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March 11, 2005

To: Members of the Executive Board

From: The Secretary

Subject: **Financing Further Debt Relief for Low-Income Countries—Preliminary Considerations**

The attached paper on preliminary considerations relating to financing further debt relief for low-income countries is tentatively scheduled for discussion in a Board seminar on **Wednesday, March 30, 2005**. Issues for discussion appear on page 26. This paper will miss the three-week circulation period by a small margin; owing to scheduling constraints and in order to ensure consideration of this matter prior to the spring meetings, it is recommended that the discussion proceed as scheduled.

The staff does not propose the publication of this paper.

Questions may be referred to Mr. Tweedie (ext. 36944) and Ms. Wagner (ext. 38847), in FIN.

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INTERNATIONAL MONETARY FUND

**Financing Further Debt Relief for Low-Income Countries: Preliminary Considerations**

Prepared by the Finance Department

(In consultation with the Legal and Policy Development and Review Departments)

Approved by Michael G. Kuhn

March 11, 2005

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## I. INTRODUCTION

1. **At the 2004 Annual Meetings, the IMFC requested further work on the financing and modalities of the Fund's engagement with low-income members,** including the financing of the PRGF after 2006 to maintain adequate capacity to meet future needs.<sup>1</sup> It also welcomed the progress in providing debt relief under the HIPC Initiative and looked forward to consideration of further debt relief, including its financing.<sup>2</sup> At their meeting in London in February 2005, G-7 Finance Ministers reaffirmed their commitment to full implementation and financing of the enhanced HIPC Initiative, while recognizing that more needs to be done.<sup>3</sup> In this context, several proposals for further debt relief were put forward, some of which involved use of the Fund's gold.

2. **This paper addresses key issues relating to the financing of the Fund's engagement with low-income members and possible further debt relief.** Issues of the modalities of debt relief and how they relate to the Fund's future engagement with low-income member countries are examined in a companion paper.<sup>4</sup> The main conclusions of this paper are as follows:

- **The financing of debt relief and the Fund's ongoing lending to low-income member countries are closely inter-twined** and must be considered together.
- **The Fund has subsidy resources to meet projected PRGF demand through 2010 under current policies, assuming that these can be supplemented by new bilateral loans.** Resources still need to be identified to meet the Fund's cost of HIPC relief for three protracted arrears cases (Liberia, Somalia, and Sudan). Further debt relief would add to these resource needs, unless it were to come at the expense of the Fund's ability to provide continued concessional financing to low-income member countries.
- **Use of part of the Fund's gold holdings could generate additional resources.** However, the Fund's Articles of Agreement place significant constraints on how the Fund's gold can be used, and any such decision would require near universal support

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<sup>1</sup> In this paper, low-income countries are defined as those that are PRGF-eligible.

<sup>2</sup> *Communiqué of International Monetary and Financial Committee* (October 2, 2004).

<sup>3</sup> *G-7 Finance Ministers' Conclusions on Development* (February 5, 2005), paragraph 7 ([http://www.hm-treasury.gov.uk/otherhmtsites/g7/news/g7\\_statement\\_conclusions050205.cfm](http://www.hm-treasury.gov.uk/otherhmtsites/g7/news/g7_statement_conclusions050205.cfm)).

<sup>4</sup> *Further Debt Relief for Low-Income Countries—Key Issues and Preliminary Considerations* (forthcoming).

of the membership (i.e., an 85 percent majority of the total voting power). Moreover, considerations relating to the impact on the Fund's finances suggest that any such operations should be limited in size and conducted through outright sales rather than off-market transactions as used in 1999–2000.

- **To avoid disrupting the gold market and penalizing gold producers,** consideration could be given to incorporating any such sales within the existing framework for official gold sales by central banks. Experience also suggests that an effective communications strategy would be very important.

3. **The rest of this paper is organized as follows.** The next section reviews the evolution of the Fund's lending to low-income member countries and examines the current status of PRGF-HIPC financing. Section III looks at the financing implications of several proposals for further debt relief. Section IV discusses the role of the Fund's gold and the implications for the Fund's finances of mobilizing part of these gold holdings. Section V reviews recent developments in the gold market, while Section VI considers possible modalities for gold sales. Section VII concludes with some issues for discussion.

## II. EVOLUTION AND CURRENT STATUS OF THE FUND'S CONCESSIONAL LENDING

4. **The current framework for the Fund's concessional lending to low-income member countries dates back to the mid-1980s.** It was recognized at that time that low-income countries had longer-term balance of payments needs that could not be adequately met by the Fund's traditional financing facilities and had repayment capacities that required longer repayment periods on concessional terms. As a result, the Structural Adjustment Facility (SAF) was established in 1986, and was transformed in 1987 into the Enhanced Structural Adjustment Facility (ESAF), which became the main vehicle for the Fund's lending operations in low-income countries (see Box 1).

5. **ESAF lending operations were conducted through trust arrangements separate from the General Resources Account (GRA).** The financing was provided through loan and subsidy resources from bilateral creditors and contributors. The Fund provided the security needed to obtain the loan resources through the ESAF Reserve Account (comprising reflows of concessional lending financed by net proceeds of gold sales in the late 1970s). In 1994, the ESAF was enlarged with new bilateral loan and subsidy contributions to allow a continuation of concessional lending.<sup>5</sup>

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<sup>5</sup> *Adjustment and Financing in Low Income Developing Countries, Including the Fund's Role Through ESAF—Report by the Managing Director (ICMS/Doc/40/93/2, 4/19/93), Attachment II.*

### **Box 1. Evolution of the Fund's Concessional Assistance**

The Fund's concessional assistance to its low-income members began in the mid-1970s and has expanded significantly in scope since the mid-1980s.

- In 1976, a **Trust Fund** was established to provide concessional financing to low-income members. Financing of the Trust Fund was made possible through the sale of 25 million ounces of the Fund's gold holdings during 1976–80. Of the amount generated, about US\$3.3 billion was lent to a group of 55 countries. These loans offered a 5½ years grace period and were repayable in 10 years, at an interest rate of ½ percent per annum.
- In 1986, the **Structural Adjustment Facility (SAF)** was established to provide concessional financing to assist low-income members in addressing balance of payments financing needs arising from structural weaknesses. The SAF was financed by reflows of Trust Fund repayments, and its loans were extended on the same terms as the Trust Fund, but the SAF contained strengthened conditionality in the context of policy framework papers (PFPs) prepared jointly with the World Bank.
- The establishment of the **Enhanced Structural Adjustment Facility (ESAF)** in 1987 brought higher conditionality to the Fund's concessional lending and offered higher access under three-year arrangements. Both ESAF loan and subsidy resources were provided mostly by member countries and administered by the ESAF Trust, with the Fund acting as Trustee. Like the SAF, the ESAF was intended initially to be a temporary facility—with the lending window open for about two years—but the cutoff date was repeatedly extended until the Trust was enlarged with new bilateral loan and subsidy contributions in 1994.
- In the 1990s, in the context of a broad international effort, the Fund reoriented its concessional lending to focus more strongly on strengthening growth and reducing poverty. In response to a multifaceted crisis of unsustainable external debt, low or no growth, and widespread poverty, the Fund and the World Bank jointly launched the **HIPC Initiative** in 1996. The Fund provided HIPC Initiative assistance through grants that helped lower recipient countries' debt service repayments to the Fund.
- **In 1999, the HIPC Initiative was further enhanced** to provide faster, deeper, and broader debt relief to eligible countries. At about the same time, the Fund transformed the ESAF into the **Poverty Reduction and Growth Facility (PRGF)** with a focus on reducing poverty and strengthening growth on the basis of country-owned poverty reduction strategies. Loan and subsidy resources for PRGF operations in 2002–05, **the so-called interim PRGF**, and grant resources needed for the HIPC Initiative assistance have been contributed by the Fund's membership and the Fund itself and administered through the PRGF and PRGF-HIPC Trusts.

6. **In 1999, agreement was reached on the modalities and financing of the Fund's contribution to debt relief for low-income countries under the enhanced HIPC Initiative and the Fund's future concessional lending operations.** At the same time, the ESAF was transformed into the Poverty Reduction and Growth Facility (PRGF), with a focus on reducing poverty and strengthening growth. It was agreed that the PRGF would become the main vehicle for the Fund's future lending operations in low-income countries, to be financed by bilateral loan and subsidy contributions, before moving to a self-sustained basis around 2006. The total cost of HIPC debt relief to the Fund and subsidies needed to support PRGF lending in 2002–2005 (the interim PRGF) was estimated at SDR 3.9 billion,<sup>6</sup> of which roughly two-thirds was to be met with the Fund's own resources and the remaining one-third with bilateral contributions.<sup>7</sup>

7. **This lending framework has contributed to the Fund's goals in several ways.** First, it has permitted the Fund to provide financial support on concessional terms—averaging about SDR 1 billion per annum since the advent of the ESAF—to its low-income members in support of their programs of economic adjustment and reform. In total, 57 members have had access to PRGF financing to date. Second, it has helped assure that the Fund's PRGF resources revolve, with a number of countries having largely or completely graduated from reliance on PRGF financing, while other countries are only now reaching the stage where they qualify for such assistance. Third, it has provided a framework for assisting countries with excessive debts to return to a sustainable debt situation under the enhanced HIPC Initiative. And fourth, it has helped the Fund to address the serious problem of overdue obligations among low-income countries that emerged in the 1980s, and to largely avoid new arrears, with only one case—Zimbabwe—of protracted arrears to the PRGF Trust.

8. **The future of the Fund's concessional lending operations was last considered by the Executive Board in early 2004.**<sup>8</sup> At that meeting, most Directors supported an option

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<sup>6</sup> On an “as needed” basis. “As needed” refers to the nominal undiscounted sum of the projected delivery of HIPC assistance, taking into account the profile of projected subsidy needs associated with PRGF lending during the interim period. See *Financing the Fund's Participation in the HIPC and PRGF Initiatives—Update on the Status of Contributions and Loan Resources* (EBS/00/188, 8/31/00).

<sup>7</sup> These bilateral contributions were facilitated in part by the refund of balances in the second Special Contingent Account (SCA-2). The SCA-2 had been established to finance the encashment of “rights” to draw on Fund resources by members in arrears following arrears clearance and to safeguard against possible losses associated with such drawings. The SCA-2 was terminated in 1999, as part of the overall agreement on PRGF/HIPC financing.

<sup>8</sup> *The Fund's Support of Low-Income Member Countries—Considerations on Instruments and Financing* (SM/04/53, 2/24/04) and *The Acting Chair's Summing Up* (BUFF/04/69, 4/7/04).

that would allow a self-sustained PRGF to begin operations in 2006, while supplementing its lending capacity with new bilateral loans. Most Directors also agreed that a loan capacity of about SDR 0.8–1.2 billion per year provided a reasonable basis for PRGF operations during 2006–2010, though some requested further clarification. Staff subsequently revisited these estimates and confirmed that they remain broadly appropriate for projecting PRGF demand under current policies, and before further debt relief (see Annex I).

9. **Staff has also updated its estimates of the adequacy of existing PRGF resources to meet this demand.** As of end-2004, available PRGF/HIPC resources totaled SDR 7.6 billion (see Box 2). This includes SDR 1.7 billion in PRGF subsidy resources and SDR 3.2 billion in the PRGF Reserve Account. Staff estimates suggest that, with uncommitted loan resources of SDR 2.4 billion as of end-2004, the interim PRGF could continue through at least mid-2006, before self-sustained operations could begin. The pace at which the available loan resources will be committed depends in part on the timing for arrears clearance for the three protracted arrears cases—Liberia, Somalia, and Sudan—and their readiness to embark on a successor PRGF arrangement thereafter. If these countries are not ready to clear arrears by 2006, then the interim PRGF could continue operations into 2007, delaying the start of the self-sustained PRGF.

10. **Based on current estimates, the resources in the PRGF Reserve Account could finance PRGF lending of about SDR 0.6 billion per annum on a self-sustained basis.** To increase this loan capacity to SDR 1 billion per annum would require additional bilateral loan resources of about SDR 3 billion.<sup>9</sup> This would raise the PRGF loan capacity through 2010 though it would reduce the self-sustained PRGF loan capacity thereafter because part of the PRGF Reserve Account resources would be used to provide subsidies associated with the new bilateral loans. These estimates are sensitive to the assumptions made regarding the reserve coverage ratio for PRGF lending, interest rate developments, and reimbursement of the administrative expenses incurred by the Fund in carrying out PRGF/HIPC operations.<sup>10</sup>

11. **If the Fund were to consider further debt relief, there are three broad options available for its financing:** (i) new bilateral grant contributions; (ii) some or all of existing PRGF and SDA resources; and (iii) new gold sales. Bilateral contributions played an important role in financing the Fund's contribution to the enhanced HIPC Initiative, as noted above, and would again be highly desirable as part of a new operation.

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<sup>9</sup> Past experience suggests that it should be possible to obtain such loan resources, given that they would earn a market interest rate (the six-month SDR rate) and be backed by the security provided by the PRGF Reserve Account.

<sup>10</sup> See SM/04/53 and *Review of Fund Finances and Financial Structure—Preliminary Considerations* (SM/05/59, 2/16/05).

**Box 2. PRGF/HIPC Resources**

The Fund currently has the following PRGF/HIPC resources:

- **PRGF Trust Subsidy Account**—contains resources required for subsidizing all existing and interim PRGF loans through 2019, the current end of the life of the PRGF Trust. Tapping these resources for uses other than subsidization of the PRGF would require a decision by the Fund, adopted by an 85 percent majority of the total voting power, and the consent of all 43 contributors. The available resources exclude four deposits, which need to be returned to contributors as they mature.<sup>1</sup>
- **PRGF Reserve Account**—established primarily to provide security to creditors to the PRGF Trust. The resources in the Reserve Account may also be used to meet temporary mismatches between repayments from borrowers and payments to creditors. The Fund could decide to use the resources in this account for purposes other than providing security to PRGF lenders, including financing further debt relief or future concessional lending. This would require a decision by the Executive Board adopted by an 85 percent majority of the total voting power and consent of all 17 creditors to the PRGF Trust.
- **Special Disbursement Account (SDA)**—the use of the SDA resources for purposes other than generating the needed income for HIPC relief would require a decision by the Executive Board with an 85 percent majority of the total voting power (see also Box 3 below) and may require parliamentary approval in some cases.

Existing PRGF and HIPC Resources  
(In billions of SDRs; as of December 31, 2004)

PRGF Subsidy Account	1.7
PRGF Reserve Account	3.2
Special Disbursement Account	2.7
Net proceeds from 1999-2000 gold transactions	2.2
Investment income	0.4
<b>Total</b>	<b>7.6</b>
<i>Memorandum item:</i>	
Members HIPC Accounts 1/	0.3

1/ IMF's HIPC assistance disbursed to member country accounts but not yet applied to cover future repayment obligations.

1/ Also excluded are (i) future expected bilateral grant contributions and income on deposit contributions (SDR 0.3 billion); and (ii) the projected future repayment from the SDA of SDR 0.9 billion that was transferred from the PRGF-HIPC Trust to finance HIPC Initiative assistance. Given the uncertainties associated with the timing and adequacy of these future inflows in relation to future needs, they have not been taken into account in estimating the resources potentially available for financing further debt relief or future concessional lending.

However, it is unclear if such financing would be available in the magnitudes needed for a new round of debt relief. Existing PRGF and SDA resources could in principle be diverted to finance debt relief, but only at the expense of substantially reducing the Fund's future concessional lending capacity. Any such decision would require near universal support of the membership, as noted in Box 2. Sale of part of the Fund's gold holdings represents a further option for raising additional resources, but this also would require near universal support, as discussed in Section IV below.

### III. FINANCING IMPLICATIONS OF PROPOSALS FOR FURTHER DEBT RELIEF AND THE FUND'S FUTURE CONCESSIONAL LENDING

12. **This section considers several alternative proposals that have recently been made to provide additional assistance to low-income countries.**<sup>11</sup> These proposals do not explicitly consider the Fund's resource needs associated with eventual debt relief for three protracted arrears cases—Liberia, Somalia, and Sudan. The resource needs associated with HIPC debt relief alone for these countries are estimated at about SDR 1.3 billion.<sup>12</sup> In the staff's view, it would be important to secure such resources as part of any proposal for financing further debt relief. The proposals differ both in terms of the additional debt relief envisaged and the Fund's future level of concessional lending. This section provides initial estimates of the possible financing implications for the Fund. Given that the full details are not yet known, these estimates should be viewed as indicative at this stage. Table 1 provides a breakdown of Fund credit outstanding to PRGF-eligible countries as of end-2004.<sup>13</sup>

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<sup>11</sup> See the annex to the companion paper.

<sup>12</sup> The total cost of the Fund's HIPC Initiative assistance for these three countries is SDR 1.5 billion (out of a stock of arrears of SDR 1.8 billion). However, the grant element of concessional lending following arrears clearance is counted as part of the Fund's share of the HIPC Initiative cost. If these countries were to clear their arrears and embark on a successor Fund arrangement in 2006, the grant element associated with these arrangements would be about SDR 0.2 billion. In that case, only the remaining SDR 1.3 billion of the Fund's share of the HIPC cost would still need to be identified.

<sup>13</sup> Tables 5 and 6 provide country-by-country details on Fund credit outstanding and forthcoming obligations to the Fund through 2015, respectively.

Table 1. Fund Credit Outstanding to PRGF-Eligible Countries  
(In billions; as of end-2004) 1/

	SDR	U.S. dollar
<b>All 78 PRGF countries</b>	<b>9.2</b>	<b>14.3</b>
GRA	2.4	3.8
PRGF	6.8	10.5
<b>All 66 IDA-eligible countries</b>	<b>7.4</b>	<b>11.5</b>
GRA	1.9	3.0
PRGF	5.5	8.5
<b>38 HIPC countries</b>	<b>6.0</b>	<b>9.2</b>
GRA	1.8	2.8
PRGF	4.2	6.5
<i>Memorandum items:</i>		
Protracted arrears HIPCs (included above)	1.8	2.8
Liberia	0.5	0.8
Somalia	0.2	0.3
Sudan	1.1	1.6

1/ Including interest arrears to Liberia, Somalia, Sudan, and Zimbabwe. The outstanding credit to these countries constitutes most of the GRA Credit outstanding to PRGF-eligible countries.

13. **The costs of these proposals would depend on a number of factors.** These include the scope of debt relief, the eligibility criteria for recipients, and the size of the Fund's future concessional lending operations.<sup>14</sup> For illustrative purposes, this section considers four different debt relief/future concessional financing options as follows:

- **Option 1:** No further debt relief is needed, as HIPC Initiative assistance has already addressed debt sustainability for eligible countries; future PRGF lending would remain at the current level of about SDR 1 billion per year through 2010.
- **Option 2:** Limited debt relief might still be needed, to be provided based on debt sustainability analysis and policy performance of eligible countries; gold sales would generate the resources for debt relief as well as to raise the PRGF lending capacity to SDR 1 billion per year through 2010 and reduce the interest rate on PRGF lending from 0.5 to zero percent.
- **Option 3:** Up to 100 percent debt service relief through 2015 would be provided to IDA-eligible member countries with sufficiently robust public expenditure

<sup>14</sup> For a discussion of the linkages between debt relief and future lending operations, see Section IV.B of the companion paper.

management systems;<sup>15</sup> gold sales would generate the needed resources; future PRGF lending would be maintained at about SDR 1 billion per year through 2010.

- **Option 4:** 100 percent debt relief would be provided on all PRGF loans outstanding using existing PRGF and SDA resources; a reduced future PRGF lending capacity of about SDR 0.65 billion per year through 2010 would be obtained through use of the remaining resources in the PRGF Reserve Account, supplemented by new bilateral loan contributions (the needed subsidy resources and security on the new bilateral loans would be provided through gold sales). After 2010, the PRGF lending capacity would fall sharply to less than SDR 0.2 billion per annum.

14. **The cost implications of these proposals for the Fund are summarized in Table 2.** Option 1 would not involve any additional costs, though bilateral loan resources would still need to be mobilized to maintain the capacity of the PRGF at SDR 1 billion per annum. In this regard, this option is similar to the staff's baseline projections under current policies, as discussed in paragraph 8 above. Option 2 envisages limited additional debt relief, but resources would also be needed to maintain the capacity of the PRGF at SDR 1 billion per annum and reduce the PRGF interest rate to zero (new bilateral loan resources would not be needed under this option, and thus the self-sustained PRGF loan capacity beyond 2010 would be higher than under the other proposals). Option 3 envisages more substantial debt relief, for which new resources would need to be raised. The cost ultimately would depend on the specific eligibility criteria and conditionality involved; the cost estimates presented in this paper show the maximum potential cost, based on the stock of debt of IDA-eligible countries as of end-2004.<sup>16</sup> Option 4 differs from the other options in that it envisages that the Fund would use existing PRGF and SDA resources for debt relief, and that it would result in a lower PRGF lending capacity of about SDR 0.65 billion per annum through 2010 (for which bilateral loan resources would be needed), and less than SDR 0.2 billion thereafter.

15. **The potential costs to the Fund of these alternative proposals differ significantly.** Total estimated financing needs are shown in Line D of Table 2. Option 1 would not involve any additional cost as no further debt relief is envisaged (though, as with all the options, resources to meet the costs associated with debt relief for the three protracted arrears cases would still need to be identified). Option 2 is estimated to have a cost similar to that of the Fund's participation in the enhanced HIPC Initiative. Options 3 and 4, on the other hand,

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<sup>15</sup> For costing purposes, it is assumed that *all* IDA-eligible countries receive 100 percent debt relief, as the eligibility list based on "sufficiently robust public expenditure management systems" is yet to be determined.

<sup>16</sup> For simplicity, the end-2004 debt stock has been used in these calculations. In cash terms, this is broadly equivalent to flow relief through 2015, given the concessional interest rate on PRGF loans.

**Table 2. Illustrative Scenarios for Financing Further Debt Relief and Future Concessional Lending Operations**  
(In billions of SDRs; unless otherwise indicated)

	Option 1	Option 2	Option 3	Option 4
<b>A. Further Debt relief</b>				
A.1. Proposed modalities	None	Limited, based on DSAs/policy performance	100 percent debt service relief through 2015 to IDA eligible countries	100 percent debt relief on PRGF credit outstanding
A.2. Estimated Cost	--	0.3 <sup>1/</sup>	5.3 <sup>2/</sup>	6.3 <sup>3/</sup>
<b>B. Future Concessional Lending</b>				
B.1. Annual lending capacity				
2006-2010	1.0	1.0	1.0	0.6
Beyond 2010	0.4	0.7	0.4	0.2
B.2. Estimated costs	-- <sup>4/</sup>	1.8 <sup>5/</sup>	-- <sup>4/</sup>	0.7 <sup>6/</sup>
<b>C. Estimated HIPC cost of protracted arrears cases <sup>7/</sup></b>	1.3	1.3	1.6 <sup>8/</sup>	1.3
<b>D. Total financing needs</b>				
D.1. Including arrears cases (A.2+B.2+C)	1.3	3.4	6.9	8.2
D.2. Excluding arrears cases (A.2+B.2)	--	2.1	5.3	7.0
<b>E. Sources of financing</b>				
E.1. Use of existing resources (PRGF/SDA)	--	--	1.5 <sup>9/</sup>	5.8 <sup>10/</sup>
E.2. Residual financing need				
E.2.1. Including arrears cases (D.1-E.1)	1.3	3.4	5.3	2.4
E.2.2. Excluding arrears cases (D.2-E.1)	--	2.1	3.7	1.1

1/ To reduce NPV of debt-to-exports ratios to 120 percent for HIPCs that have not yet reached HIPC completion points and by an additional 20 percentage points for post-completion point HIPCs.

2/ Outstanding Fund credit to all IDA-eligible countries at end-2004 (SDR 7.4 billion) minus HIPC assistance disbursed but not yet used (SDR 0.3 billion) and stock of protracted arrears (SDR 1.8 billion).

3/ Outstanding PRGF credit (SDR 6.8 billion) minus HIPC assistance disbursed but not yet used (SDR 0.3 billion) and arrears to the Trust Fund and SAF (SDR 0.1 billion).

4/ Assumes bilateral loan contributions would be provided to raise the annual PRGF lending capacity to SDR 1 billion in 2006-2010, implying no additional resource needs.

5/ Resource needs to increase annual PRGF lending capacity in 2006-2010 to SDR 1 billion and reduce PRGF interest rate to zero.

6/ Resource needs to meet estimated cost of subsidy and reserve requirements associated with new bilateral loans to increase annual PRGF lending capacity to SDR 0.6 billion in 2006-2010. Assumes existing PRGF/SDA resources are used for debt relief.

7/ The Fund's share of HIPC Initiative assistance to Liberia, Somalia, and Sudan is estimated at SDR 1.5 billion (out of stock of arrears of SDR 1.8 billion at end-2004). As the grant element associated with successor Fund arrangements following arrears clearance would be counted as part of the Fund's assistance under the HIPC Initiative, the remaining HIPC cost for these countries would be about SDR 1.3 billion.

8/ Cost of 100 percent debt relief for the protracted arrears cases (SDR 1.8 billion), minus the grant element (SDR 0.2 billion) associated with successor arrangements following arrears clearance.

9/ Subsidies (SDR 0.7 billion) required for covering PRGF credit outstanding to IDA-eligible countries plus HIPC assistance not yet disbursed (SDR 0.9 billion).

10/ Includes use of the SDA (SDR 2.7 billion), PRGF Reserve Account (SDR 2 billion), and PRGF Subsidy Account (SDR 1.1 billion). The last figure excludes subsidy resources needed for undisbursed commitments under existing PRGF arrangements (SDR 0.4 billion) plus successor arrangements following arrears clearance (SDR 0.2 billion).

would have a cost that is substantially higher than that of the HIPC Initiative. Under Option 3, the incremental cost of providing 100 percent debt service relief takes account of the fact that subsidy resources are already available to reduce the interest rate on PRGF loans to 0.5 percent. The latest estimate of the subsidies required for existing PRGF credit outstanding to IDA-eligible countries is SDR 0.7 billion. The remaining subsidy resources would be required to meet the needs related to undisbursed PRGF commitments and the continuation of interim PRGF lending. Option 4 assumes that financing would first be obtained from full use of the cash resources in the PRGF Subsidy Account and SDA, and partial use of the Reserve Account. This lowers the residual financial need (Line E.2) but at the cost of eliminating PRGF subsidy and SDA resources and a much lower future PRGF lending capacity, as noted above.

16. **Table 3 illustrates the potential gold sales associated with different resource needs.** These calculations involve a number of simplifying assumptions and should be viewed as only indicative. In particular, they assume that the full amount of the gold could be sold upfront whereas, in practice, gold sales would likely need to be phased, as discussed in Section VI. Also, the estimates of the gold sales needed if only the investment income is available for financing debt relief (as was the case in 1999–2000) are highly sensitive to assumptions regarding interest rates and the period over which the investment income may be earned. For illustrative purposes, calculations are shown for both a 10- and a 15-year period; the longer period lowers the level of needed gold sales.

Table 3. Estimated Financing Needs and Gold Sales

Total financing needs (In billions of SDRs)	Volume of gold sales needed 1/			Volume of gold sales needed 1/		
	Corpus	Investment income		Corpus	Investment income	
		Alternative I 2/	Alternative II 3/		Alternative I 2/	Alternative II 3/
	(In millions of ounces)			(In tons)		
1	4	12	9	134	379	272
2	9	24	17	268	758	544
3	13	37	26	403	1,137	816
4	17	49	35	537	1,517	1,087
5	22	61	44	671	1,896	1,359
6	26	73	52	806	2,275	1,631
7	30	85	61	940	2,654	1,903

1/ Assumes average gold price of US\$400 per ounce, converted into SDRs at exchange rate of US\$ 1.5 per SDR; after transfer of SDR 35 per ounce to GRA.

2/ Assumes an investment horizon of 10 years.

3/ Assumes an investment horizon of 15 years.

#### IV. POTENTIAL USE OF THE FUND'S GOLD FOR DEBT RELIEF

##### A. The Role of the Fund's Gold Holdings

17. **The Fund's gold holdings have remained essentially unchanged since the Second Amendment of the Articles of Agreement in the late 1970s.** At that time, it was decided to reduce these holdings by about a third, as part of the agreement on the Second Amendment and with the objective of reducing the role of gold in the international monetary system.<sup>17</sup> The Fund distributed 25 million ounces to members in proportion to quotas at SDR 35 per ounce ("restitution"). Another 25 million ounces was sold at public auctions and the profits used for concessional lending to developing countries by the newly constituted Trust Fund.<sup>18</sup>

18. **The Fund is the world's third largest official holder of gold, after the United States and Germany.** The Fund holds 103.4 million fine ounces of gold (3,217 metric tons),<sup>19</sup> valued on its balance sheet at historical cost of SDR 5.9 billion (\$9 billion). As of end-2004, the value of these gold holdings at market prices was SDR 29 billion (\$45 billion).

19. **Fund policies on gold have been governed by five long-standing principles.** These principles were set out during the last comprehensive review of the Fund's gold in 1995 and reaffirmed in the discussions leading up to agreement on the financing package for the interim PRGF and the enhanced HIPC Initiative.<sup>20</sup> An immediate issue for consideration, therefore, is the extent to which these principles still hold and their implications for the proposals to use gold to finance further debt relief. The five principles are as follows:

- (1) As the only asset with a significant unrealized value, gold provides fundamental strength to the Fund's balance sheet. Any mobilization of gold should avoid weakening the Fund's overall financial position.

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<sup>17</sup> The Second Amendment took effect in April 1978; the gold sales commenced in 1976 and were completed by 1980.

<sup>18</sup> The repayments of Trust Fund loans in turn provided the basis of lending under the SAF and reflows from the SAF were transferred to the Reserve Account of the PRGF Trust.

<sup>19</sup> The conversion factor is 1 metric ton equals 32,151 ounces; references to tons in the remainder of this paper are based on this conversion factor.

<sup>20</sup> *Concluding Remarks by the Chairman—Gold in the Fund—Executive Board Meeting 95/54* (BUFF/95/53, 6/12/95). See, also, *Statement by the Managing Director on Options for Financing a Continuation of ESAF Operations* (BUFF/96/5, 1/25/96); *Summing Up by the Chairman—Continued Financing and Adaptation of the ESAF and Possible Modalities for Use of Gold in Connection With a Continuation of ESAF Operations* (BUFF/95/95, 9/14/95).

(2) Gold holdings provide the Fund with operational maneuverability both as regards the use of its resources and by adding credibility to its precautionary balances. In these respects, the benefits of the Fund's gold are passed on to the membership at large, including both creditors and borrowing members.

(3) The Fund has a systemic responsibility to avoid causing disruption to the functioning of the gold market.

(4) The Fund should continue to hold a relatively large amount of gold among its assets, not only for prudential reasons, but also to meet unforeseen contingencies.

(5) Profits from any gold sales should be retained, and only the investment income should be used for purposes that may be agreed upon by Fund members and are permitted by the Articles of Agreement.

20. **In general, these principles would seem to retain significant validity.** The potential unrealized gains on the Fund's gold are clearly important to its overall financial strength and integrity. Gold sales per se need not erode this strength, and could indeed be seen as enhancing it, for example, if the profits were retained in the General Department and used to generate income which could be transferred to the GRA if the need arose. This would be akin to exchanging a non-interest earning asset for one that earns interest. However, use of the profits for debt relief would inevitably weaken the Fund's finances to some degree, and the issue then becomes one of degree, and a judgment on the costs of such an operation against the perceived benefits.

21. **As regards the second principle, the following considerations appear relevant:**

- **The Fund's gold is available in case of need to meet claims on the Fund.** In particular, gold provides an important backstop as it could be used in the event that the Fund's other assets were not available for mobilization, for whatever reason.
- **The Fund's gold strengthens its ability to borrow, if needed.** Gold would provide assurances to allow the Fund to borrow in markets or from official sources, in case of need, to supplement its resources.
- **The Fund's gold enhances its capacity to respond to unexpected developments of a systemic nature.** In its role akin to a lender of last resort, the Fund stands ready to respond to unknown future crises. Gold provides assurances of the financial viability of the Fund in the event of future contingencies that cannot now be specified.

- **Gold complements but is separate from the Fund’s precautionary balances.**<sup>21</sup> The latter (currently SDR 6.4 billion) are readily available resources held primarily to protect the Fund in the event that outstanding credit becomes impaired. In contrast, gold provides a buffer against unforeseen contingencies associated with the Fund’s role at the center of the international financial system. Gold could be mobilized to augment precautionary balances, but is illiquid for prudential purposes given the broad consensus among the membership required for such a decision.
- **Finally, gold provides a safeguard against possible income shortfalls in the Fund’s operations.** Transfer of the profits from gold sales to an Investment Account for use to meet the expenses for conducting the business of the Fund is explicitly provided for in Article XII, Section 6 (f) (introduced by the Second Amendment), though no such account has yet been established. While other options are available to broaden the Fund’s income base, it is conceivable that this option would be needed at low levels of credit outstanding.<sup>22</sup>

22. **As the third largest official gold holder, the Fund’s actions could have a significant impact on the gold market.** In this regard, the third principle above still seems highly relevant, as discussed below. The last two principles also remain relevant, though their implications must be viewed in the context of the decision at hand. The above considerations seem to argue for the Fund retaining a large gold holding, but do not point to a specific level. This then becomes a matter for the judgment of the membership. As regards the last principle, it has been considered important by the membership to date for the Fund to retain the nominal value, or “corpus,” of the profits from gold sales on its balance sheet, and only make available the investment income on those profits for other purposes. Depending on the desired amount of resources to be raised, however, this principle could conflict with the others, as it could require the Fund to sell a much larger amount of gold than would be the case if the corpus was available (as illustrated by the calculations in Table 3).

23. **The Articles of Agreement limit the use of gold, and decisions on gold require near universal support.** In particular, decisions of the Fund to engage in gold operations and transactions require an 85 percent majority of the total voting power. Moreover, parliamentary approval can be required for an Executive Director to be in a position to vote in favor of gold transactions. It should also be noted that the requirement for special majorities also holds for any disposition of financial resources initially derived from gold

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<sup>21</sup> The relationship between gold holdings and precautionary balances was discussed in detail by the Fund’s External Audit Committee in response to a specific question by an Executive Director. See *Memorandum from the Secretary to Members of the Executive Board—Briefing by the External Audit Committee* (FO/DIS/03/57, 6/24/03). See also *Financial Risk in the Fund and the Level of Precautionary Balances* (EBS/04/11, 2/4/04).

<sup>22</sup> See SM/05/59, especially Sections II.A and III.A.

operations or transactions (see Box 3). The Fund is not able to revalue its gold holdings.<sup>23</sup> Rather, the Articles provide that the Fund may:

- sell gold held on the date of the Second Amendment to those members that were members on August 31, 1975 in proportion to their quotas at that date and at a price of SDR 35 per ounce;
- sell gold outright on the basis of prevailing market prices; and
- accept payments from a member in gold instead of SDRs or currencies in any operation or transaction under the Articles and at an agreed price on the basis of prices in the market.

24. **Decisions to mobilize gold have been rare and carefully circumscribed.**

Reflecting the policies governing the use of gold, and the high voting majorities required, the Fund has essentially only taken two decisions involving gold since 1980.<sup>24</sup>

- In 1993, the Fund decided to **“pledge” up to three million ounces of gold** as additional security for creditors of the ESAF Trust (now PRGF Trust) on loans made to encash rights under “rights accumulation programs.”<sup>25</sup> The gold sales under the “pledge” take effect only if it is determined that the resources in the PRGF Trust Reserve Account and all other available means of financing are insufficient to meet payments to creditors.<sup>26</sup>

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<sup>23</sup> A revaluation would, in any case, not generate usable financial resources. The Fund also does not have the authority to engage in any other gold transactions, such as loans, leases, swaps, or use of gold as collateral; or to buy gold.

<sup>24</sup> The Fund also accepted a small quantity of gold (21,396 ounces) from Cambodia in payment of its overdue obligations in 1992.

<sup>25</sup> A rights accumulation program, or RAP, is an economic program agreed between the Fund and an eligible member in protracted arrears to the Fund that provides a framework for the member to establish a satisfactory track record of policy and payments performance. The RAP permits the member to accumulate rights to future drawings of Fund resources following its clearance of arrears. This rights approach is available to those members which were in protracted arrears to the Fund at end-1989 (i.e., Liberia, Somalia, and Sudan are eligible for the rights approach, but Zimbabwe is not).

<sup>26</sup> The so-called “gold pledge” is an authorization to sell gold under specified circumstances. The Fund would lack the authority to pledge gold as security.

- In 1999–2000 , the Fund engaged in **off-market transactions of nearly 13 million ounces to help finance its contribution to the enhanced HIPC Initiative.** In September 1999, the Board of Governors adopted a resolution stating that these transactions would “be a one-time operation of a highly exceptional nature.”

### **Box 3. Mobilizing the Fund’s Gold—Disposition of the Proceeds**

The Fund’s Articles provide for certain differences between the sale of gold held on the date of the Second Amendment and the sale of gold acquired by the Fund after that date:

**Gold held by the Fund on the date of the Second Amendment (90.4 million ounces)** can either be (i) sold to members or third parties at a price agreed for each transaction based on market prices, or (ii) sold as “restitution” to those members that were members on August 31, 1975 (and Papua New Guinea), in proportion to quotas, at SDR 35 per ounce. An amount equivalent to SDR 35 per ounce must be placed in the GRA. Proceeds in excess of this value (i.e., the profits) must be placed to the Special Disbursement Account (SDA), or to the Investment Account, which has not yet been established. The assets placed in the SDA may be used only:

- **To make transfers to the GRA** for immediate use in operations and transactions authorized by the Articles (requires a 70 percent majority of the total voting power).
- **For operations and transactions consistent with the purposes of the Fund**, such as the provision of balance of payments assistance on special terms to developing countries, taking into account their level of per capita income (requires a 85 percent majority of the total voting power).
- **For distribution to developing countries** (requires a 85 percent majority of the total voting power).

**The sale of gold acquired by the Fund after the Second Amendment (13.4 million ounces)**, whether to a member or third party, can only take place at a price agreed for each transaction based on market prices. Any profit or loss arising from a sale of this gold would be realized directly by the GRA and recorded as either income or expense in that year.

## **B. Implications for the Fund’s Finances**

25. **The implications of gold sales for the Fund’s finances depend on the quantity of gold sold, and the use to which the profits are put.** As noted, the sale of gold need not necessarily weaken the Fund’s finances if the full proceeds are retained for the benefit of the General Department. However, it would reduce the amount potentially available to be restituted to members as of August 31, 1975, and could also be viewed as eroding the substantial and ultimate reserve associated with gold.

26. **The financial effects of outright gold sales are summarized in Box 4.** In terms of balance sheet effects, the equivalent of the book value of the gold sold (the historic cost of

SDR 35 per ounce) must be retained in the GRA. This implies a small increase in the Fund's liquidity. However, given that market prices are now a multiple of book value, the much larger effect depends on the use to which the profits (i.e., the difference between book and sales value) are put. In general, if the profits are retained for the benefit of the General Department, there would be no weakening in the Fund's financial position. If they are used for another purpose such as debt relief, however, there would be some weakening, and the extent of this would depend on the relative magnitudes involved. This effect could also be mitigated if the corpus was retained (i.e., only the investment income used), as has been the case in the past, and kept available (in nominal terms) for the ultimate benefit of the General Department.

27. **In terms of income effects, gold sales would have a positive effect.** This reflects the fact that gold is a non-interest earning asset. If the profits are not retained for the benefit of the General Department, however, this income effect would be relatively small, reflecting the reduction in remunerated reserve tranche positions as usable currencies equivalent to the book value of gold sold are placed in the GRA. If the profits themselves were to be used for the benefit of the General Department (e.g., in an investment account), the positive income effects could be significantly larger.

28. **An important exception to this conclusion was the off-market gold transactions conducted in 1999–2000.** As explained in Box 4, these transactions essentially involved an additional step, namely, a decision by the Fund to accept in payment the gold it had just sold at market prices. This is financially equivalent to borrowing at the SDR rate to buy gold at market prices. The on-going cost of this operation was SDR 94 million per annum, which has so far been burden-shared by debtor and creditor members to avoid having the cost of this operation fall solely on members paying charges.<sup>27</sup> This negative income effect, and the burden it may impose on debtor and creditor members, raises questions whether it would make sense for the Fund as a financial institution to repeat such an operation, particularly as the negative income effect would be additive.

## V. RECENT DEVELOPMENTS IN THE GOLD MARKET

29. **As a major official gold holder, and given its broader systemic responsibilities, the Fund needs to pay careful attention to the effect of its actions on the gold market.** Indeed, the Articles mandate that the Fund's policies on gold should be guided by the objective of avoiding the management of the price, or the establishment of a fixed price, in

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<sup>27</sup> See *Review of Fund Finances and Financial Structure—Preliminary Considerations* (SM/05/59, 2/16/05), Section III.F.

**Box 4. Financial Effects of Gold Sales**

**Outright sales of gold involve two steps.** First, the gold sale increases the Fund’s usable currency holdings and yields a profit: the difference between the book value at SDR 35 per ounce and market value. Second, the usable currencies reflecting the profit are transferred to the SDA for investment. The usable currencies reflecting the book value are retained in the GRA. The net effect is a small increase in the Fund’s usable currency holdings and therefore a small reduction in remunerated reserve tranche positions. This reduction in the Fund’s remuneration expense would have a small positive effect on income.

**The 1999–2000 off-market transactions also involved a third step** in which the Fund accepted the gold just sold at market prices for repurchases falling due. This transaction brought the Fund’s physical gold holdings back to the initial level, but at a higher book value, and reduced its usable currency holdings below where they would have been if repurchases were made in usable currencies (thus remunerated reserve tranche positions were permanently higher). This is financially equivalent to borrowing at the SDR rate to buy gold at market prices, and has an ongoing financial cost, which has been burden-shared between debtor and creditor members.

Table. Financial Effects on the GRA of 1999–2000 Off-Market Transactions in Gold  
(In millions of SDRs)

	Gold (book value)	Usable currency holdings	Profit	Income effect 1/
1. Sale of gold and receipt of proceeds	- 453	+ 2,679	+ 2,226	
2. Placement of profits in SDA	<u>0</u>	<u>- 2,226</u>	<u>- 2,226</u>	
<b>Net effect of outright sales</b>	- 453	+ 453	0	+ 19
3. Acceptance of gold instead of repurchase	<u>+ 2,679</u>	<u>- 2,679</u>	<u>0</u>	
<b>Net effect of off-market transactions</b>	+ 2,226	- 2,226	0	- 94

1/ Recurrent on an annual basis. Calculated at an SDR interest rate of 4.22 percent per annum.

the gold market.<sup>28</sup> Relative indicators of the Fund’s gold holdings are summarized in Table 4. With the Fund holding over 10 percent of official sector stocks, any actions—or public discussion of actions—on gold by the Fund are likely to affect the market, possibly significantly. More generally, the Fund should seek to avoid actions that could destabilize the gold market and have an adverse effect on gold producers, many of which are low income countries (see Annex II).

<sup>28</sup> Article V, Section 12 (a).

Table 4. Gold Market Indicators

	In millions of ounces	In tons
<b>Stocks</b>		
Total world stock (end-2003)	4,839	150,500
Official sector stock (end-2003)	1,023	31,811
Of which: IMF	103	3,217
<b>Flows</b>		
Total annual demand 1/	128	3,991
Mining production (annual) 1/	82	2,553
Official sector sales (annual) 1/	18	553
Daily turnover in London market and Comex 2/	22	686

Sources: GFMS, Ltd., *Gold Survey 2004 and Update 2*, and IFS.

1/ Average for 2002-2004.

2/ Average for 2001-2003.

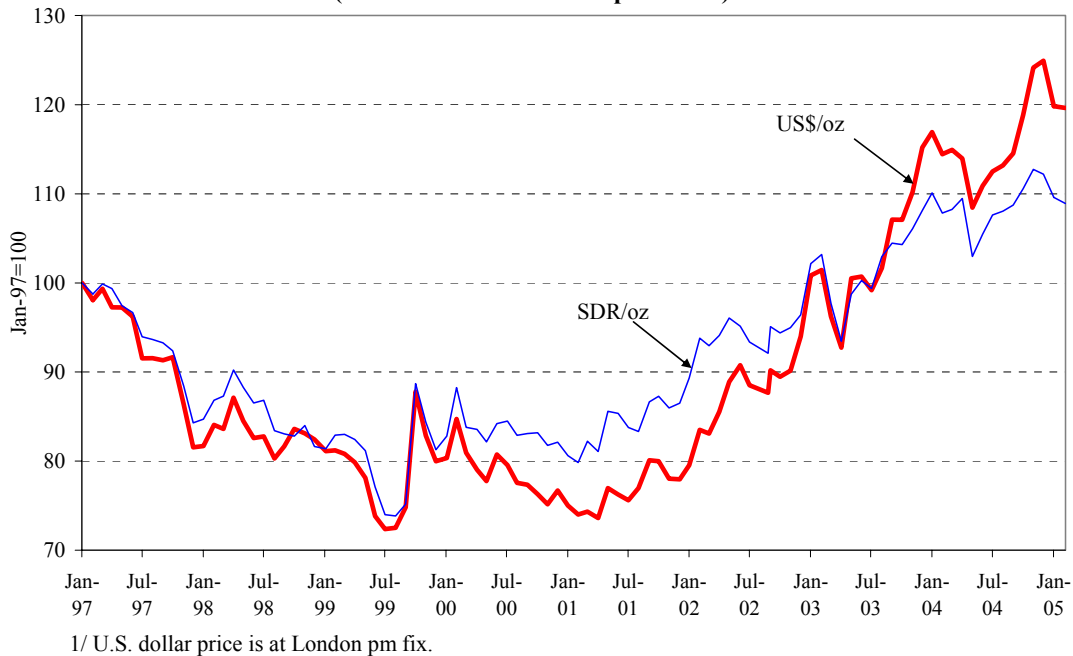
30. **Demand and supply conditions in the gold market have changed markedly since 1999, when the Fund last considered gold sales.** At that time, the price of gold had fallen to a 20-year low, in part reflecting concerns about potential gold sales by official holders and the market's ability to absorb such sales. Indeed, the gold price was falling during the course of 1999, as the Executive Board was discussing possible gold sales. Announcements of official sales by other important holders (e.g., Switzerland and the United Kingdom) also contributed to this decline, which ultimately played an important role in the decision to use off-market transactions rather than outright sales to raise the resources needed for the enhanced HIPC Initiative.

31. **Since 1999, the market price of gold has risen significantly** (Figure 1). This is true both in U.S. dollars, where the price is up about 66 percent from its 1999 low, and also in SDRs (an increase of 48 percent). Factors contributing to this recovery have included:

- On the **demand** side, heightened geo-political uncertainties and the global economic recovery concomitant with a low interest rate environment.
- A lagged **supply** response, as new mine production, accounting for most of the annual supply of gold, has been stable. In addition, there has been consistent dehedging behavior in the private market since 2000, reducing supply by about half of new production (on a cumulative basis).

32. **A major structural change in the gold market since 1999 has been the institutionalization and regularization of official gold sales.** The signing in September 1999 of the Central Bank Gold Agreement (CBGA) has enabled official gold sales to be

**Figure 1. Gold Price Indices**  
(In U.S. dollars and SDR per ounce) 1/



accommodated in an orderly fashion (Box 5). Official sector sales to the market have increased significantly on average since 1999, without the disruption that accompanied the announcement of unanticipated official sales in the late 1990s. Indeed, the recent announcement of a new expanded 5-year CBGA (effective September 2004) had little if any adverse effect on the market. The new CBGA provides for sales of 2,500 tons (from 2,000 tons) and includes sales of 500 tons on an annual basis (up from 400 tons). The CBGA has supported the capacity of the gold market to handle significant official sales by conducting such sales in a transparent and predictable manner.

## VI. POSSIBLE MODALITIES FOR GOLD SALES

33. **This section considers key issues relating to the modalities of possible Fund gold sales**, i.e., assuming that the broader issues discussed above, including the impact on the Fund's finances, can be satisfactorily addressed. Building on recent experience, it would seem that a successful strategy for Fund gold sales—e.g., little impact on the gold market price and gold producers—should include the following elements:

- **A small amount of phased sales** that could be readily accommodated by the market.<sup>29</sup>

<sup>29</sup> The annual and cumulative levels under the recently agreed CBGA II may provide indicative benchmarks as to volumes in aggregate that the market could absorb.

### Box 5. Central Bank Gold Agreement

In September 1999, a group of central banks in Europe launched a new initiative—the Central Bank Gold Agreement (CBGA)—to ensure orderly and concerted sales of their gold holdings, in light of increasing volatility in gold markets. The CBGA was designed to provide further transparency in the gold market and to avoid the potentially disruptive effects of central bank gold sales. The sales under the CBGA during 1999-2004 amounted to 2,008 tons and were estimated to account for about 70-80 percent of the total gold sales by the official sector.

In September 2004, upon expiration of the first CBGA, a new CBGA was launched by 15 signatories (the ECB has been a signatory of both CBGAs). The new five-year CBGA provided for an extra 25 percent of sales to 2,500 tons, with a maximum of 500 tons per annum.

Sales under the Central Bank Gold Agreement  
(In tons)

	Gold Holdings (Sep. 1999)	Gold Sales (1999-2004)	Gold Holdings (Sep. 2004)	Gold sales (2004-09) 1/	Projected gold holdings (Sep. 2009)
Switzerland	2,590	1,171	1,419	130	1,289
UK 2/	664	352	n.a.	n.a.	n.a.
Netherlands	1,012	234	777	166	611
Portugal	607	124	482	...	...
Austria	407	90	318	...	...
Germany	3,469	35	3,433	600	2,833
Belgium	258	0	258	...	...
Spain	524	0	523	...	...
Luxembourg	2	0	2	...	...
Finland	49	0	49	...	...
Ireland	5	0	5	...	...
Italy	2,452	0	2,452	...	...
Sweden	185	0	185	...	...
France	3,025	0	3,024	500-600	2,424-2,524
Greece 2/	n.a.	n.a.	108	...	...
<b>All CBGA countries</b>	<b>15,249</b>	<b>2,008</b>	<b>13,037</b>	<b>2,500</b>	<b>10,537</b>

Source: GFMS, Ltd., *Gold Survey Update 2*.

1/ The total sales under the CBGA II are up to 2,500 tons (about 80 million ounces). Very few central banks have made official statements specifying their future sales plans, even though some have alluded to potential sales.

2/ The United Kingdom opted out of the new agreement, while Greece is a new signatory.

- **A clear and consistent communications strategy** vis-à-vis markets.
- **Close consultation with other official actors.**

34. **In the past, four main modalities have been considered for possible gold sales by the Fund:** (i) direct sales to another official holder of gold; (ii) placements into the market through a private intermediary or a group of intermediaries, such as bullion banks; (iii) market placements through the intermediation of a central bank with experience in gold sales or the BIS; and (iv) direct market sales through public auctions, as used for the Fund gold sales between 1976 and 1980.<sup>30</sup>

35. **Direct placements with official holders would take place outside the gold market, but would still be conducted at a market-related price.** The direct sale of gold to one or several central banks would involve only a redistribution of existing official gold holdings, and therefore should have little effect on the gold market. Such sales would need to be conducted at a price that is based on the prevailing market price—for example, based on the fixing prices in the London market. The possibility of official sector placements could be explored further if there was agreement on proceeding with gold sales. Staff does not currently have any indications of official buyers wishing to increase their gold holdings, though a small number of central banks have done so in recent years.

36. **Assuming on-market sales would be needed, a key consideration is whether those sales would be additional to or within the 2,500 tons envisaged under the CBGA II.** In the staff's view, the latter option would offer the best prospects of limiting any potential adverse effects on the gold market, since the agreed overall sales volume is already in the public domain and has been fully discounted. This would require that existing CBGA participants would be willing to reduce their planned gold sales to make room for gold sales by the Fund. It would also allow gold sales by the Fund to take place at a carefully measured pace and in an orderly manner.

37. **As noted, to avoid market disruption, any gold sales program by the Fund would need to be of limited size.** Considerations relating to current market capacity suggest that an overall sale of, say, 13–16 million ounces (400–500 tons) could probably be accommodated without significant difficulty, particularly if it is spread over a reasonable period. This would not be out of line with the range of recent gold sales by some central banks, which have been accommodated without disrupting the market.<sup>31</sup> Such a program would compare with sales of 395 tons by the United Kingdom over three years beginning 1999, and 1,171 tons by the Swiss National Bank in 2000–2004 (under the first CBGA). It would also be well below

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<sup>30</sup> *Modalities for Gold Sales by the Fund* (EBS/99/110, 6/25/99).

<sup>31</sup> Based on average annual official sales from 2002–2004.

average daily market turnover and about one-tenth of annual mining production (Table 4 above). Relative to the new CBGA, such a sales program would represent about one-fifth.

38. **A decision would also be needed as to whether to sell gold through placements in the market via intermediaries or through direct sales to the market.** Gold transactions of most major gold producers and industrial consumers of gold now take place through private intermediaries such as bullion banks. Central banks have typically conducted their sales through private intermediaries or other official institutions. It may also be feasible to request one or more of the central banks that have acquired the requisite expertise through participation in the CBGA to act as the Fund's financial intermediary. With the exception of the gold auctions by the United Kingdom in 1999–2002, public auctions have not been used for any significant gold sales by either official or private sellers since the auctions conducted by the Fund and the United States in the 1970s.

39. **It would be important for any further gold sales program by the Fund to avoid the notion that the sales are the first step in a plan to sell significant amounts of the Fund's gold.** In this regard, careful "ring-fencing" of a gold sales program would be essential to place the sales in the proper context, though this could be complicated by the description of the 1999–2000 transactions as a one-time and exceptional operation, as noted above. Unambiguous limits on the amount of gold to be sold, together with an indicative time-frame and clear communication on the exceptional nature of such sales, would be important not only for gold market participants, but to manage the expectations of other interested parties. A gold sales program would also need to take into account the possibly long lead times required for Executive Directors to secure the necessary parliamentary approvals (where required) to be in a position to vote for a decision to sell gold, and to carry out orderly and well-timed sales operations.

40. **Finally, a well thought-out and coherent communications strategy would be essential to manage market expectations.** The experience in 1999 is noteworthy in this regard as various public statements concerning gold sales by the Fund and other official holders contributed to a sharp drop in the gold price and eventually undermined support for proceeding with outright gold sales, leading to the agreement on off-market transactions despite their negative effects on the Fund's finances. An early statement that any gold sales by the Fund would be accommodated within the new CBGA could help significantly in addressing such concerns.

## VII. ISSUES FOR DISCUSSION

41. **Directors may wish to comment on the following issues:**

- Do Directors agree that the current structure of financing the Fund's concessional lending to low income countries through the PRGF Trust and thus separate from the GRA has served the Fund well? Do they consider that the longstanding plan to move to a self-sustained PRGF remains appropriate?

- If it were desired to provide further debt relief for low income countries, how do Directors see the trade-off between more debt relief and maintaining an adequate financing capacity for lending to low-income countries going forward?
- Do Directors share the staff's view that resources for HIPC debt relief for Liberia, Somalia and Sudan should be secured as part of any agreement on a new debt relief initiative?
- What are Director's views on the relative merits of the three main alternative financing sources for further debt relief identified in this paper (new bilateral contributions, existing PRGF/HIPC resources, and gold sales)?
- Do Directors consider that the five long-standing principles that have governed Fund policies on gold remain valid? What do they see as the implications of these principles for the proposals to use the Fund's gold to finance further debt relief?
- Do Directors agree that, if it were decided to proceed with new gold sales, this should be pursued through outright sales rather than a repeat of the off-market transactions conducted in 1999–2000? How do Directors view developments in the gold market since 1999 and their implications for the alternative modalities for Fund gold sales discussed in this paper? Directors may wish to give their views on the relative priority that should be accorded to these options, and desirability of exploring the scope for making room for Fund gold sales within the CBGA.

Table 5. IMF Credit Outstanding to PRGF-Eligible Countries  
(In millions of SDRs; as of December 31, 2004)

Members	GRA Credit	PRGF/ESAF Loans 1/	Total	HIPC assistance disbursed but not yet used 2/
<b>I. 38 HIPCs</b>	<b>1,796.6</b>	<b>4,154.2</b>	<b>5,950.8</b>	<b>343.5</b>
<b>I.1. 35 HIPCs</b>	<b>130.2</b>	<b>4,027.1</b>	<b>4,157.3</b>	<b>343.5</b>
1 Benin	-	42.0	42.0	3.3
2 Bolivia <sup>3/</sup>	101.8	95.8	197.7	14.8
3 Burkina Faso	-	73.8	73.8	14.1
4 Burundi	-	26.4	26.4	-
5 Cameroon	-	214.7	214.7	-
6 Central African Republic	5.6	22.8	28.4	-
7 Chad	-	61.8	61.8	-
8 Comoros	-	-	-	-
9 Congo, Democratic Republic of	-	526.8	526.8	-
10 Congo, Republic of	5.3	13.4	18.7	-
11 Cote d'Ivoire	-	200.5	200.5	-
12 Ethiopia	-	118.0	118.0	16.9
13 Gambia, The	-	15.9	15.9	-
14 Ghana	-	301.6	301.6	59.9
15 Guinea	-	78.5	78.5	-
16 Guinea-Bissau	0.2	10.0	10.2	-
17 Guyana	-	56.7	56.7	19.9
18 Honduras	-	125.7	125.7	0.4
19 Lao People's Democratic Republic	-	24.6	24.6	-
20 Madagascar	-	145.4	145.4	8.6
21 Malawi	17.4	42.2	59.5	-
22 Mali	-	93.2	93.2	19.9
23 Mauritania	-	58.2	58.2	6.5
24 Mozambique	-	127.0	127.0	31.4
25 Myanmar	-	-	-	-
26 Nicaragua	-	159.5	159.5	62.6
27 Niger	-	87.2	87.2	14.4
28 Rwanda	-	59.4	59.4	1.3
29 Sao Tome & Principe	-	1.9	1.9	-
30 Senegal	-	131.5	131.5	15.2
31 Sierra Leone	-	126.0	126.0	-
32 Tanzania	-	272.3	272.3	32.3
33 Togo	-	17.4	17.4	-
34 Uganda	-	123.3	123.3	21.7
35 Zambia	-	573.3	573.3	-
<b>I.1.2. Protracted Arrears HIPCs</b>	<b>1,666.3</b>	<b>127.1</b>	<b>1,793.4</b>	<b>-</b>
36 Liberia <sup>4/</sup>	478.6	30.4	509.0	-
37 Somalia <sup>4/</sup>	204.7	17.6	222.2	-
38 Sudan <sup>4/</sup>	983.0	79.2	1,062.2	-
<b>II. Non-HIPC IDA countries</b>	<b>241.7</b>	<b>1,405.9</b>	<b>1,647.6</b>	<b>-</b>
39 Afghanistan	-	-	-	-
40 Albania	-	62.4	62.4	-
41 Angola	-	-	-	-
42 Armenia, Republic of	1.4	138.7	140.1	-
43 Bangladesh	-	148.5	148.5	-
44 Bhutan	-	-	-	-
45 Cambodia	-	62.7	62.7	-

Table 5. IMF Credit Outstanding to PRGF-Eligible Countries  
(In millions of SDRs; as of December 31, 2004)

Members	GRA Credit	PRGF/ESAF Loans 1/	Total	HIPC assistance disbursed but not yet used 2/
46 Cape Verde	-	6.2	6.2	-
47 Djibouti	-	13.6	13.6	-
48 Eritrea	-	-	-	-
49 Georgia	2.3	169.0	171.3	-
50 Haiti	-	6.1	6.1	-
51 Kenya	-	66.1	66.1	-
52 Kiribati	-	-	-	-
53 Kyrgyz Republic	-	133.2	133.2	-
54 Lesotho	-	24.5	24.5	-
55 Maldives	-	-	-	-
56 Moldova, Republic of	53.6	27.7	81.4	-
57 Mongolia	-	28.5	28.5	-
58 Nepal	-	14.3	14.3	-
59 Samoa	-	-	-	-
60 Solomon Islands	-	-	-	-
61 Sri Lanka	150.9	38.4	189.3	-
62 Tajikistan, Republic of	-	78.7	78.7	-
63 Timor Leste	-	-	-	-
64 Tonga	-	-	-	-
65 Vanuatu	-	-	-	-
66 Vietnam	-	178.6	178.6	-
67 Yemen, Republic of	33.5	208.8	242.2	-
<b>Sub-total for 66 IDA-eligible countries (I+II) 5/</b>	<b>1,936.5</b>	<b>5,464.2</b>	<b>7,400.7</b>	<b>328.6</b>
<b>III. PRGF-eligible non-IDA countries</b>	<b>390.0</b>	<b>1,219.9</b>	<b>1,609.9</b>	-
68 Azerbaijan	38.2	96.0	134.2	-
69 Dominica	3.0	3.0	5.9	-
70 Grenada	5.9	-	5.9	-
71 India	-	-	-	-
72 Nigeria	-	-	-	-
73 Pakistan	164.5	1,043.4	1,207.9	-
74 Papua New Guinea	41.4	-	41.4	-
75 St. Lucia	-	-	-	-
76 St. Vincent & the Grenadines	-	-	-	-
77 Uzbekistan, Republic of	12.5	-	12.5	-
78 Zimbabwe 4/ 6/	124.5	77.6	202.1	-
<b>Total for 78 PRGF-eligible countries</b>	<b>2,428.2</b>	<b>6,780.0</b>	<b>9,208.2</b>	<b>343.5</b>

Source: IMF Finance Department.

1/ Including SAF loans and Trust Fund loans in arrears.

2/ IMF's HIPC assistance disbursed to members but not yet applied to cover future repayment obligations.

3/ Bolivia is listed under HIPCs. It is not IDA-only eligible, but eligible for blend borrowing.

4/ Including interest arrears.

5/ Excluding Bolivia; see footnote 3.

6/ On September 24, 2001 Zimbabwe was removed from the PRGF-eligible countries list due to overdue obligations to the PRGF Trust.

Table 6. Forthcoming Obligations to the Fund of Selected Countries after the Disbursement of HIPC Assistance I/  
(In millions of SDRs; as of December 31, 2004)

Members	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total 2005-2015			Arrears
												Total (A+B+C)	Principal (A)	Interest (B)	
<b>I. 38 HIPCs</b>	<b>568.1</b>	<b>427.4</b>	<b>532.2</b>	<b>583.6</b>	<b>528.2</b>	<b>511.9</b>	<b>431.4</b>	<b>280.8</b>	<b>152.7</b>	<b>86.1</b>	<b>5.1</b>	<b>4,107.4</b>	<b>4,157.3</b>	<b>293.5</b>	<b>343.5</b>
<b>I.1. 35 HIPCs</b>	<b>548.3</b>	<b>407.6</b>	<b>512.4</b>	<b>563.8</b>	<b>508.4</b>	<b>492.1</b>	<b>411.5</b>	<b>260.9</b>	<b>132.9</b>	<b>66.3</b>	-	<b>3,904.2</b>	<b>4,157.3</b>	<b>90.4</b>	<b>343.5</b>
1 Benin	4.7	5.2	4.5	5.7	6.4	5.4	3.7	2.4	1.2	0.1	-	39.5	42.0	0.8	3.3
2 Bolivia 2/3/	18.8	33.2	59.9	54.5	20.8	4.9	1.9	-	-	-	-	194.0	197.7	11.1	14.8
3 Burkina Faso	2.3	7.4	10.9	11.7	9.6	8.2	6.4	3.1	1.0	0.3	-	61.0	73.8	1.3	14.1
4 Burundi	0.1	0.1	0.1	0.1	2.8	5.4	5.4	5.3	5.3	2.6	-	27.3	26.4	0.9	-
5 Cameroon	28.0	36.5	41.0	37.5	29.7	21.5	12.8	8.0	3.2	-	-	218.3	214.7	3.6	-
6 Central African Republic	3.6	4.4	5.8	7.8	5.4	1.6	0.8	-	-	-	-	29.4	28.4	1.0	-
7 Chad	10.7	10.8	9.9	9.0	8.3	6.9	4.3	1.8	1.0	-	-	62.8	61.8	1.0	-
8 Comoros	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
9 Congo, Democratic Republic of	2.6	2.6	44.6	89.0	99.2	106.7	106.1	63.6	18.8	8.0	-	541.2	526.8	14.5	-
10 Congo, Republic of	8.2	2.8	0.0	0.0	0.0	1.6	1.6	1.6	1.6	1.6	-	19.1	18.7	0.4	-
11 Cote d'Ivoire	62.6	39.7	31.1	28.4	11.9	11.8	11.8	5.9	-	-	-	203.1	200.5	2.6	-
12 Ethiopia	5.6	5.6	8.0	12.7	14.5	18.9	18.5	10.8	6.3	3.1	-	103.9	118.0	2.9	16.9
13 Gambia, The	1.5	2.8	2.8	3.4	2.7	2.0	0.6	0.6	-	-	-	16.2	15.9	0.3	-
14 Ghana	21.4	22.0	25.5	32.8	32.2	37.4	37.2	21.3	13.3	5.3	-	248.3	301.6	6.6	59.9
15 Guinea	17.7	13.4	14.2	12.0	8.4	7.6	3.9	2.6	-	-	-	79.6	78.5	1.1	-
16 Guinea-Bissau	2.2	2.6	2.2	1.3	1.0	1.0	-	-	-	-	-	10.3	10.2	0.1	-
17 Guyana	4.5	4.3	4.3	4.3	4.7	5.0	3.5	3.5	2.4	1.2	-	37.7	56.7	1.0	19.9
18 Honduras	18.2	18.7	21.9	21.9	17.6	10.6	7.4	4.1	4.1	3.1	-	127.6	125.7	2.4	0.4
19 Lao People's Democratic Republic	4.2	2.3	2.0	2.8	3.7	3.7	3.2	2.3	0.9	-	-	25.1	24.6	0.5	-
20 Madagascar	7.7	12.9	15.4	17.6	22.1	23.9	15.1	11.6	9.3	4.6	-	140.2	145.4	3.3	8.6
21 Malawi	12.6	18.0	13.5	5.4	4.1	2.6	1.3	1.3	1.3	-	-	60.2	59.5	0.6	-
22 Mali	10.5	9.2	9.8	10.1	11.6	9.3	7.9	4.2	2.2	0.1	-	74.8	93.2	1.5	19.9
23 Mauritania	7.2	6.0	8.8	8.6	8.6	6.7	4.9	1.8	-	-	-	52.7	58.2	1.0	6.5
24 Mozambique	10.9	14.6	16.5	18.2	16.7	10.8	5.4	2.9	1.2	0.3	-	97.6	127.0	1.9	31.4
25 Myanmar	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
26 Nicaragua	4.2	8.1	10.6	12.2	14.5	15.4	11.3	11.2	8.4	4.2	-	100.1	159.5	3.1	62.6
27 Niger	5.9	5.7	7.7	9.5	11.2	12.0	10.3	7.7	3.9	0.8	-	74.8	87.2	2.0	14.4
28 Rwanda	5.6	10.7	12.6	11.5	9.2	6.2	2.4	0.5	0.3	0.1	-	59.1	59.4	1.0	1.3
29 Sao Tome & Principe	0.1	0.4	0.4	0.4	0.4	0.3	-	-	-	-	-	1.9	1.9	0.0	-
30 Senegal	21.8	21.4	24.1	18.1	13.3	9.3	6.4	2.3	1.0	0.3	-	118.1	131.5	1.8	15.2
31 Sierra Leone	6.3	3.6	11.4	16.9	19.6	23.7	23.6	13.2	7.1	4.2	-	129.5	126.0	3.5	-
32 Tanzania	32.7	41.5	40.1	36.3	32.0	26.9	18.8	10.7	4.7	0.8	-	244.6	272.3	4.6	32.3
33 Togo	7.7	4.4	4.4	1.1	-	-	-	-	-	-	-	17.5	17.4	0.1	-
34 Uganda	25.0	24.2	19.5	13.9	9.9	5.1	2.4	1.5	1.2	0.4	-	103.1	123.3	1.4	21.7
35 Zambia	173.3	12.5	28.9	49.2	56.3	79.7	72.8	55.0	33.3	24.8	-	585.8	573.3	12.5	-
<b>I.1.2. Protracted Arrears HIPCs</b>	<b>19.8</b>	<b>19.8</b>	<b>19.8</b>	<b>19.8</b>	<b>19.8</b>	<b>19.8</b>	<b>19.8</b>	<b>19.8</b>	<b>19.8</b>	<b>19.8</b>	<b>5.1</b>	<b>203.2</b>	<b>-</b>	<b>203.2</b>	<b>1,793.4</b>
36 Liberia 4/	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	6.4	1.6	65.3	-	65.3	509.0
37 Somalia 4/	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	0.8	31.7	-	31.7	222.2
38 Sudan 4/	10.3	10.4	10.4	10.4	10.3	10.4	10.4	10.4	10.3	10.4	2.7	106.2	-	106.2	1,062.2

Table 6. Forthcoming Obligations to the Fund of Selected Countries after the Disbursement of HIPC Assistance 1/  
(In millions of SDRs; as of December 31, 2004)

Members	Total 2005-2015												Arrears			
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	Total (A+B+C)		Principal (A)	Interest (B)	HIPC assistance (C)
<b>II. Non-HIPC IDA countries</b>	<b>242.5</b>	<b>276.3</b>	<b>225.4</b>	<b>202.4</b>	<b>196.1</b>	<b>186.2</b>	<b>156.5</b>	<b>111.0</b>	<b>68.3</b>	<b>28.8</b>	-	-	<b>1,693.6</b>	<b>1,647.6</b>	<b>46.0</b>	-
39 Afghanistan	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
40 Albania	6.5	7.9	9.6	9.8	9.2	7.6	5.5	3.6	2.8	1.2	-	-	63.7	62.4	1.2	-
41 Angola	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
42 Armenia, Republic of	24.0	21.7	15.9	17.4	15.5	14.0	12.9	11.9	6.8	2.8	-	-	142.9	140.1	2.8	-
43 Bangladesh	0.7	0.7	0.7	5.7	15.5	30.3	30.1	30.0	24.9	14.9	-	-	153.6	148.5	5.1	-
44 Bhutan	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
45 Cambodia	6.2	4.5	7.8	11.1	11.8	10.1	7.6	4.2	0.8	-	-	-	64.0	62.7	1.3	-
46 Cape Verde	0.0	0.0	0.2	0.5	1.0	1.2	1.2	1.1	0.7	0.2	-	-	6.3	6.2	0.2	-
47 Djibouti	0.6	1.2	1.9	2.8	2.8	2.2	1.6	0.9	-	-	-	-	13.9	13.6	0.3	-
48 Eritrea	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
49 Georgia	37.5	34.0	26.4	22.4	18.2	12.8	11.0	7.3	2.8	1.4	-	-	173.9	171.3	2.6	-
50 Haiti	3.1	3.0	-	-	-	-	-	-	-	-	-	-	6.1	6.1	0.0	-
51 Kenya	5.3	9.5	7.0	6.9	11.9	11.8	5.1	5.0	5.0	-	-	-	67.5	66.1	1.5	-
52 Kiribati	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
53 Kyrgyz Republic	21.5	19.1	16.5	15.1	15.0	15.3	12.9	10.5	6.9	2.9	-	-	135.8	133.2	2.6	-
54 Lesotho	0.1	0.5	1.9	3.3	3.9	5.0	4.6	3.2	1.8	1.1	-	-	25.2	24.5	0.7	-
55 Maldives	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
56 Moldova, Republic of	16.2	17.6	15.3	14.3	11.9	5.6	2.8	1.9	-	-	-	-	85.4	81.4	4.1	-
57 Mongolia	4.1	4.2	4.4	3.3	4.3	3.1	2.5	1.6	1.6	-	-	-	29.0	28.5	0.5	-
58 Nepal	0.1	0.1	0.1	0.1	1.5	2.9	2.9	2.9	2.9	1.4	-	-	14.8	14.3	0.5	-
59 Samoa	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
60 Solomon Islands	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
61 Sri Lanka 2/	30.6	77.2	33.2	8.0	11.8	11.7	11.6	11.4	5.7	-	-	-	201.2	189.3	12.0	-
62 Tajikistan, Republic of	9.8	10.9	10.9	10.6	6.9	8.5	7.2	7.2	5.5	2.9	-	-	80.4	78.7	1.7	-
63 Timor Leste	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
64 Tonga	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
65 Vanuatu	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-	-
66 Vietnam	37.0	22.9	17.1	25.3	25.2	25.0	20.8	8.3	-	-	-	-	181.7	178.6	3.1	-
67 Yemen, Republic of 2/	39.2	41.3	56.6	45.9	29.8	19.0	16.3	-	-	-	-	-	248.1	242.3	5.9	-
<b>Total for 66 IDA-eligible countries 5/</b>	<b>791.8</b>	<b>670.5</b>	<b>697.7</b>	<b>731.5</b>	<b>703.5</b>	<b>693.1</b>	<b>586.0</b>	<b>391.8</b>	<b>221.1</b>	<b>114.9</b>	<b>5.1</b>	<b>5,607.0</b>	<b>5,607.3</b>	<b>328.4</b>	<b>328.4</b>	<b>1,793.4</b>
<b>Total for 67 countries</b>	<b>810.6</b>	<b>703.7</b>	<b>757.6</b>	<b>786.0</b>	<b>724.3</b>	<b>698.1</b>	<b>587.9</b>	<b>391.8</b>	<b>221.1</b>	<b>114.9</b>	<b>5.1</b>	<b>5,801.0</b>	<b>5,804.9</b>	<b>339.6</b>	<b>343.5</b>	<b>1,793.4</b>

Source: IMF Finance Department.

1/ After IMF's HIPC assistance disbursed to members but not yet applied to cover future repayment obligations according to the proportions approved by the Board. Excludes net SDR charges and SDR assessments.

2/ Based on obligation schedule.

3/ Bolivia is listed under HIPCs. It is not IDA-only eligible, but eligible for blend borrowing.

4/ Assuming no arrears clearance.

5/ Excluding Bolivia; see footnote 3.

## PRGF Demand Projections for 2006–10

### *Overview*

Updated staff projections of medium-term demand under the PRGF were prepared during the summer of 2004 in response to a request made at the March 2004 Board discussion of a staff paper on instruments and financing for low-income members.<sup>32</sup> The updated projections were not issued to the Board pending clarification of a range of issues related to the Fund's financial assistance to low-income members, including proposals for additional debt relief.

**The updated staff projections, which showed total demand under the PRGF during the period 2006–2010 of SDR 0.8–1.2 billion per annum, were based on two elements:**

- Detailed country-by-country projections of potential demand under **standard PRGF operations** (see below for a detailed explanation of this approach). These projections yielded a point estimate of about SDR 0.9 billion per annum, with a range allowing for normal uncertainties of SDR 0.7–1.1 billion; and
- An allowance for additional demand in response to **external shocks** of SDR 100 million per annum. This estimate took account of the historical experience with PRGF augmentations as well as potential additional demand under the Trade Integration Mechanism (TIM) (see below).<sup>33</sup>

**These projections also took explicit account of a number of factors that are relevant when considering potential future financing needs:**

- the new tapered access norms for PRGF arrangements;
- expected graduation from PRGF financing;
- projected use of low-access PRGF arrangements;
- application of the new criteria on blends; and
- potential demand for concessional resources from the four current protracted arrears cases, once their arrears have been cleared.

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<sup>32</sup> *The Fund's Support of Low-Income Member Countries—Considerations on Instruments and Financing* (SM/04/53, 2/24/04) and *The Acting Chair's Summing Up* (BUFF/04/69, 4/7/04).

<sup>33</sup> However, the Board has asked staff to develop proposals for a concessional shocks facility, which would be likely to result in an increase in demand for resources beyond the estimate of SDR 100 million per year.

***Projections of Demand for Standard PRGF Operations***

Demand projections for standard PRGF operations were based on a bottom-up approach using country-specific information submitted by area departments. This approach grouped countries according to their history of PRGF use (Table A.1), and took into account the new access norms and criteria on blends. The information provided by area departments specified the potential timing, probability, and access for a country’s possible request for a new PRGF arrangement, and was incorporated into the projections in line with the assumptions below. These projections suggested that total resource needs for standard PRGF operations could average about SDR 0.9 billion per year during 2006–2010 (Table A.2).

- Existing arrangements as of end-2005 were assumed to be renewed after four years (allowing one year, on average, for slippage), unless a country was specifically expected to not request a new arrangement or to graduate from PRGF-eligibility, as indicated by the area department.
- The assumption for access was standardized based on the norms adopted by the Executive Board in March 2004, unless a country was expected to have an arrangement with lower-than-norm access, as indicated by the area department.
- Unless specific country information indicated otherwise, access of a successor arrangement was always assumed to be no more than that of the previous arrangement, even when the access of the previous arrangement was below the norm.
- For countries that meet the guidelines for blended PRGF/EFF arrangements, it was assumed that access under the PRGF is one half of the PRGF norms in percent of quota for successive arrangements.

**PRGF Access Norms (in percent of quota)**

First-time user	90
Second-time user	65
Third-time user	55
Fourth-time user	45
Fifth-time user	35
Sixth/seventh-time user	25

In view of their quota size and large impact on PRGF resource requirements, Nigeria and Pakistan were assumed to not request PRGF arrangements during this period. Pakistan has, in fact, indicated that it would not seek a further PRGF arrangement.

***Projections of Demand for Shocks***

Financing needs for shocks are, by their nature, difficult to estimate and subject to great uncertainty. Nevertheless, history provides some guidance on the potential needs associated with PRGF augmentations. Of the 140 ESAF/PRGF arrangements approved since 1988, augmentations were agreed in 35 of the cases, for an average amount of almost SDR 42 million per annum. During the same period, use of the CFF by PRGF-eligible countries also

averaged about SDR 40 million per year. Since 2000, the CFF has not been used, while PRGF augmentation has averaged about SDR 57 million per year.

Projected demand for shock financing also included the prospective impact of the TIM. At the outset of the TIM, it was estimated that total additional demand for PRGF resources during the full period of the trade adjustment process could be in the range of SDR 500–600 million. However, this estimate included financing which was likely to be concentrated in 2005 and therefore would be covered by the interim PRGF. It was therefore assumed that incremental demand for PRGF resources during 2006–2010 associated with the TIM could amount to about half of the total estimate, or SDR 50–60 million per year.

The above considerations suggested that demand for shock financing during 2006–10 was unlikely to be less than SDR 100 million per annum. This assumed continued demand for PRGF augmentation at around the historical average of SDR 40–50 million, combined with allowance for additional demand of SDR 50–60 million per annum under the TIM.

**Table A.1. Grouping of PRGF-Eligible Countries**

<b>Groups</b>	<b>Quota</b>	<b>Countries</b>
<b>A. Countries that have not used PRGF resources as of 2004</b>	<b>7,160</b>	Afghanistan, Angola, Bhutan, Comoros, Eritrea, Grenada, India, Kiribati, Maldives, Myanmar, Nigeria, Papua New Guinea, Samoa, Solomon Islands, St. Lucia, St. Vincent, Timor Leste, Tonga, Uzbekistan, and Vanuatu.
<b>B. Countries that have used PRGF resources as of 2004</b>	<b>8,429</b>	Albania, Armenia, Azerbaijan, Bangladesh, Benin, Bolivia, Burkina Faso, Burundi, Cambodia, Cameroon, Cape Verde, Central African Republic, Chad, Congo, Dem. Rep. of, Republic of Congo, Cote d'Ivoire, Djibouti, Dominica, Ethiopia, Gambia, The, Georgia, Ghana, Guinea, Guinea-Bissau, Guyana, Haiti, Honduras, Kenya, Kyrgyz Republic, Lao, PDR, Lesotho, Madagascar, Malawi, Mali, Mauritania, Moldova, Mongolia, Mozambique, Nepal, Nicaragua, Niger, Pakistan, Rwanda, Sao Tome & Principe, Senegal, Sierra Leone, Sri Lanka, Tajikistan, Tanzania, Togo, Uganda, Vietnam, Yemen, and Zambia.
<b>C. Protracted Arrears Cases</b>	<b>879</b>	Liberia, Sudan, Somalia, and Zimbabwe.
<b>Total</b>	<b>16,467</b>	

**Table A.2. Country-Specific Projections of Demand for Standard PRGF Operations 1/**  
(In millions of SDRs unless otherwise specified)

Groups	Quota	Annual average		Average access (in percent of quota)	
		2002-2005	2006-2010	2002-2005	2006-2010
<b>A. Countries that have not used PRGF resources as of 2004 (20)</b>	<b>7,160</b>	<b>92</b>	<b>195</b>	<b>64</b>	<b>73</b>
A.1. not expected to request new arrangement during 2005-2010 (11)	6,002	-	-	n.a	n.a
A.2. prospective users during 2005-2010 (9)	1,157	92	195	64	73
<b>B. Countries that have used PRGF resources as of 2004 (54)</b>	<b>8,429</b>	<b>1,064</b>	<b>467</b>	<b>49</b>	<b>41</b>
B.1. not expected to request new arrangement during 2005-2010 (9)	2,491	126	-	37	n.a
B.2. expected to request new arrangement during 2005-2010 (45)	5,938	938	467	51	41
B.2.1. with low-access arrangement (7)	1,124	69	21	14	10
B.2.2. with fifth/sixth arrangement (11) 2/	1,115	213	100	54	35
B.2.3. others (27)	3,699	656	346	63	50
<b>C. Protracted Arrears Cases (4)</b>	<b>879</b>	<b>146</b>	<b>221</b>	<b>185</b>	<b>103</b>
<b>Total</b>	<b>16,467</b>	<b>1,302</b>	<b>882</b>	<b>53</b>	<b>52</b>

1/ Commitment basis. Does not include an allowance for financing of external shocks.

2/ Excluding those with low-access, which are included in B.2.1.

## The World Gold Market

### A. Overview

1. **While gold is a commodity, it has a number of distinctive features which are reflected in the organization and functioning of the gold market.** Like many other commodities, gold has widespread industrial and commercial uses. But it is also used as a store of value and financial asset by individuals (although this role has been decreasing over time) and still retains a residual role as a monetary and reserve asset for central banks and international organizations.
2. **Gold is highly durable and is not consumed like many other commodities.** Thus, most of the gold that has ever been mined remains in above-ground stocks, with a substantial share readily marketable. This implies that there could be a substantial overhang of potential supply from existing gold stocks, most notably that held by the official sector. For this reason, the gold market is very sensitive to changes in expectations regarding the policies of major gold holders.

### B. Gold Market Developments

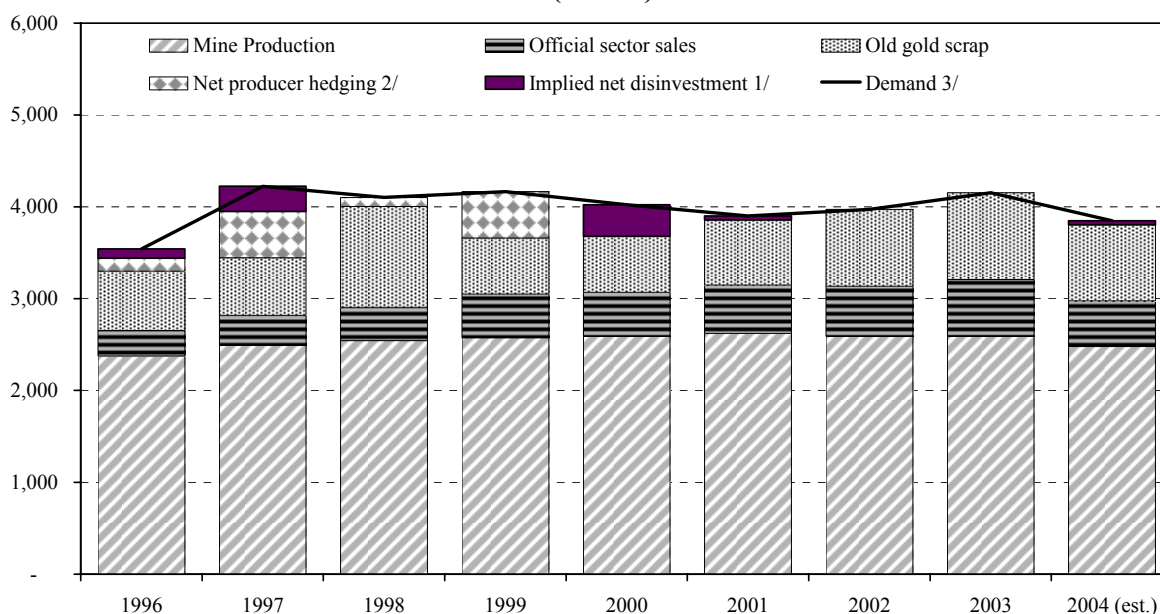
3. **In terms of annual demand (flow), fabrication has comprised the lion's share:** nearly 90 percent of total demand over the past decade through 2001 has been due to fabrication (Table A.3). Since 2001, however, its share has fallen by more than 10 percentage points. Implied net investment (disinvestment in 1996–97, 2000–01, and 2004) is the residual balancing item for gold demand.
4. **The annual supply of gold comes from two sources: new mine production, which accounts for 64 percent of supply, and the recycling or mobilization of existing above-ground stocks.** The latter consists mainly of official sector sales, which account for 13 percent of supply, and private sector sales of gold scrap, which accounts for 22 percent of supply (Table A.3 and Figure A.1).<sup>34</sup> Mine production has been stable since the late 1990s, while scrap has expanded.<sup>35</sup>

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<sup>34</sup> Based on 2004 estimates from *Gold Survey 2004, Update 2*, GFMS, Ltd.

<sup>35</sup> In 2003, growth in production was virtually flat, and temporary operational difficulties contributed to a large decline in the first half of 2004. The single largest factor in the output decline was an accident at the Grasberg mine in Indonesia. Output in 2005 is projected to be higher with a return to normal operations in the Grasberg mine.

**Figure A.1. Components of Gold Supply, 1996-2004  
(In tons)**



Source: Gold Fields Mineral Services, Ltd.

1/ Residual from combining all other data on gold supply/demand. Implied net investment is included in demand.

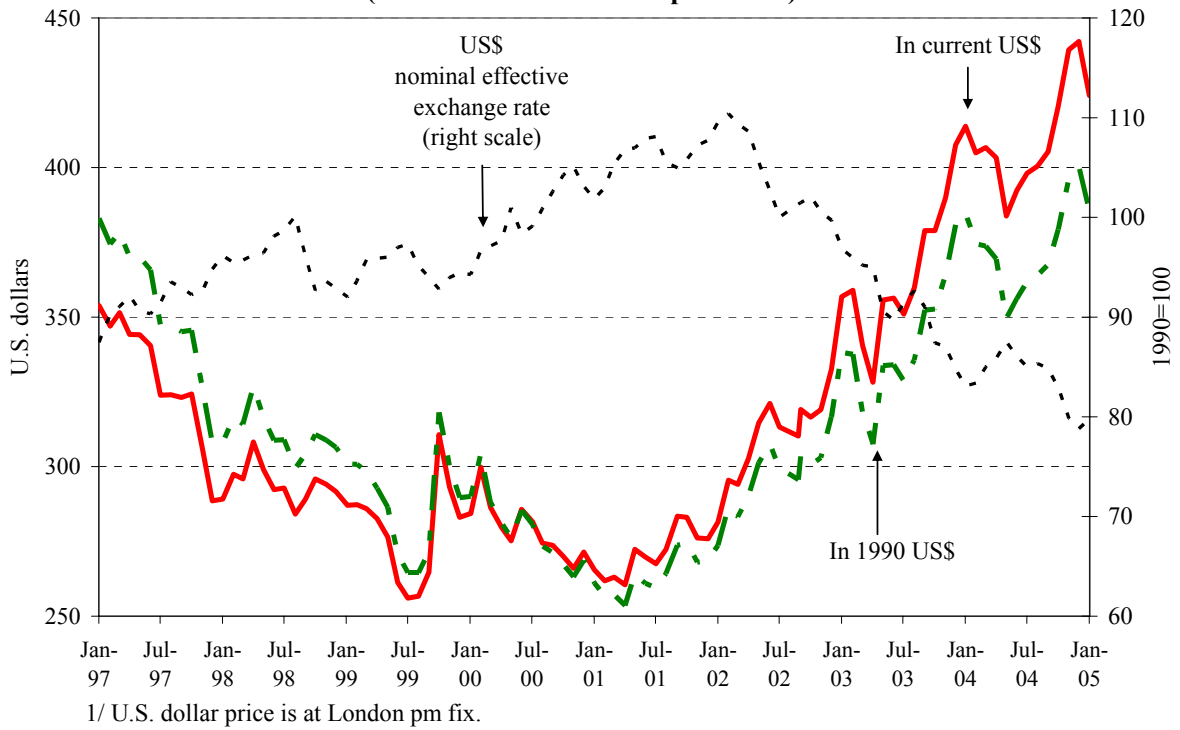
2/ Mining companies' gold loans, forwards, and options positions.

3/ Includes fabrication and investment demand and net producer de-hedging.

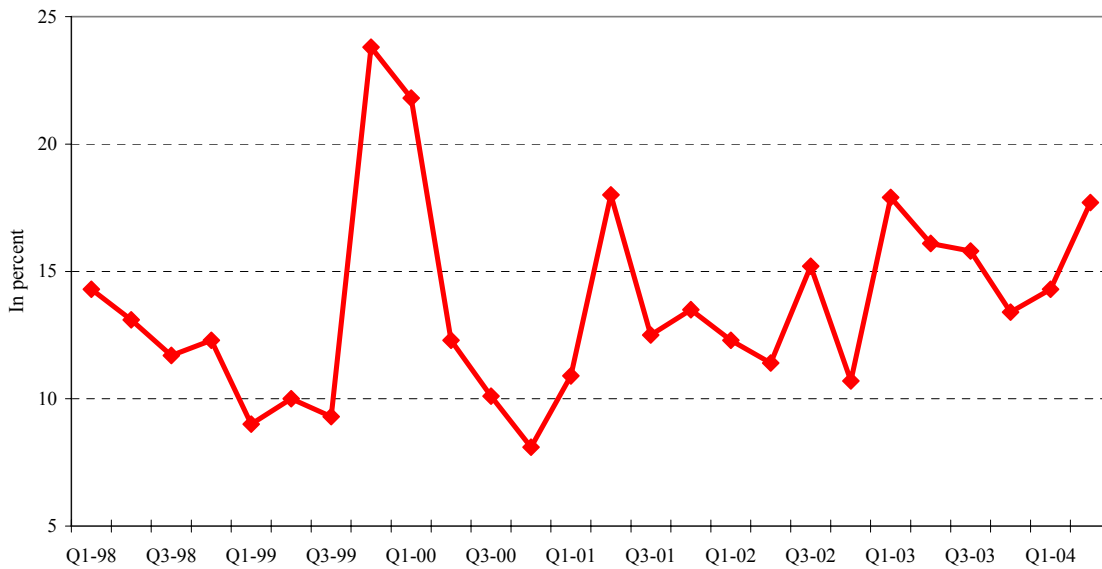
5. **Historically, gold prices in U.S. dollar terms reached a peak in 1980.** Prices reached an all-time peak of US\$850 per ounce on January 21, 1980 (with a monthly average of US\$678 per ounce in January 1980), in the aftermath of the 1970s oil shocks, rising inflation, and growing global uncertainty. This spike was followed by a two-decade long decline and volatile trend that ended in August 1999, when a price of US\$257 per ounce (monthly average) was reached.

6. **Gold prices fell sharply in the late 1990s before starting an upward trend by end-1999** (Figure A.2). The fall in prices resulted from the negative impact of the Asian crisis on fabrication demand, at a time when mining production was still on the rise, and there was lower demand for gold as a store of value and investment alternative. In addition, market prices appear to have been further depressed, and volatility increased, by the successive announcements in 1999 of plans for sizeable gold sales by the U.K. Treasury and other European official gold holders (Figure A.3).

**Figure A.2. Gold Price**  
(In U.S. dollars and SDR per ounce) 1/



**Figure A.3. Gold Price Volatility 1/**  
(In percent; based on U.S. dollars Spot)



Source: GFMS, Ltd., Gold Survey.

1/ Measured by the 30-day standard deviation of logged price returns.

7. **Apart from the strong price recovery, current underlying conditions in the gold market are also substantially different from those prevailing in the late 1990s.** Notably:

- **In real terms, the price of gold is now substantially higher than in 1999.** Since 1999, the gold price has increased by over 30 percent (through January 2005) when adjusted for U.S. CPI inflation (Figure A.2), after falling by almost 20 percent between 1997 and 1999 (annual averages). In addition, current market forecasts for the first half of 2005 reflect the continuation of the upward trend with stable underlying demand factors. As a result, some market analysts anticipate a price increase of an additional 4–5 percent in real terms in this period (to an average nominal price close to US\$450 per ounce.).
- **A number of factors have reinforced the demand for gold with a positive price impact.** These include: the weakening of the U.S. dollar since 2001 as noted; the global low-interest-rate environment and economic recovery; and heightened geopolitical uncertainties (in the aftermath of September 11 and the subsequent war in Iraq). These factors have made gold more attractive as a store of value and consumption commodity and reduced its carrying cost, thereby strengthening demand.
- **Gold supply, which has lagged market demand, has been affected by:** (i) limited growth in mining production since 1999; (ii) producer de-hedging, a consistent behavior since 2000 and estimated to have reduced supply by a cumulative 1,300 tons;<sup>36</sup> and (iii) increased scrap supply since 1999 that averaged about 890 tons in 2003–04.<sup>37</sup>
- **Sales by official sources—in particular the CBGA, currently in its second five-year period—are now an integral component of the gold supply.** Official sales have accounted for 13–15 percent of total supply (9 percent in 1998) and grew by about 30 percent from 1999 to 2003, before falling by 20 percent in 2004 to just under 500 tons. At the same time, some official gold holders, outside the CBGA, reduced their holdings through long-term sales programs (Canada and Mexico).<sup>38</sup>

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<sup>36</sup> By selling future production (hedging through gold loans, forwards, and options contracts) producers increase gold supply with a negative impact on prices. The reverse operation (de-hedging) boosts prices by increasing demand.

<sup>37</sup> The supply of old gold scrap averaged 626 tons a year in 1996–1999. This excludes 1998, when scrap exceeded 1,000 tons due mainly to distress sales out of East Asia.

<sup>38</sup> Canada reduced its gold holdings by some 649 tons since the initiation of gold sales in 1980. Mexico reduced its gold holdings by 24 tons since 1990.

### C. Gold Production and Distribution of Gold Holdings

8. **Gold production has become more geographically diversified since the late 1990s and played an increasingly important role in developing and transition countries** (Table A.4). The three largest producers of gold continue to be South Africa, the United States, and Australia which account for about 35 percent of the total production in 2004. However, their share in world production has declined in the last 5 years, while production in China (8½ percent of total production) and Russia (7 percent of total production) has increased. Indonesia and Peru witnessed the most dramatic increases in production in the past decade.
9. **Five of the top 20 producers are now low income countries** (Ghana, Papua New Guinea, Mali and Tanzania and Uzbekistan).<sup>39</sup> Of these, three are highly indebted poor countries or HIPC's (Ghana, Mali, and Tanzania), for which gold accounts for a significant portion of their exports (25, 50, and 30 percent, respectively). Sixteen of the next 30 largest producers are also low-income countries. Based on 2003 production levels, a 10 percent decline in the gold price would adversely impact gold receipts for all low-income countries by some US\$520 million. Of course this scenario does not take into account second round effects, nor is it able to capture the adverse impact of price volatility on macroeconomic stability.
10. **The bulk of global gold stocks, estimated at 150,500 metric tons at end-2003,** (Table A.5) were held by the private sector in the form of fabricated products. Gold holdings of the official sector, accounting for about 20 percent of the above ground stocks, are concentrated in the United States and European central banks (primarily Germany, France, Italy, and Switzerland). The Fund is the third largest holder of gold after the United States and Germany. Table A.6 shows the changes in official gold stocks in the 2000–04 period.

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<sup>39</sup> Low income countries are defined as those which are PRGF-eligible.

Table A.3. Annual World Gold Supply and Demand  
(In tons)

	1996	1997	1998	1999	2000	2001	2002	2003	2004 Est.
<b>Supply</b>									
Mine Production	2,375	2,493	2,542	2,574	2,591	2,621	2,590	2,592	2,478
Official sector sales	279	326	363	477	479	527	545	617	497
Old gold scrap	644	626	1,099	608	610	708	836	944	829
Net producer hedging	142	504	97	506	0	0	0	0	0
Implied net disinvestment	102	275	0	0	342	44	0	0	43
<b>Total Supply</b>	<b>3,541</b>	<b>4,223</b>	<b>4,102</b>	<b>4,165</b>	<b>4,022</b>	<b>3,900</b>	<b>3,972</b>	<b>4,154</b>	<b>3,848</b>
<b>Demand</b>									
<b>Fabrication</b>									
Jewelry	2,856	3,311	3,182	3,148	3,222	3,026	2,680	2,523	2,622
Other	485	562	567	593	555	476	482	516	556
<b>Total Fabrication</b>	<b>3,341</b>	<b>3,873</b>	<b>3,749</b>	<b>3,741</b>	<b>3,777</b>	<b>3,501</b>	<b>3,163</b>	<b>3,040</b>	<b>3,179</b>
Bar hoarding	200	350	163	266	230	248	250	183	245
Net producer de-hedging	0	0	0	0	15	151	437	279	424
Implied net investment	0	0	190	158	0	0	122	652	0
<b>Total Demand</b>	<b>3,541</b>	<b>4,223</b>	<b>4,102</b>	<b>4,165</b>	<b>4,022</b>	<b>3,900</b>	<b>3,972</b>	<b>4,154</b>	<b>3,848</b>
<b>Gold Price (US\$/oz)</b>	<b>387.87</b>	<b>331.29</b>	<b>294.09</b>	<b>278.57</b>	<b>279.11</b>	<b>271.04</b>	<b>309.68</b>	<b>363.32</b>	<b>409.17</b>

Source: Gold Field Mining Services, Ltd, *Gold Survey 2004, Updates 1 and 2*.

Table A.4. Top 20 Gold Producing Countries 1/

	2003	2004 (Estimate)		
	Production (In tons)	Production (In tons)	Percentage change (Year-on-year)	In percent of total production
South Africa	376	344	-8	13.9
United States	285	271	-5	10.9
Australia	284	257	-9	10.4
China	206	213	4	8.6
Russia	182	178	-2	7.2
Peru	172	172	0	6.9
Canada	141	130	-8	5.2
Indonesia	163	112	-31	4.5
Uzbekistan	80	85	6	3.4
Papua New Guinea	69	72	5	2.9
Ghana	70	61	-13	2.5
Tanzania	45	47	6	1.9
Brazil	43	45	6	1.8
Chile	38	41	8	1.7
Mali	47	36	-24	1.5
Philippines	34	31	-8	1.3
Argentina	29	27	-7	1.1
Mexico	22	25	12	1.0
Colombia	25	24	-5	1.0
Venezuela	20	23	15	0.9
Rest of World	264	285	8	11.5
World Total	2,592	2,478	-4	

Source: GFMS, Ltd., *Gold Survey 2004 Update 2*.

1/ Ranked by 2004 production.

Table A.5. Distribution of Holdings of World Gold Stocks, 2003

	In tons	In millions of ounces	In percent of total
<b>World Gold Stocks 1/</b>	150,500	4,839	100
Official sector holdings	29,200	939	19
Private sector holdings	121,300	3,900	81
Jewelry	76,800	2,469	51
Private stocks	23,600	759	16
Other fabrication	17,300	556	11
Unaccounted	3,600	116	2
<b>Official gold stocks 2/</b>	31,811	1,023	100
Central bank holdings	28,400	913	89
Industrial countries	23,461	754	74
Developing countries	4,939	159	16
International Monetary Fund	3,217	103	10
Bank for International Settlements	193	6	0.6

Sources: Gold Fields Mineral Services, Ltd, Gold Survey 2004 and Update 1; and International Financial Statistics.

1/ Above ground stock of gold defined as the cumulative historical mine production.

2/ International Financial Statistics (IFS) data as of end-2004. IFS figures differ from GFMS data for official stocks as GFMS data exclude gold lent or supplied to the market and include estimates of undeclared reserves of official institutions other than monetary authorities, forward sales and official sector gold lending.

Table A.6. Changes in Official Gold Holdings, 2000-04

	Stocks end-1999 (In tons)	Stocks end-2004 (In tons)	Cumulative change 2000-04 (In tons)	Percent change in stocks 2000-04
Total	33,496	31,423	-2,072	-6.2
All countries	30,079	28,000	-2,079	-6.9
United States	8,139	8,136	-3	0.0
Japan	754	765	12	1.5
China,P.R.: Mainland	395	600	205	51.9
Russia	414	387	-28	-6.6
India	358	358	0	0.0
Venezuela, Rep. Bol.	304	357	54	17.7
Lebanon	287	287	0	0.0
Philippines	193	221	29	14.8
Algeria	174	174	0	0.0
Libya	144	144	0	0.0
Saudi Arabia	143	143	0	0.0
South Africa	123	124	1	1.1
Turkey	116	116	0	-0.3
Greece	132	108	-24	-18.3
Romania	103	105	2	1.6
Poland	103	103	0	0.1
Indonesia	96	96	0	0.0
Thailand	77	84	7	9.1
Australia	80	80	0	0.1
Kuwait	79	79	0	0.0
Egypt	76	76	0	0.0
Denmark	67	67	0	-0.1
Pakistan	65	65	0	0.5
Kazakhstan	56	57	1	2.1
Argentina	11	55	45	423.7
Bulgaria	40	40	0	-0.2
Malaysia	37	36	0	-0.8
Slovak Republic	40	35	-5	-12.5
Peru	34	35	0	1.3
<i>of which</i> : CBGA signatories 1/				
CBGA countries	15,195	13,108	-2,087	-13.7
Germany	3,469	3,433	-35	-1.0
France	3,025	2,985	-39	-1.3
Italy	2,452	2,452	0	0.0
Switzerland	2,590	1,354	-1,236	-47.7
Netherlands	982	777	-205	-20.8
Spain	523	523	0	0.0
Portugal	607	462	-144	-23.8
United Kingdom	639	312	-327	-51.1
Austria	407	307	-100	-24.5
Belgium	258	258	0	-0.1
Sweden	185	185	0	0.0
Finland	49	49	0	0.2
Ireland	5	5	0	0.0
Luxembourg	2	2	0	-2.6
ECB 2/	747	767	19	2.6
BIS	199	206 3/	7	3.6
IMF	3,217	3,217	0	0.0
Other	1,500	1,193	-308	-20.5

Source: *International Financial Statistics*.

1/ Those countries which were signatories of the 1999 agreement. In 2004 the agreement was renewed did not sign the new agreement, while the Bank of Greece became a new signator.

2/ The EMI held 20 percent of the gold holdings of the European Monetary System. The gold holding transferred to the EMS member countries at end-1998. The gold transfers from euro zone countries European Central Bank (ECB) took place in January 1999.

3/ Data as of end-November 2004.