The IMF, gold sales and multilateral debt cancellation

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Executive Summary

The IMF holds the largest official reserves of gold in the world after the United States and Germany. These are held at a significant discount to the market price and have a latent additional value of about $34 billion at current price levels. The IMF has no real use for this gold[1] and it is not used in the general day to day operations of the Fund. Moreover gold constitutes only about 2% of the IMF's total available resources.

There is also a significant opportunity cost to holding gold in its present form. Our calculations show that by holding gold the IMF has lost about $30 billion in potential revenue since 1979-80 when fund staff first suggested that the gold be sold.

By combining the uncommitted principal from gold revaluations carried out in 1999-2000 with the revenues from gold sales, the Fund could generate up to $37 billion of additional resources.

We recommend that these resources should be used for the cancellation of poor country multilateral debt. An earlier report[2] by Debt and Development Ireland showed how the IMF could afford to use these resources for debt cancellation without in any way jeopardizing its operations. It recommended the sale of 5 million ounces of gold every year for the next twenty years.

The suggestions for the use of IMF gold to cancel multilateral debt have been taken up by policy makers and are now being considered seriously at the G-7. This gold could be used to generate resources either though the use of off-market transactions similar to the ones negotiated by the fund in 1999-2000 or though outright gold sales. One significant advantage of using IMF gold is that the resources would be additional and hence debt cancellation would not cannibalize aid budgets.

Using off-market revaluations would diminish the interest free resources of the fund significantly and increase the cost for the borrowing members. That is why previous reports[3] recommended the use of outright gold sales instead. This would not have any impact on the cost of using Fund resources.

Despite most arguments surrounding the gold sales of the IMF having been convincingly answered, some concerns about the potential negative impact on gold prices still persist.

This report aims to set these doubts to rest by showing how the sale of IMF gold spread over a sufficient period would not have any significant impact on gold prices. Past IMF gold sales have not had any significant price impact. When the Swiss government got a green light to sell 42 million ounces of Swiss gold in a referendum in 1999, gold price actually went up.

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[1] See footnote 16

[2] Can the IMF and the World Bank cancel 100% of HIPC debt – by Sony Kapoor September 2003 at Jubilee Research for Debt and Development Coalition Ireland

[3] Can the IMF and the World Bank cancel 100% of HIPC debt – by Sony Kapoor September 2003 at Jubilee Research for Debt and Development Coalition Ireland, Resource Rich BWIs 100% debt cancellation and the MDGs – by Sony Kapoor June 2004 for the Foreign Ministry of the Dutch Government (IOB)

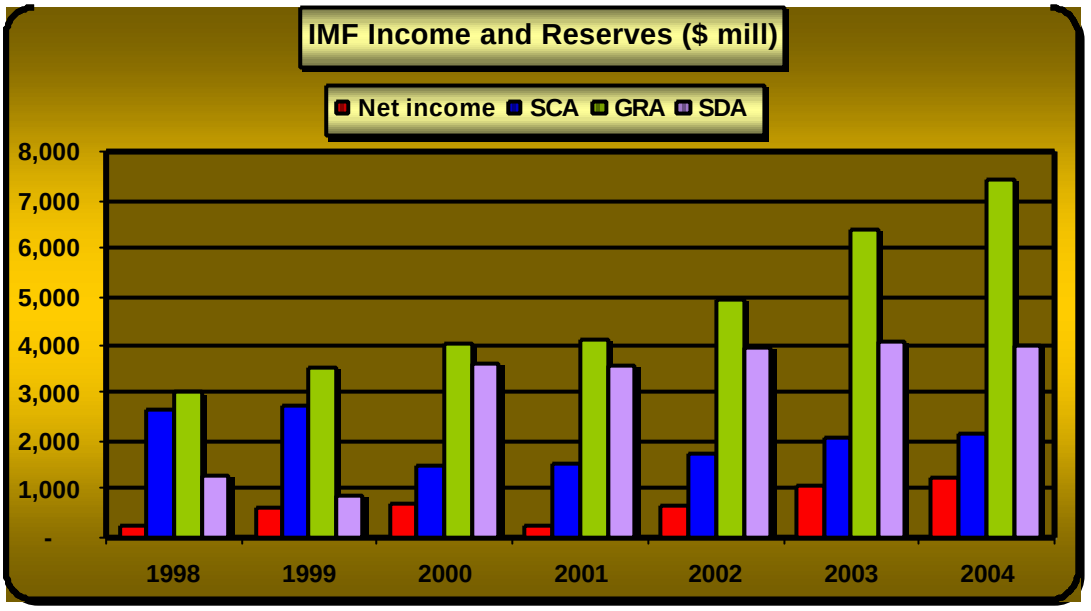
In fact, though central banks have been selling large amounts of gold into the market in recent years, gold price has actually been increasing. The annual sale of gold by many countries such as Switzerland, Belgium, Australia and the Netherlands exceeded the five million ounces of gold that we recommend the IMF should sell annually. Under the new Central Bank Gold Agreement, central banks in Europe alone can sell as much as 16 million ounces of gold into the market every year.

It is important that the gold sales be conducted in an open and transparent manner to avoid uncertainty and rumours in the market. It is uncertainty, combined with substantial amounts of producer hedging and gold leasing by central banks that had a significant impact on gold price in the 1990s and not the actual sale of gold by central banks.

Even if there is no eventual consensus on the impact of gold sales, the rich country central banks currently selling gold under the CBGA can always agree to cut down their annual sales from 16 million ounces to 11 million ounces in order to accommodate 5 million ounces of IMF gold sales. The central banks selling gold are doing so because of strategic long-term reasons of portfolio rebalancing and have no immediate need to sell gold. There is, on the other hand, an immediate need to sell IMF gold to help reduce poverty and suffering in the poorest countries in the world. Portfolio rebalancing by rich country central banks in Europe can wait, the suffering people in poor countries cannot.

The IMF and gold

The IMF holds the largest reserves of gold in the world after the United States and Germany; its gold reserves amount to 103.4 million ounces and the IMF holds them at a book value of only about $8.5 billion when the market value is closer to $42.3 billion. Most gold is held at SDR 35($51) per ounce as compared to the current market price of $408[4] per ounce. Hence, there is about $34 billion of latent value locked up in the IMF's gold reserves. We believe that unlocking this value by selling the gold at market rates can generate substantial resources that can be put to productive use such as financing multilateral debt cancellation.



The IMF has no real use for this gold and it is not used in the general day to day operations of the Fund. Also, at the present book value gold just constitutes 2% of the total $370 billion in resources[5] ($290 billion is in usable currencies). Even at the market value of $42 billion, gold would only be 10% of the Funds available resources.

We have suggested[6] that the IMF sell 5 million ounces of gold every year for the next 20 years in order to finance multilateral debt cancellation. At the current market price of $408 per ounce, this would generate about $1.8 billion of additional resources every year for the next 20 years or about $34 billion. If we use a 24 year historical average for the price of gold – about $370 per ounce then the sale of this gold would still generate additional resources of about $30 billion over the next 20 years.

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[4] On the 1st of September 2004

[5] http://www.imf.org/external/np/tre/liquid/2004/0304.htm and Table

[6] See Can the IMF and the World Bank cancel 100% of HIPC debt – by Sony Kapoor September 2003 at Jubilee Research for Debt and Development Coalition Ireland, Resource Rich BWIs 100% debt cancellation and the MDGs – by Sony Kapoor June 2004 for the Foreign Ministry of the Dutch Government (IOB)

These can then be used to cancel the multilateral debt owed to the IMF by the poorest countries and the excess amount can be used to finance the cancellation of debt owed to other multilaterals. The HIPC countries owe the IMF about $7 billion (NPV) of which $2 billion (NPV) has already been budgeted for.

While our suggestions have generated debate, there is still a concern that such a sale would have a severe negative impact on the price of gold. This in turn has the potential to have a negative impact on some of the poorest countries that are major gold producers.

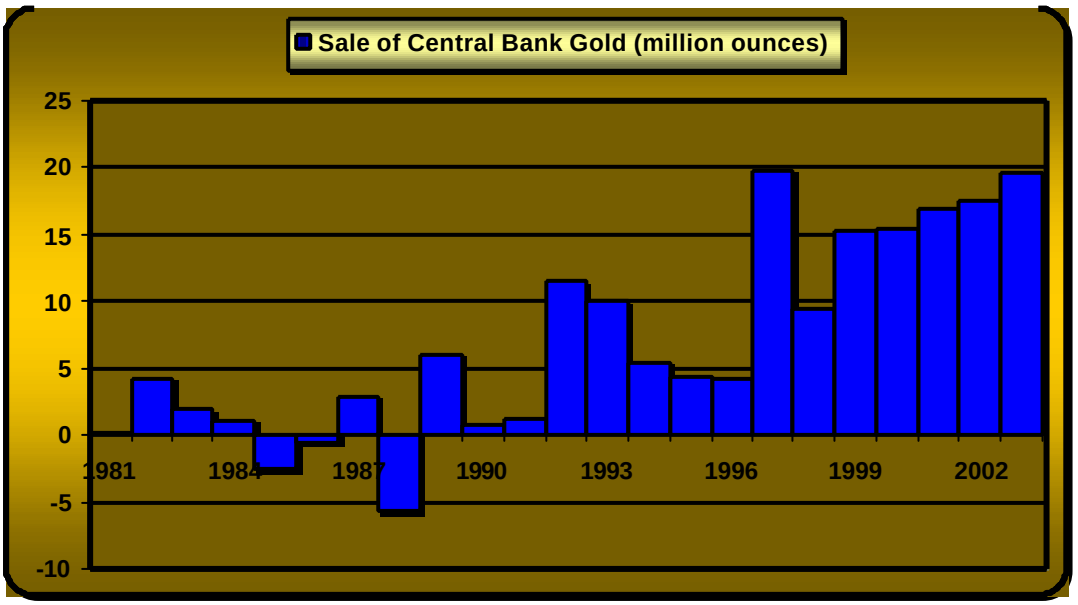
However, we do not think that there would be any significant fall in the price of gold if the sale of IMF gold does go ahead. The following section on the gold market and gold sales shows why.

The gold market and the sale of official gold

Before the Second Amendment of the Articles of Agreement of the International Monetary Fund in April 1978, the role of gold in the international monetary system was central and pervasive. The Second Amendment contained a number of provisions that, in combination, were intended to achieve a gradual reduction of the role of gold in the international monetary system and in the IMF. The world had come off the gold standard and subsequent to this amendment no central bank provided for full convertibility of its currency into gold.

This was expected to drastically decrease the amount of gold reserves held by countries. However, this large decrease in gold reserves never happened and even now gold is still an important asset in the reserve holdings of a number of countries. In fact, between 1978 and 2004 the total reserve holdings of gold in the world have only gone down by about 150 million ounces from 1,166 million ounces in 1978 to 1,016 million ounces in 2004, a decrease of only about 13%.

However, there is an increasing trend for central banks to get rid of their gold reserves. More than 75% of the 150 million ounces sold have been brought to the market since 1992 and more than half the gold sales have occurred since 1997.

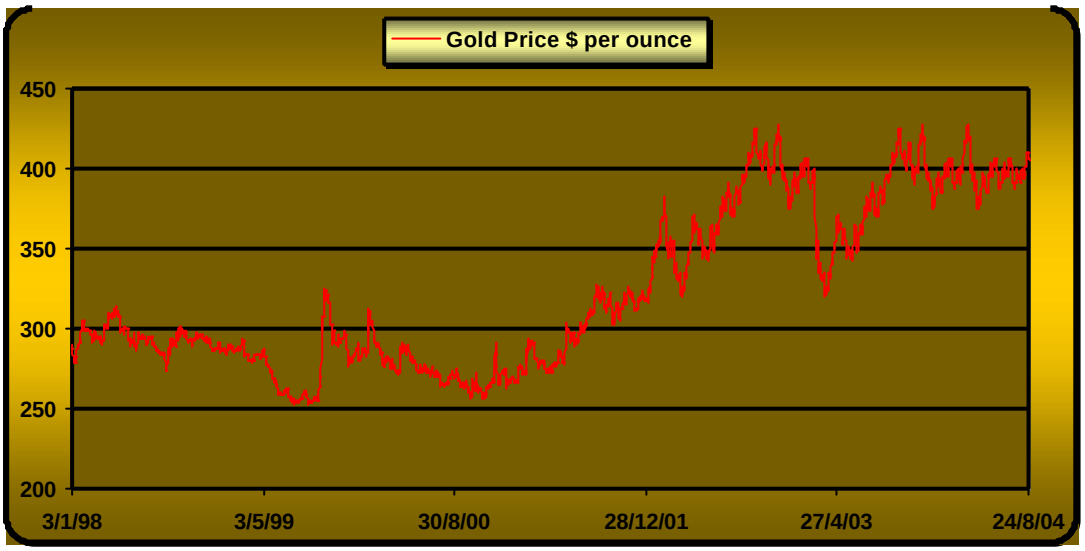


In fact most of the largest sales of central bank gold have taken place in recent years. The official sector sold 19.5 million ounces in 2003, 17.5 million ounces in 2002, 16.9 million ounces in 2001, 15.4 million ounces in 2000, 15.3 million ounces in 1999 and 19.8 million ounces in 1997.

To put things in perspective, we are proposing a sale of only about 5 million ounces of IMF gold every year. This is only about 25% of the annual official sector gold sales since 1997.

There is a trend for ever increasing gold sales by central banks. Despite this, gold price has generally trended higher since 2000.

This is illustrated by the following graph, which tracks the price of gold from 1998 right up to 2004.



Switzerland, the Netherlands, Belgium, UK, Australia, Canada and other OECD countries have been major sellers of gold recently and a decrease in the overall level of gold reserve holdings is now a fact of life in the gold market.

In fact large annual sales of central bank gold are fairly common.

- Switzerland sold 5.5 million ounces in 2000, 7.1 million ounces in 2001, 9.1 million ounces in 2002, 9.15 million ounces in 2003 and has already sold more than 5 million ounces this year.

- The Netherlands sold 12.9 million ounces in 1993, 9.7 million ounces in 1999 and is in the process of selling another 9.6 million ounces

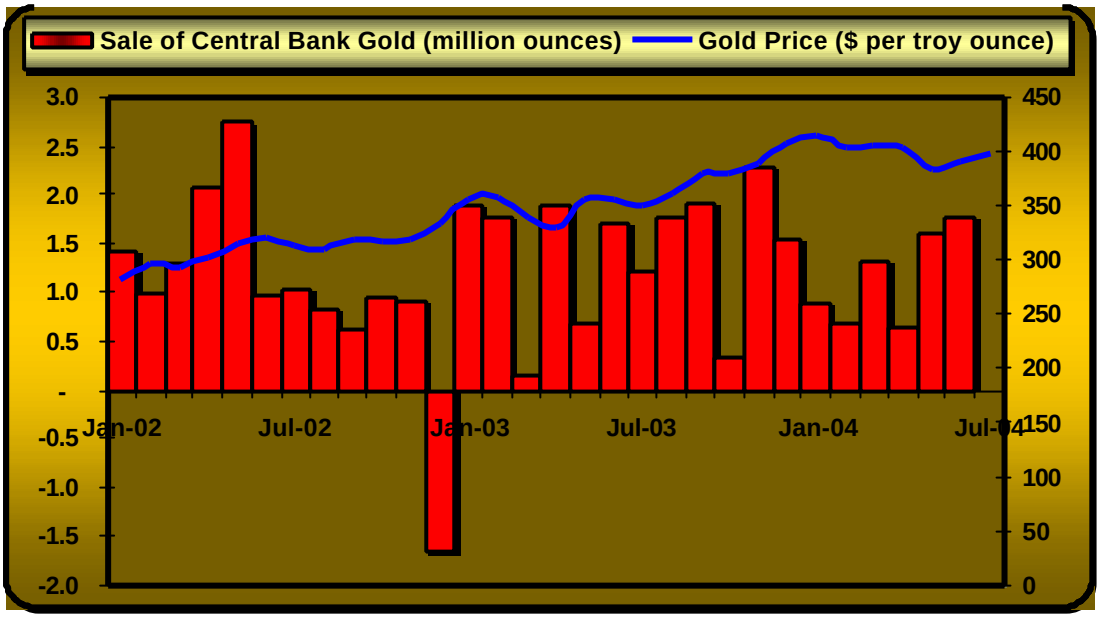
- Belgium sold 9.6 million ounces in 1998, 6.54 million ounces in 1996, 5.6 million ounces in 1995, 6.51 million ounces in 1992 and 4 million ounces in 1989

- Australia sold 5.3 million ounces in 1997

✍✍The UK sold 12.7 million ounces from 1999-2002

✍✍Austria sold 3.2 million ounces in 1994

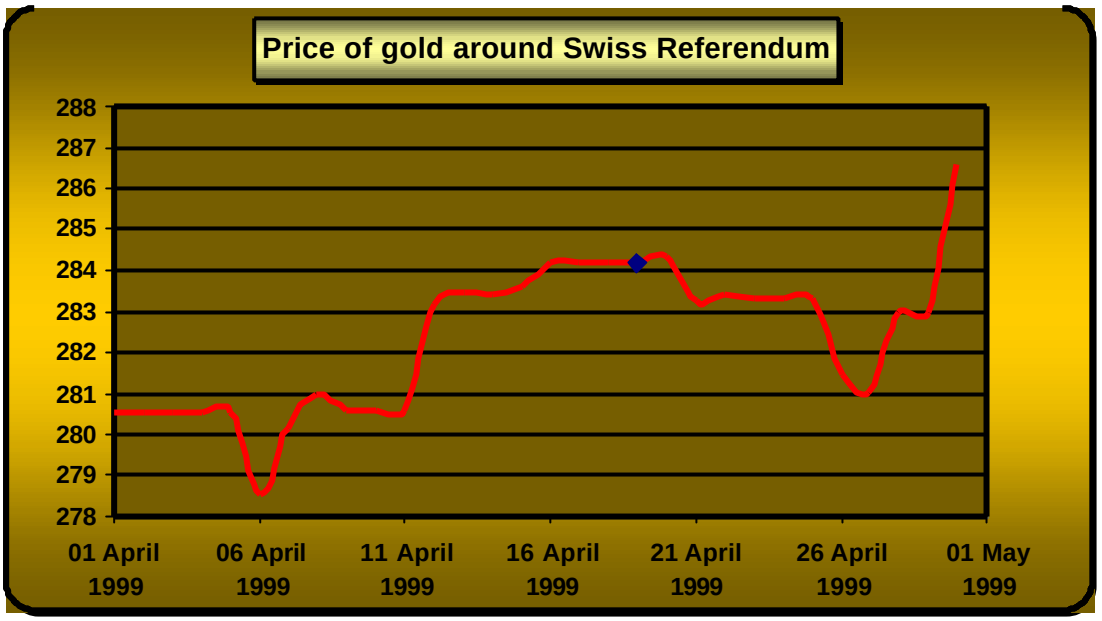
✍✍Canada sold 3.9 million ounces in 1992



While any sale of gold will change the balance of demand and supply in the market and can have some price impact, the impact is limited. The above graph shows that despite a significant and continuing sale of gold by the central banks since January 2002 gold price has trended higher.

Gold sales announcements

In the weekend of 17th-18th of April, the Swiss voted in a referendum to decide whether to let the central bank sell as much as half its gold holdings. While the referendum was not very close, its outcome was still uncertain and the gold sale camp eventually won with 59% of the votes . The following graph shows how the market did not react to the announcement in a negative way. The first day of trading after the announcement (marked in graph) actually saw a small (but insignificant) price rise.



A news report from the Evening Standard on the 19th of April confirms this interpretation.

"THE gold market took in its stride Switzerland's weekend referendum which paves the way for the nation to sell-off its vast stockpile of the precious metal. Gold for immediate delivery rose $ 1.15 an ounce from Friday's New York close to $ 285 an ounce in early trading today, underpinned by buying from the Far East.

Swiss voters approved by a 59% majority government plans to sell as much as $ 12 billion of gold to finance more profitable investments. Switzerland is the third-biggest country gold holder, with 42 million ounces - equivalent to half the world's annual output.

It is one of the last countries to sever the link between its currency and gold. Swiss gold sales could begin as early as spring 2000."

On the 7th of May 1999, the UK treasury announced its intention to sell 13.3 million ounces of gold. This drew a sharp response from the World Gold Council, a body that represents the interests of gold producers and is opposed to gold sales. In a press release it said that the announcement "...has had an immediately damaging effect on the gold price, which fell nearly $7 to $281.50 an ounce in early trading in London..."

While it is true that the price dropped $7.25 at one stage, it rose again to finish only $5.35 down. This shows that the market had overreacted in the first instance and that price recovered soon after. Also, a price move of this magnitude is fairly common gold sale or not. Our calculations show that gold price changed by more than $5.35 per ounce more than 210 times between January 1998 and August 2004 a full 9% of the time. Surely all of these changes cannot be attributed to gold sales.

The gold market is considered to be one of the largest and most efficient of financial markets where new information is incorporated into the prices almost immediately. It has an annual turnover of more than $4.5 trillion almost half as much as the whole of the New York Stock Exchange. Yet in September 1999 a commentator said that

prices had fallen to about $256 per ounce since the UK announced its sale of gold in May and seemed to suggest that this fall was due to the announcement. This goes contrary to common sense and finance theory as there was no new information on UK gold sales in the period[7]. In any case, the price of gold reached $325 per ounce in the first week of October and our commentator fell silent.

A little bit of digression

While the sale price of gold in the market fluctuates significantly - sometimes by as much as 30% or more in a year- the costs of mining and producing gold are much less variable. Gold producers derive profits from the difference between this eventual sale price and the costs of mining.

However, this profit is uncertain and very volatile. In order to reduce this uncertainty gold producers with proven reserves in the ground sell a portion of these reserves forward – enter into long term contracts for selling future gold at a fixed price mutually agreed with gold dealers. This is called producer hedging.

Central banks hold stocks of reserve assets, mostly liquid foreign currencies such as dollars, yen or euro. Gold too constitutes a significant part of the total reserve holdings. Current total foreign exchange reserve holdings of central banks stand at about $2,500 billion of which gold accounts for about $400 billion at current market price.

Most foreign currency holdings are not held as cash but are instead invested in safe liquid securities such as government bonds. Depending on the interest rate environment and holding period, these securities generate interest income of between 1-6%. Meanwhile, holding gold does not generate any income. There is thus an opportunity cost to holding reserves of gold.

In order to try and earn some income on their holdings of gold, some central banks started leasing their gold reserves to financial institutions such as gold dealers, banks and hedge funds in return for an income that has been around a meagre 0.5-1.5% per annum.

The gold dealers who buy forward gold from producers are exposed to possible losses if gold price falls in the future. So, in order to hedge their position, they lease gold from central banks and sell it in the spot market.

Hence, leasing of gold increases current supply and makes it easier to 'short sell' gold. This can help depress current gold price. Producer hedging – selling gold forward to lock in prices for future gold production also helps keep future gold prices low.

While there is no clear statistic for the amount of producer hedging and central bank gold leasing, it is clear that the numbers are significant. Some estimates for producer hedging put it at about 100 million ounces built up over the past ten years. The

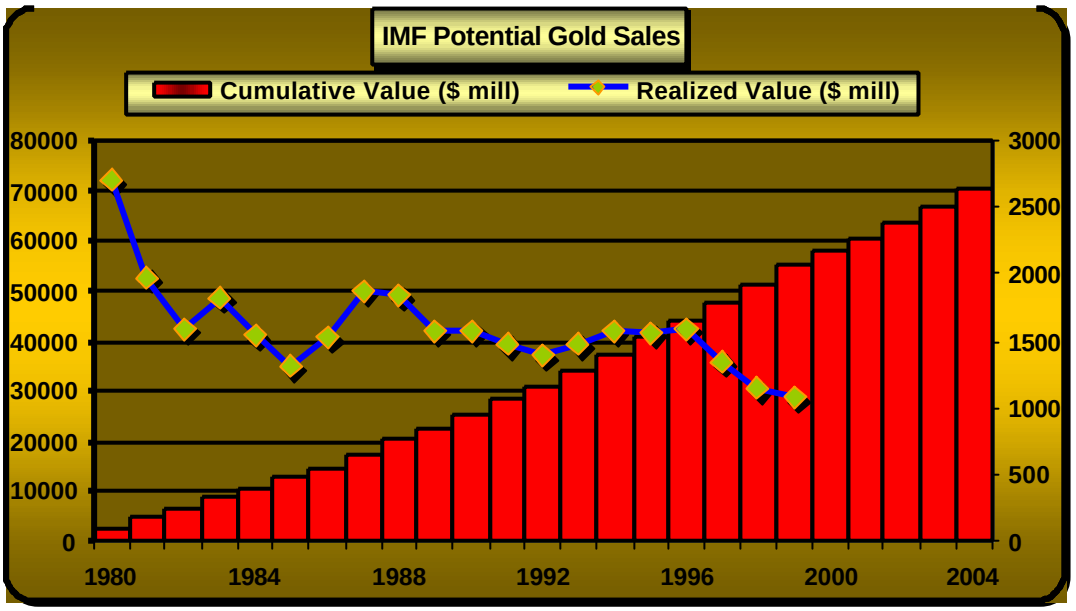
[7] There is one way in which the UK sale could have affected the market price significantly. This would be if the UK sale was seen as a precedent for extensive further sales of gold by other countries. However, other countries such as the Netherlands and Belgium etc. had been selling central bank gold into the market for many years before the UK sale was announced. So while this uncertainty could have impacted gold prices somewhat, a large effect is unlikely.

numbers for central bank gold leasing are estimated to be as high as 150 million ounces. Some estimates put the amount of leased gold even higher that that number.

In fact, the effect of leasing gold and producer hedging on gold prices is far more significant than the effect of central bank gold sales.

The opportunity cost of holding gold

The IMF claims that the benefits of gold holdings are being passed on to members. However, this is misleading as these stated benefits are intangible and insignificant compared to the significant opportunity cost of holding undervalued gold reserves. According to our calculations[8], if the IMF had sold its gold holdings into the market gradually over a period of say twenty years from 1980 and invested the proceeds, it would have had current reserves of more than $78 billion[9]; almost twice the current market value of its gold holdings of $42 billion.



It is important to recollect, that Fund staff in 1979-1980 wanted to sell the gold and invest proceeds in income generating assets but were thwarted by lack of political will. Had the fund sold gold gradually and invested in income generating assets, it would have had current reserves worth as much as twice the current market value of gold.

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[8] We assume that the IMF sold 5 million ounces of gold in the market every year from 1980-1999 at the market price and the proceeds from such sales in excess of SDR 35 per ounce were invested in securities yielding 5% per annum. A simple calculation shows that the IMF would now have more than $70 billion. If we add the current book value of IMF gold of about $8 billion this gives a potential current market value of $78 billion. This compares with the actual current market value of $42 billion..

[9] In Can the IMF and the World Bank cancel 100% of HIPC debt – by Sony Kapoor September 2003 at Jubilee Research for Debt and Development Coalition Ireland, we have used slightly different assumptions. In that paper, we performed conservative calculations that used a 10% discount to the market price of gold. Also, instead of using the actual value of SDR 35 we used $43 throughout as an approximation. This gave a current potential market value of $71 billion as compared to the present calculation that gives a value of $78 billion.

The Central Bank Gold Agreement (CBGA) and Gold Price

In general, the financial markets do not like uncertainty. This is because valuation of financial assets derives from the confidence in their value and uncertainty can dent confidence. One of the reasons why central bank gold sales became a contentious issue in the late 1990s was that they were sporadic and unpredictable. There was no way of knowing when a central bank could suddenly announce the sale of significant stocks of gold. This could have had a negative impact on market confidence.

Moreover, central banks were leasing increasing amounts of gold to financial market participants. While, no one really thought that central banks would sell a large chunk of their gold holdings, there were real fears that gold leasing could increase exponentially and depress gold prices.

It was in this environment that the first Central Bank Gold Agreement[10] was announced on September 26th 1999. All major central banks that had been significant sellers of gold signed up to this agreement which the declaration said was "In the interest of clarifying their intentions with respect to their gold holdings..." or in other words to reduce uncertainty surrounding gold sales and leasing by central banks.

The agreement did not limit reduce gold sales as is widely stated by those opposed to gold sales but in fact totalled up the gold sales that were planned by the signatories and disclosed the number to the market. This helped reduce uncertainty.

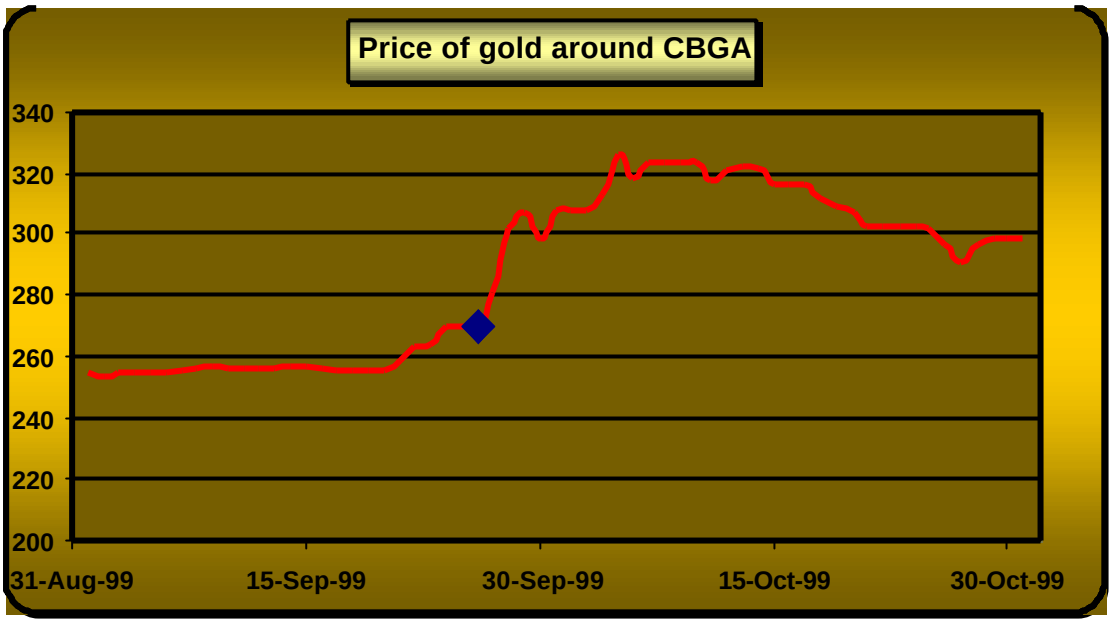
What the agreement did limit was the further leasing of gold to financial market participants. The growth in gold leasing was depressing gold prices and there was also concern about leased gold being used for speculative purposes. The CBGA sought to freeze gold leasing, futures and options at levels prevailing in 1999.

This helped alleviate market concerns of an exponential growth in gold leasing and there was an instant rise in gold price. It is interesting to note that this happened while the CBGA announced that the signatories would actually sell over 65 million ounces of gold over the next five years – about 13 million ounces every year.

The bounce in gold price was primarily a result of 1) a more certain environment for gold sales and 2) a limit on further leasing of gold and not because the planned sales of gold were cut down.

The following graph illustrates how the gold market reacted to the announcement. There was a clear positive price reaction around the date the CBGA was announced (marked in graph) before the price settled down again.

[10] http://www.usagold.com/NewGoldMarket.html



The recent renewal of the agreement[11] did not have much of a market impact though it expands the sales to about 80 million ounces over 5 years or about 16 million ounces every year. Importantly, it keeps the freeze on gold leasing, futures and options in place.

This shows that the gold market can absorb sales of significant amounts of gold as long as they are carried in an open and transparent manner with the planned sale timetable released into the public domain. This helps curb speculation and uncertainty in the market. This conclusion is supported in another study[12] of previous IMF gold sales.

We have suggested that the IMF sell about 5 million ounces of gold every year for the next twenty years. This annual amount is only about a third of the gold sales already agreed under the renewed CBGA and about a fourth of the annual official sector gold sales over the past few years.

Precedents for the sale of gold

Our suggestion that the IMF sell gold is not new; the fund has already engaged in several transactions[13] where it sold gold.

From 1976-1980, the IMF sold approximately one third (50 million ounces) of its then-existing gold holdings following an agreement by its members to reduce the

[11] http://www.gold.org/value/reserve_asset/agreements/ecb_pressrelease2.html

[12] "transparency in announcing and then sticking to an auction calendar gave reassurance to the markets" The IMF and Gold, World Gold council, 2001

[13] "Financing the Fund's Operations—Review of Issues." 2001, IMF. "In the late 1950s and in the 1960s, the IMF sold gold on several occasions to replenish its holdings of currencies.", " In order to generate income to offset operational deficits, some gold was sold to the United States and the proceeds invested in U.S. government securities. A significant build-up of reserves through income from charges prompted the IMF to reacquire this gold from the U.S. government in the early 1970s."

role of gold in the international monetary system[14] and to finance concessional lending to poor countries.

In 1999-2000, the IMF once again carried out transactions involving 12.9 million ounces of gold in order to generate resources for HIPC debt cancellation. These precedents indicate that when the political will is there, resources can be found for debt cancellation.

IMF members having long since agreed to reduce the role of gold in the international monetary system should now put their votes behind the sale of IMF gold.

Again there is a precedent here. In 1979-80, staff discussions took place regarding the establishment of a Substitution Account[15] in lieu of gold reserves. However, the question of a Substitution Account was later dropped, as was the issue of gold sale for the purpose of deriving income for the Fund. Sale of gold by the Fund was then seen to be problematic because of its possible adverse impact on the gold price and the value of central bank gold holdings.

Things have moved on since then and a sale now would just be belated recognition of the relatively insignificant role that gold now plays in the monetary system. The gold market has become bigger, more liquid and diverse and central banks themselves have been off loading their reserves in the market for years. [16]

For all these reasons, we believe that this is the right time to re-consider the sale of IMF gold to fund multilateral debt cancellation.

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[14] "Financing the Fund's Operations—Review of Issues." 2001, IMF. "Auctions and restitution sales (1976-80). The IMF sold approximately one third (50 million ounces) of its then-existing gold holdings following an agreement by its members to reduce the role of gold in the international monetary system. Half of this amount was sold in restitution to members at the then-official price of SDR 35 per ounce; the other half was auctioned to the market to finance the Trust Fund, which supported concessional lending by the IMF to low-income countries".

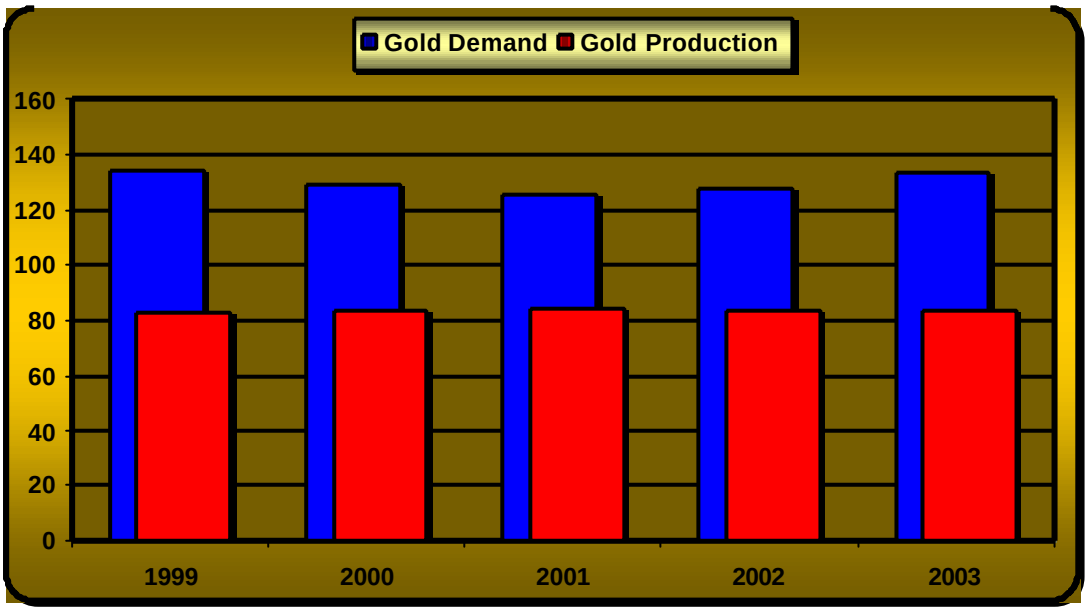
[15] "Financing the Fund's Operations—Review of Issues." 2001, IMF. "In 1979-80, discussions took place regarding the establishment of a Substitution Account. Fund management supported the use of a (substantial) part of the Fund's gold holdings to ensure the viability of the Account, and also the sale of a small portion of the Fund's gold and use of the profits to create an investment fund and thereby strengthen the Fund's income position. The question of a Substitution Account was later dropped, as was the issue of gold sale for the purpose of deriving income for the Fund. This was done primarily because of the lack of a political consensus and concerns about the impact on the still nascent post gold standard international gold market.

[16] http://www.gold.org/value/reserve_asset/

Some other facts about the gold market

Gold has recently trended higher and some fundamental factors are at work here. The fall of the dollar is one. The low interest rates seen in the last few years also helped gold price as it reduced the opportunity cost of holding gold. Also, the years after the September 11th attacks have been uncertain ones for the global economy. Gold has always been an asset of choice in times of uncertainty.

Also, production of gold has lagged behind demand. The annual production of gold in the world has averaged around 83 million ounces over 1999-2003 and the demand has averaged about 130 million ounces during the same period. The gap is met by official sector gold sales and through recycling. The known stock of gold reserves is also slowly getting depleted as new finds of gold in recent years have not kept pace with mining.



However, even as the OECD group is decreasing its gold reserves, many other countries such Developing countries have record levels of foreign exchange reserves that are greater than $1,500 billion. While OECD reserves have a larger proportion of gold in their reserves, developing country reserves are mostly denominated in the US dollar though the proportion of Euro and Yen is steadily on the rise.

Finance theory dictates that diversification of risk adds to the long term value of a portfolio. This would mean that it makes sense for developing countries to hold as many different assets as is reasonably possible. Gold is especially good for diversification as its price varies inversely to that of most other assets – when some of the major currencies fall gold mostly rises. Holding gold would mean that the reserve portfolio would be more likely to maintain its value in a volatile environment.

As the dollar has fallen, developing countries have booked real capital losses on their reserve portfolios. There could then be a case for them to diversify their portfolios by holding more gold[17]. However, this case is tempered by the opportunity cost (highlighted in a previous section) associated with holding gold.

In any case, some countries such as China, the Philippines and Russia are actually already increasing their gold reserve holdings. China for instance bought about 6.6 million ounces of Gold in 2001-2002. This year the Argentine government has been buying gold in the market in order to diversify its holdings of reserve assets.

On average, developing countries hold a much smaller proportion of their reserves in gold as compared to the OECD. There is a real possibility that more developing countries would diversify their reserve holdings to include more gold.

One possible way selling IMF gold in order to minimize market impact would then include off market direct sales to central banks that are looking to increase their gold holdings[18].

Under the renewed CBGA, Switzerland is likely to continue to be a large seller. Statements coming out of France and Germany also indicate they are likely to be other major sellers.

Italy is likely to be another major seller. Significantly, Renato Brunetta, the economic advisor to the Italian Prime Minister has said that Italy could use its gold reserves to help slash its government debt[19].

This is analogous to our suggestion for the sale of IMF gold to help reduce poor country debt. If Italy, one of the richest countries in the world can contemplate the sale of its gold reserves for paying of national debt, surely our suggestion for the sale of IMF gold to cancel poor country debt is not preposterous.

Why sales, not revaluation?

The IMF pays an interest on the contributions of members. However, there is a part of the contribution that is provided to the fund as interest free resources[20] (also

[17] The IMF already holds the most well-diversified portfolio of reserves even without its gold holdings. Since its portfolio consists of the currencies of over 170 members, it does not need gold to add to the diversification and hence can easily get rid of it without any adverse affects.

[18] See Resource Rich BWIs 100% debt cancellation and the MDGs – by Sony Kapoor June 2004 for the Foreign Ministry of the Dutch Government (IOB)

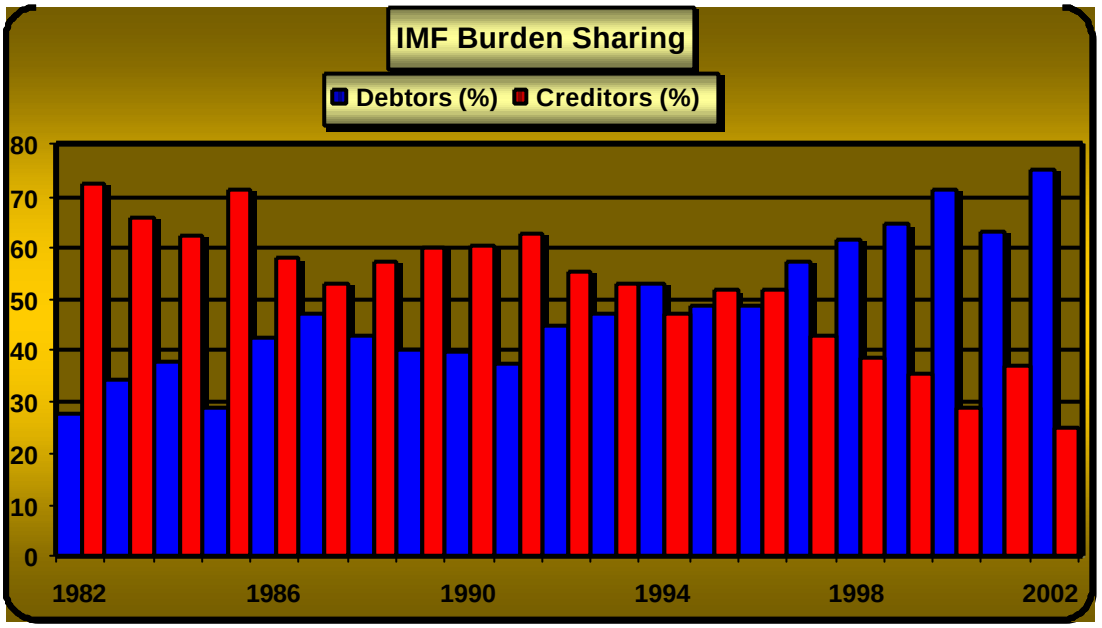
[19] Interview with Rachel Sanderson, August 5 (Reuters)

[20] The sale of gold to the market adds to the Fund's interest-free resources, but acceptance of gold in lieu of payments in currency or SDRs by a member satisfying its obligations to the Fund has the opposite effect. A sale of gold to the market provides interest-free resources equal to SDR 35 per fine ounce, and the excess also provides interest-free resources in the SDA, which, among other uses, could be transferred to the GRA or invested to generate income. Acceptance of gold in lieu of currency (or SDRs) would reduce outstanding Fund credit without a corresponding reduction in members' reserve tranche positions (or increase in SDR holdings of the Fund), and consequently would reduce the Fund's net income. Combining a sale of gold and its acceptance results in a loss of income in the GRA that is offset by investment earnings in the SDA.

called the unremunerated reserve tranche). Currently, this stands at an average of about 3.8% of the members' quota but varies substantially across members. Since no interest is payable on this money, it helps the IMF keep its operational expenses (cost of raising funds) low. This in turn helps the IMF pass on some of the benefits to debtor countries in the form of lower borrowing costs. The IMF makes an income by adding a margin to its cost of funds and lending to debtor countries.

Interest free resources can also be viewed as creditor contributions since creditors are forgoing interest on the amount of interest free assets. The absolute amount of interest free assets has more or less stayed the same since 1978 but the total resources of the Fund have gone up substantially. Consequently, as the relative level of interest free resources has shrunk from 25% of quota in 1978 to 3.8% of quota now, the burden of the costs of running the IMF has fallen more and more on debtor countries. This is illustrated in the graph below.

This shows that from 1982 when the cost of running the Fund was mostly borne by the creditors (72.3%) the burden has shifted mostly to the debtors who contributed 75% towards the cost of running the IMF in 2002.



If, as has been suggested by some policymakers, the Fund were to repeat the revaluations of gold carried out in 1999-2000, it would result in a significant decrease in the interest free resources of the Fund. As a consequence of revaluation, the Fund's interest free resources decrease by the margin over an above the SDR 35 per ounce book value of the gold. The Fund's SDR 2.2 billion of earnings from the 1999-2000 revaluations were accompanied by a corresponding SDR 2.2 billion decrease in interest free assets.

This in turn led to a loss of income of about SDR 94 million in 2001. This loss of income is recurrent and can end up as additional costs for borrowers if the Fund maintains operational parameters. So a one time benefit from gold revaluation comes at the cost of a long term loss in income or a long term increase in costs for members especially debtors.

A revaluation of all of the IMF's gold reserves could lead to a SDR 30 billion loss of interest free assets resulting in as much as a SDR 1.4 billion increase in costs to members every year.

An outright gold sale does not affect the interest free assets at all and hence does not impose any additional recurring costs on members. This is why we strongly favour the sale of gold over any revaluation.

A additional note on gold sales

We have seen above that OECD central banks have been selling large quantities of gold in the open market. They have already sold about 100 million ounces of gold since 1999. Of this more than 19 million ounces was sold in 2003 and 17 million ounces in 2002. Of this Swiss sales alone accounted for more than 9 million ounces each year. The Netherlands, Belgium, Australia, Austria, Canada and the UK have been other major sellers.

The new CBGA expands the sanctioned gold sales by its signatories from 65 million ounces to 80 million ounces. The countries selling gold under the CBGA are amongst the richest in the world. If central bank sale of gold impacts gold price as some critics say and has the kind of negative impact on poor countries that are gold producers then this sale of central bank gold is directly harming the poor countries.

None of the rich countries selling gold have any pressing needs that would require such a sale. Their decision to sell is strategic rather than urgent. The sale of IMF gold, on the other hand, is urgently needed to help cancel the debilitating debt of the poorest countries in the world.

Also, the suggested sale of 5 million ounces of IMF gold every year pales in comparison to the 16 million ounces sales agreed under the CBGA. If the OECD countries believe that IMF gold sale would damage the economy of poor gold producing countries, then a simple way round this problem would be to revise the CBGA to limit central bank gold sales to 11 million ounces per year and let the IMF sell 5 million ounces every year.

Annexe

Gold sales and HIPC exports

Some commentators have pointed out that the sale of gold to help cancel poor country debt would actually end up damaging them. They reason that the sale of IMF gold would significantly depress gold prices and this would damage many of the poorest countries since they are gold producers.

However, this reasoning is flawed for two reasons. 1) As we showed in a previous section, a transparent pre-announced sale of IMF gold spread over a number of years would not have a significant price impact. 2) Even if the price of gold were to fall somewhat temporarily, the benefits to these countries from IMF gold sales would far exceed any costs.

We show this below by focusing on the 30 gold producing countries that are part of the Heavily Indebted Poor Country (HIPC) Initiative. These countries were together responsible for producing about 6.4 million ounces of gold in 2000. Our calculations show that roughly two thirds of the benefits of HIPC multilateral debt cancellation would flow to this group of countries.

The following graph illustrates that even in the extremely unlikely event of IMF gold sales depressing gold prices; the benefits to African HIPCs would far exceed the lost export revenues. In any case, as highlighted in a previous section, a number of the gold producers have already locked in a fixed future sale price for their gold though hedging and would not feel any impact from a change in gold price. Also, current gold price is very high by historical standards falling within the top ten percentile.

For example a 1% price fall would cost the group $26 million and deliver benefits of $1,175 million every year. Even if gold price does fall by this amount, the affected countries could easily be compensated from the proceeds of the gold sales.