the yuan) to the US dollar. If China stockpiles dollars, it raises the dollar value versus yuan, making Chinese exports cheaper than American-made goods, increasing China's sales

- 2. To keep a domestic currency lower than the dollar.**

In much the same way as fixed currencies, a lot of central banks with floating exchange rate systems use their reserves to keep their currency lower than the

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US dollar. For example, the Bank of Japan buys US Treasuries to keep its value lower than the dollar, ensuring that Japan's exports stay relatively cheaper

3. **To maintain liquidity in case of economic crisis.**

In this case, a central bank can step in and exchange its foreign currency for the local currency, allowing local companies to continue importing and exporting competitively

4. **To meet a country's international financial obligations.**

These could include international payments like sovereign and commercial debts, financing imports and absorbing sudden capital movements

5. **To fund internal projects.**

Sometimes countries will use their currency reserves to provide cash to industries, most often infrastructure programmes

6. **To reassure foreign investors.**

Holding large amounts in forex reserves projects an air of confidence, which can prevent investors moving their capital to other countries, which could cause an economic downturn

7. **To diversify their portfolio**

By holding different currencies and other assets, such as gold, in reserve, a central bank can diversify its risk across different instruments. This provides protection should one investment decline

(source: <https://www.cityindex.com/en-uk/news-and-analysis/what-are-currency-reserves/>)

Slide 8: Russia's use of foreign reserves

After discussing foreign reserve usage in general, the instructor proceeds to explain the usage by Russia for economic and geopolitical purposes.

Russia's accumulation and sale of yuan and gold reserves over the years can be explained by immediate motivations and longer-term goals. First, to compensate for a drop in oil and gas revenues caused by the **G7's price cap of \$60 per barrel or less on Russian crude oil** since December, Russia sold yuan and gold reserves. After Western governments had frozen \$300bn of foreign currency reserves held in dollar, sterling, euro and yen back in March 2022, Russia had to resort to yuan and gold.

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As for underlying motivations, **the war against Ukraine** has strongly impacted Russia's budget, with [national defence, security, and law enforcement spendings reaching \\$44 to \\$59bn in 2022, making up a significant share of the 2022-deficit of \\$50bn](#). Moreover, Putin's geopolitical actions had already been influencing the composition of Russia's foreign reserves since long before the invasion, with the government starting its accumulation of yuan and gold after the annexation of Crimea in 2014. This has helped Russia to **become less vulnerable to Western sanctions** and to **weaken the role of the dollar**, undermining US economic dominance.

Slide 9: The role of values in the economy

Value judgements are at the core of economic questions. Students should learn to distinguish between different values and learn to discuss them rather than sweep them under the carpet. The purpose of this last slide is to use the example of Russia's foreign exchange sales to bring this point across and examine the role that values can play in the economy.

One role is determining what is seen as a desired outcome. Contrary to what mainstream economic theory teaches, economic efficiency is not always the main outcome that economic actors such as governments or society as a whole desire.

Had it been the main goal, the Russian government would likely not have increased its gold and yuan reserves over the past years, as they are not the most efficient foreign reserves to hold in order to serve the seven purposes discussed before. Likewise, selling reserves mainly serves to cover the budget deficit in the short term, but does not promote economic efficiency in the long term.

The accumulation and recent sale of yuan and gold reserves has been motivated by outcomes that were valued more than efficiency, that is, the ability to withstand sanctions and the continued financing of the war against Ukraine.