SHIELDING THE POOREST FROM THE GLOBAL CRISIS:

How IMF Gold Sales Could Generate $10 Billion for Poor Country Debt Relief

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Jubilee USA Network is an alliance of 75 religious denominations, faith-based networks, human rights, labor, environment, and development organizations working to build the political will for poor country debt cancellation and more responsible lending policies of international financial institutions.

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I. Executive Summary

All around the world, people are feeling the impact of the global economic crisis. The World Bank projects that more than 53 million people in the developing world will be pushed into poverty this year due to the crisis. Low-income countries are being hit especially hard. Meanwhile, the crisis threatens to re-ignite a debt crisis in the poorest nations: the International Monetary Fund (IMF) projects 31 low-income countries may be pushed into debt distress.

The IMF has already increased its lending to developing (and some developed) countries in response to this crisis. As the crisis deepens, world leaders are expected to bestow an even greater role and additional funds on the IMF; the G-20 is likely to provide the institution with upwards of $500 billion in capital to address the crisis. But little has yet been decided about how to address the economic challenges facing low-income countries. The IMF has found that low-income countries may need as much as $25 billion to weather the storm.

Just over a year ago, the IMF was in a very different position. With long-time borrowers pre- paying and developing countries spurning the IMF's advice, the IMF's Board approved a plan to sell some of the Fund's gold to finance its administrative budget. That proposal is still pending approval by the US Congress and other legislatures.

This report argues that in light of the unfolding global crisis, the IMF's gold sales plan should be revised to reflect the new global reality and need. The IMF's gold is a global public good, comprised of contributions from the IMF's member countries over a period of many years. As the global financial crisis has already sent millions back into poverty across the globe, the IMF can help by expanding its gold sales proposal to help finance anti-poverty efforts during this difficult time. The best way to do this is through expanded poor country debt cancellation.

This report proposes that the IMF sell an additional, equivalent amount of gold to the amount already agreed by the Board for use for administrative costs, and devote the proceeds to a new "Debt Relief and MDG Trust Fund." The purposes of this fund would be threefold: (1) to finance expanded debt relief from the IMF and the International Development Association (IDA); (2) to transfer funds to and finance expended low-income county debt relief from the IDA and the African Development Bank (AfDB); and (3) to be available to help current Heavily Indebted Poor Countries Initiative (HIPC) – eligible countries with protracted arrears if and when they qualify for the initiative.

We propose the sale be performed in conjunction with the current IMF proposal for gold sales – but that the sale occur over a timeframe of six years rather than the three year timeframe proposed by the IMF. This would mean that the amount of gold entering the market would remain the same as it was in the IMF proposal, reducing possible concerns about an impact on the gold price. We propose that in each of the six years, half of the proceeds go to the IMF's administrative budget and half go to the Debt Relief and MDG Trust Fund.

Gold would be sold outright and placed into the Debt Relief and MDG Trust Fund directly. At the end of six years, we estimate that the sale could raise $10 billion for low-income country debt relief, at a rate of $1.67 billion per year. If this proposal were agreed to at the IMF/World Bank Spring meetings in April, and implemented by the 2009 G-8 summit, gold could be sold in July 2009, and more than $500 million in poor country debt relief could be written off by the end of the year, directly helping ease the burden of the current crisis on low-income countries with transparent and accountable governance systems.

This could have a huge impact on some of the world's most impoverished countries. Kenya, for instance, would see $825 million in debt payments over the next five years wiped out with this proposal. This would enable significant investment in health, education, infrastructure and other urgent social needs.

We estimate that over six years, $10 billion is enough to finance expanded debt cancellation for up to 12 countries to the IMF, to finance a transfer of funds to the International Development Association (IDA), which could provide debt cancellation for 8 of the potentially eligible 22 countries to IDA, and finance debt cancellation for up to 7 African nations with debts to the African Development Bank.

In a context of growing global need and diminishing rich country aid budgets, selling IMF gold for low-income country debt relief is a win-win solution.

There is a particular role for the US Congress to play in this debate: by law, the U.S. Executive Director to the IMF cannot support gold sales until Congress approves them. The US Treasury Department has indicated its intent to submit a request to authorize IMF gold sales to the US Congress. Rarely does Congress have such a direct influence over IMF policy, and it should use this key opportunity to urge expanded gold sales for debt cancellation as outlined in this brief as well as for IMF reforms including an end to harmful economic policy prescriptions, and fairer and broader governance and transparency at the institution.

II. The Financial Crisis in Low-Income Countries

Capital flows are drying up across the developing world. According the Institute for International Finance, this year, developing countries will be lucky to attract $165 billion in capital flows, one fifth of the level in 2007.[1] Moreover, the IMF is projecting growth in Africa to decline significantly in 2009 due in part to decreased demand for African exports. The IMF is now projecting growth of 3.3% in 2009 in Africa, down three percentage points from its April 2008 projections.

"The slowdown in growth could be much larger than we estimate currently," the IMF's Africa Department Director Antoinette Sayeh recently stated.[2]

A recent IMF report on the implications of the crisis for low-income countries (LICs) found:

> *LICs are exposed to the current downturn more than in previous decades, as they are more integrated than before with the global economy through trade, FDI, and remittances. The crisis significantly impacts these countries through reduced demand for exports....A sharp slowdown in FDI is expected in about half of all LICs. Prospects for higher aid to offset these effects are particularly uncertain…The global financial crisis will worsen the budgetary position of many LIC governments. Government revenues are expected to suffer as economic activity slows and commodity prices fall. Potential declines in donor support and tighter financing conditions will likely impose further pressures on LICs' budgets.*[3]

1 Cited in "Capital Flows," Financial Times, February 1, 2009

2 "Africa growth slowdown may be much sharper: IMF," Reuters, February 4, 2009.

3 IMF, The Implications of the Global Financial Crisis for Low-Income Countries, March 2009.

Indeed the IMF has identified a group of 26 low-income countries that it considers “highly vulnerable” to the adverse effects associated with the global recession, especially aid, trade and remittances shocks.

What Impact on Poor Country Indebtedness?

Lower export revenue due to shrinking demand from the US and other export markets for Africa and other low-income nations will make it more difficult for these nations to make debt service payments. Combined with tumbling prices for commodities, exchange rate volatility, and increased difficulty in accessing capital and credit on concessional terms, the stage is set for a renewed debt crisis for poor countries unless action is taken by the international community.

As the IMF points out, “In recent years, debt indicators in LICs have improved dramatically [due to debt relief and other efforts],” but in a recent simulation, found that the crisis may push as many as 31 countries into “debt distress” including 16 HIPCs and 15 low-income countries not eligible for HIPC. The IMF predicts that if the crisis continues for a year, the average low-income country debt burden would be raised by 4% of GDP.[4]

As a recent report by Annalisa Prizzon with the OECD Development Centre found, “The financial crisis will further compromise external debt sustainability for many developing countries, as growth rates and export earnings fall. Moreover, foreign debt is denominated in hard currencies, making repayment ability highly sensitive to shifts in exchange rates. And with the collapse in commodity prices and the recent appreciation of the dollar, exchange rates in many low-income countries have already been falling.” Prizzon cites the Zambian kwacha, which fell 24% against the dollar between August and October 2008. “Such depreciations make it obviously much harder to service foreign debt,” she explains.[5]

III. The IMF’s Gold Sales Proposal

Though it’s hard to believe now, the IMF’s proposal to sell some its gold stems from a time not too long ago when the IMF was shrinking dramatically. In 2006, the IMF projected an income shortfall in fiscal year 2007 of $165 million. This shortfall was projected to reach $400 million by FY2010.[6] The IMF gets its operating and administrative funds from fees and interest rates on its loans, so when lending is down, its budget faces pressures. The predicted deficit was due to sharp reductions in outstanding credit to the IMF over the previous few years, as borrowers had been paying back loans faster than expected due to concerns over loan conditions and the increased popularity of other lenders.

To come up with options to address its financial woes, in 2006 the IMF convened a group of experts and asked them to produce recommendations to change the institution’s income model. JPMorgan Chase International Chairman Andrew Crockett chaired the Committee of Eminent Persons and the group released a report in January 2007 proposing a new income model to make the organization more sustainable. A formal proposal based on the Crockett Report -- the New Income and Expenditure Framework -- was introduced to the IMF’s governing body by the IMF Managing Director at the Fund’s spring meetings in April 2008. The framework would change the IMF’s income model so the institution is no longer so reliant on making profits through lending. The

4 IMF 2009, op cit, p. 25.

5 Annalisa Prizzon, “The Fallout from the Financial Crisis (2):External Debt Sustainability - Should More Be Done for the Poor?,” OECD Development Centre, Policy Insights No. 84, December 2008, at http://www.oecd.org/dataoecd/56/32/41804246.pdf

6 IMF, “IMF Gold Sales – Frequently Asked Questions,” April 11, 2008.

proposal included the call to finance ongoing administrative costs through proceeds from limited gold sales.[7]

Under the IMF's gold sales proposal, an endowment would be established to be funded through the limited sale of 403.3 tons of gold over three years. The profit made from selling the gold would be placed in IMF's Investment Account and invested in order to generate income and "preserve the long-term real value of these resources."[8] The Crockett Report estimated that the investment would average a profit of 3% a year. The amount equivalent to the original purchase price of the gold when it was acquired by the IMF (SDR 207 per ounce) would be placed in the General Resources Account. The gold sales would be phased in starting in 2010. Based on average price of $850 an ounce, this would generate a profit of $2.917 billion a year over three years. This money, invested at a rate of 3%, would generate at least $200 million of extra income a year, growing annually as interest accrued, according to the IMF and the Crockett Report[9]

The IMF's proposal would sell gold acquired by the institution after the Second Amendment (referred to as "post-Second Amendment gold"). This gold was acquired in 1999 through an off-market transaction and is not subject to restitution. The majority of the IMF's gold reserves falls into another category - pre-Second Amendment - which is subject to restitution, meaning that the gold could be given back to contributor countries if an agreement was made by 85% of the Executive Board.

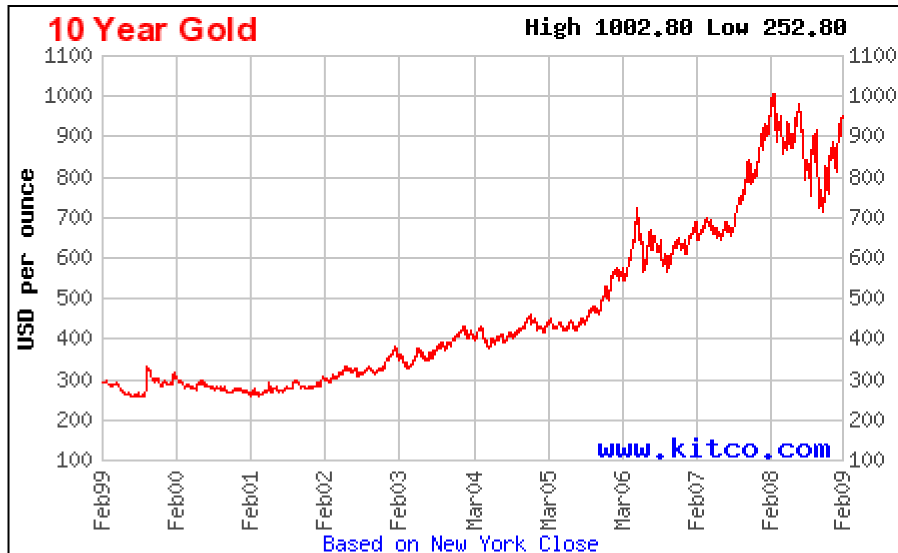
On May 5, 2008 the IMF's Board of Governors approved a resolution in support of the Framework, pending the approval of member countries' legislatures, like the U.S. Writes the IMF: "While no decision has yet been taken to sell post-Second Amendment gold, all Executive Directors have indicated either that they are ready to vote in favor of such a decision, or that they will seek approval from their domestic legislature to enable them to vote in favor of such a decision."[10]

Why Gold Sales Now, When Previous Efforts Failed?

For decades, there have been a range of proposals to sell IMF gold, but previous efforts to sell have been met by strong opposition from the gold industry over concerns that sales would lower the price of gold. Other concerns have come from the IMF that its own balance sheet would weaken. In the past three years, however, there have been a number of important developments that addressed these concerns and allowed the proposal to pass the IMF's Board.

First, gold prices are at historically high levels. As of mid-February 2009, gold was selling for $947 an ounce. The financial crisis has placed gold as one of the best options for long-term investment and diversification.

7 Crockett, Andrew, "Final Report of the Committee to Study Sustainable Long-Term Financing of the IMF," January 31, 2007.
8 IMF, "Report of the Managing Director to the International Monetary and Financial Committee on a New Income and Expenditure Framework for the International Monetary Fund," April 9, 2008.
9 Ibid.
10 Ibid.



Second, both IMF management and the high-level panel of eminent persons chaired by Andrew Crockett developed a new approach to gold sales that makes it very unlikely that the price of gold would decrease as a result of the sale of IMF gold, which in turn has removed serious concerns about the proposal from the gold industry.[11]

THE CENTRAL BANK GOLD AGREEMENT

Under the IMF proposal, the price impact can be mitigated if gold is sold in a responsible way and in coordination with the amount of gold sold each year by the world's central banks under the terms of the Central Bank Gold Agreement (CBGA).[12] Other studies have also shown that the market can absorb a significant amount of gold if the process is transparent, and clearly and specifically laid out in advance of the sale, as the IMF proposal would be.

The Central Bank Gold Agreement was created in 1999 to help bring coordination and stability to the world gold market. It does not reduce the amount of gold sold on the market, but instead establishes an agreed upon annual ceiling of gold sales. Parties to the CBGA include the European Central Bank and 14 other central banks who have traditionally been the largest sellers of gold.[13] In 2004 the countries renewed their five-year agreement by increasing the maximum amount of gold to be sold per year from 400 tons to 500 tons, opening up more space for gold sales.

The agreement is up for renegotiation in 2009. As a recent story in The Financial Times explains: "Traders and officials familiar with central bank thinking say that a new CBGA is likely, even if some central bankers consider that the market no longer needs the guidance of the pact. Gold prices have recently been above $1,000 an ounce and none of the banks is thought to have plans for major sales."[14]

11 See Final Report of the Committee to Study Sustainable Long-Term Financing of the IMF, January 31, 2007.

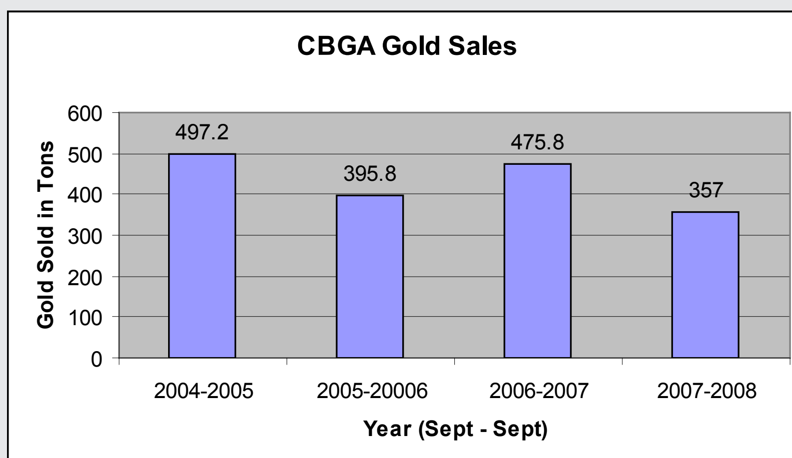
12 International Monetary Fund: Finance Department, "Financing Further Debt Relief for Low-Income Countries: Preliminary Considerations," March 30, 2005.

13 "The Central Bank Gold Agreement (CBGA) Statement on Gold," September 26 1999.

14 Blas, Javier, "Central banks look at bullion sales pact," Financial Times, March 5, 2009.

The CGBA was agreed upon at a time when the gold price was exceptionally low ($280 per ounce).[15] Since then the price of gold has been in an upward trend, despite the varying prices last year due to the instability of financial markets.

Last year, gold sales under the CBGA only totaled 357 tons, the lowest amount since 1999, and well short of the 500 ton limit.[16] Since the increase in 2004, central bank gold sales have never reached the limit, signifying room for IMF sales within the proposed agreement.



Source: World Gold Council

The CGBA members already anticipate IMF gold sales; although it is unlikely the IMF will become a member, according to an official it will maintain a “loose association” with the agreement.[17] In this manner, IMF sales would be incorporated within the overall annual ceiling allowed under the CBGA. As a result, the flow of gold onto the world market would remain consistent and limited, thus significantly limiting the potential for price impact. These strategies and studies should provide confidence to gold producers in the United States and abroad.

The Fate of the IMF Gold Sales Proposal in the Changing Global Context

The International Monetary Fund made the decision to sell its gold when it faced a large budget deficit. Since then, the financial crisis impact has increased demand for IMF lending significantly, allowing it to return to its original income model. Recent proposals from the US Treasury and the G-20 would increase available IMF resources to above $500 billion.

Meanwhile, the proposal for gold sales to fund its administrative budget still stands. While the IMF may not need a new income model with all the new demand for lending, IMF staff have indicated that they plan to push forward with the plan for gold sales because it will provide long-term income stability to the institution. Moreover, in its statement ahead of the G-20 Finance Ministers meeting in mid-March, the US Treasury department indicated its intent to submit legislation to the US Congress authorizing gold sales.[18]

15 Based on 1999 average price of gold.

16 World Gold Council, “Record Dollar Demand for Gold as World Looks for Haven from Turmoil,” November 19 2008.

17 Blas, op. cit.

18 US Department of Treasury, “US Fact Sheet in Advance of G-20 Finance Ministers and Central Bank Governors Meeting,” March 11, 2009.

But as the current global financial crisis deepens, and its impacts on low-income countries grow, this brief argues that the proposal to sell IMF gold should also be changed to ensure it is addressing the key challenges now facing the global economy, and that it considers the need of the world's poor.

IV. Gold Sales for Poor Country Debt Relief

The financial crisis combined with the increase in global food prices has pushed more than 100 million people into poverty in the developing world. As the impacts of the crisis grow, there are increasing calls for expanded assistance to low-income countries. This report argues that expanded low-income country debt relief, financed by IMF gold sales, should be part of that assistance.

A recent report from the OECD Development Centre found that, "To avoid countries tipping over the edge from a situation in which debt is sustainable to one in which suddenly they are unable to meet their payments, now, more than ever, debt renegotiations need to be kept on track and, where possible, the number of eligible countries expanded."[19]

There is international support for debt cancellation as an effective, cost-efficient development strategy, but in this time of tightening budgets, rich country development aid budgets are threatened. The IMF holds an answer to this problem in its gold reserves: this global resource should be sold to create an endowment to fund expanded debt relief and help clear protracted arrears (back-payments) for countries eligible for debt relief under the current program. And it could be done at no additional cost to budget-conscious rich country taxpayers.

Why Debt Relief Rather than Loans?

Why debt relief, rather than new IMF loans for poor countries? First, unless support is provided as grants or debt relief, the crisis could have the effect pushing dozens of poor countries into debt distress. As a result, loans from the IMF to low-income countries are less desirable than grants or debt relief, which is a form of grant assistance.

As the IMF explains, "…higher borrowing to help offset the impact of the crisis could pose serious risks, in particular for those LICs that already have a high debt burden."[20]

Center for Global Development President Nancy Birdsall and other leading development experts have long held that debt relief is an extremely effective and efficient form of aid.[21] Writes Birdsall, "the substitution of debt relief for aid disbursements can increase the efficiency of aid by increasing ownership of their development programs by poor countries, reducing transaction costs, increasing fungibility, eliminating tying, and reassuring the private sector that countries are going to be able to implement their plans."[22]

Moreover, debt cancellation has a proven record of success. Poverty-reducing expenditures have risen by

19 Prizzon, op cit.

20 IMF March 2009, op cit.

21 Birdsall, Nancy and John Williamson, "Delivering on Debt Relief: From IMF Gold to a New Aid Architecture," Peterson Institute for International Economics, April 2002.

22 Ibid at p. 116-117.

75% in countries that have received debt relief, with funds used to abolish school fees, provide basic health care, build schools, hire teachers, and improve access to safe drinking water.[23] In 2003, Zambia spent twice as much on debt repayments as on health care. Now thanks to debt cancellation, fees for rural healthcare were abolished to give citizens free basic medical services. In Tanzania, debt relief has helped increase the number of children in primary schools by over 50%, build almost 2,500 new primary schools and recruit 28,000 extra teachers. If this rate of progress continues, Tanzania will attain universal primary education significantly ahead of the 2015 target date set under the Millennium Development Goals.

Debt relief also enjoys political support – especially in the rich countries that dominate the IMF board. G-8 leaders embraced expanded or enhanced debt relief deals in 1999 and again in 2005. Since the G-8 in 2005, the UK has gone further than multilateral initiatives and has created the UK MDRI which provides debt service relief to several IDA-only countries that are not eligible for HIPC, but need debt relief to meet the MDGs. In the United States, the "Jubilee Act" was passed by the House of Representatives and the Senate Foreign Relations Committee in 2008. The Act would expand debt cancellation to up to 22 additional low-income countries that need debt relief to reach the Millennium Development Goals and is expected to be reintroduced this year.

The current debt cancellation program, the Multilateral Debt Relief Initiative (MDRI) will ultimately provide debt cancellation for up to 41 countries. While an important step forward in the fight against poverty, the initiative falls far short of what is needed in many ways, including: (1) funding has not been committed to enable countries with protracted arrears to enter the initiative once they qualify and (2) it is limited to only 41 counties while an additional 22 low-income, IDA only countries need debt relief to meet the MDGs and weather the current financial crisis.

Sale of IMF gold could finance the solution to both of these debt policy problems.

Precedent for Gold Sales for Debt Relief and Poverty Reduction

There is precedent for using gold sales to fund support poverty-reduction efforts and debt relief. In 1985, the IMF auctioned off a portion of its gold to support concessional lending to low-income countries.[24] In 1993, the IMF made the decision to "pledge" up to three million ounces of gold as risk insurance for the ESAF Trust (now the Poverty Reduction Growth Facility), a low-income country lending arm, in the case that the resources available were not enough to pay the creditors.[25] But these instances went to the issuance of more loans rather than grants or debt relief, which are more useful for low-income countries.

In 1999-2000, the IMF engaged in a revaluation of 12.9 million ounces of gold to help finance the Heavily Indebted Poor Countries Initiative (HIPC). The Crockett Report advises against another revaluation of gold in this manner because it resulted in a loss of income for the IMF, the cost of which is still shared by debtor and creditor members.

Then, three years ago, in a report to its Board, the IMF offered gold sales as a possible means to pay for debt cancellation in the context of the debate leading up the G-8 summit in 2005; in March 2005, the IMF Board published a report showing that gold sales was one possible way to fund debt cancellation under what would

23 International Development Association & International Monetary Fund, "Heavily Indebted Poor Countries (HIPC) Initiative and Multilateral Debt Relief Initiative (MDRI)—Status of Implementation," September 12, 2008

24 IMF, "IMF Survey Supplement on the Fund," September 1999.

25 IMF, "Financing Further Debt Relief for Low-Income Countries – Preliminary Considerations," March 11, 2005, 17.

become the Multilateral Debt Relief Initiative.[26] They estimated that the sale of 400-500 tons could "probably be accommodated without significant difficulty, particularly if it is spread over a reasonable period."[27] Ultimately, the proposal was not agreed to (in part because the price of gold was much lower at the time), but the report that demonstrated its possibility is instructive in today's context.

V. Operationalizing the Proposal: Selling IMF Gold to Fund a Debt Relief and MDG Trust Fund

Overview

This report proposes that the IMF sell an additional, equivalent amount of gold to the amount already agreed by the Board for use for administrative costs, and devote the proceeds to a new "Debt Relief and MDG Trust Fund." The purposes of this fund would be threefold: (1) to finance expanded debt relief from the IMF and the International Development Association (IDA); (2) to transfer funds to and finance expended low-income county debt relief from the IDA and the African Development Bank (AfDB); and (3) to be available to help current HIPC – eligible countries with protracted arrears if and when they qualify for the initiative.

Sell An Additional, Equivalent Amount of IMF Gold for Debt Relief

In order to best take advantage of the opportunity for gold sales, we propose that the IMF sell an equivalent, additional amount of gold than has been proposed by the IMF Board and place the proceeds in a new "Debt Relief and MDG Trust Fund." Under this proposal, the current IMF proposal to sell 403.3 tons over three years would be expanded to the sale of 806.6 tons over six years.

The additional gold sales would follow the same proposal as IMF's original proposal: the IMF would retain the original value of the gold in the General Reserve Account (valued at SDR 35 per ounce), thus maintaining the IMF's balance sheet position.

Sales of 806.6 tons of the IMF gold would then be sold over a six year timeline, with profits from the sale being placed equally in an account for the IMF's administrative budget and the Debt Relief and MDG Trust Fund.

In the IMF's gold sale approach, the profits from the gold sale are invested and only interest generated on gold sale would be used. But for the Debt Relief and MDG Trust Fund, all proceeds from the gold sale (aside from the original value which would be replaced in the IMF's General Reserve Account) would be placed directly into the fund so that the money can be used immediately. The reason for the difference is that there are two different needs. For the gold sales for the IMF's administrative budget, gold sales should be done in a way that provides long-term stability to the organization through a stable income source over many years. Investments will generate continuing funds for the institution, estimated at about $200 million a year if sold at $850 an ounce, they predict.

The Debt Relief and MDG Trust Fund serves a different purpose: one time debt cancellation and/or arrears clearance for a specific set of countries. Investing the profits of debt cancellation is not necessary since it is a

26 IMF: Finance Department, "Financing Further Debt Relief for Low-Income Countries: Preliminary Considerations," March 30, 2005.

27 Ibid.

one-time action with no need for funds to be generating over many years.

The only impact of this proposal is that the IMF will receive less annually from the sale of the first 403.3 ounces for their administrative budget, as we are proposing that it be spread over six years instead of three years. But especially given the new lending that the IMF is doing, the IMF has other sources of revenue to replace this decline.

After the six years of phased-in gold sales, the Debt Relief and MDG Trust Fund would have accumulated $10 billion, which would be enough to cover both expanded debt cancellation and arrears clearance. Our specific proposal is detailed in the subsequent section.

Responding to Concerns About Additional Gold Sales

In the past, the IMF has argued against gold sales because they worry about a reduction in the strength of their portfolio. In this case, these concerns should be moot because we propose to replace the current value of the gold on the IMF's books into the IMF's General Reserve Account.

The IMF has also expressed concern that further gold sales will reduce the IMF's lending capacity. However, the IMF has one of the most diversified portfolios with currencies from 185 members. Current gold holdings only account for two percent of the IMF's resources. More importantly, the IMF's rules do not allow gold to be used for lending. Any gold sale must follow a long process and gold adds strength only if it could be utilized somehow. The only way that is possible is through its sale.[28] Finally, even after gold sales, the IMF would still have massive reserves; and the proposal for increased sales would only represent the sale of a quarter of the IMF's total gold reserves, making the IMF the fifth largest gold holder instead of the third. Moreover, the G-20 are proposing a massive new infusion of funds to the IMF which make this point nearly irrelevant.

Another possible concern – from the gold industry and potentially developing country gold producers – is that increased gold sales may affect the price of gold. Given the historic highs in the price of gold now, this argument is less relevant today especially as investors flee to gold as a safe investment. As referenced earlier, gold industry analysts are expecting very few central banks to sell their gold at all in this environment, meaning a limited IMF would not be likely to have any effect on gold price.

But even so, the price impact can be easily mitigated so long as the IMF manages the additional sales within the agreed framework, or in the context of an agreed expanded framework of the CBGA. We propose that the same amount of IMF gold be sold each year under the agreement and that the timeline for sale for additional sales take place over six instead of the IMF's proposed three. Under our proposal, the amount of gold sold per year would remain the same - 134 ounces – but each year half would go to the IMF's general fund and half to the debt relief fund. The IMF had already approved this amount – were this proposal to be adopted, it would simply be a matter of increasing the length of time over which it is sold.

As previously mentioned, annual gold sales under the second CBGA agreement have not met the 500 ton cap, analysts do not anticipate major gold sales in the future for central banks, and the CBGA banks have already planned to accommodate future IMF gold sales. Beyond this, the CBGA will be renegotiated this year and agreed upon in September 2009. If a need existed, though it remains highly unlikely, the banks could increase the cap to accommodate additional gold sales from the IMF.

28 Kapoor, op cit.

The financial crisis has made gold one of the most stable holdings. Investors have returned to gold as a preferred investment, concerned over certain types of reserve assets due to the financial crisis and the declining value of the dollar. "The gold price rally has been driven by surging demand for gold in all forms: physical gold, exchange-traded funds (ETFs), and futures contracts as investors seek 'a safe store of value' amid the financial distress and inflation risks," Goldman Sachs recently announced. Based on these predictions, the bank's 12-month gold forecast was increased to $825 an ounce, up from $795.[29]

At the same time global supply has decreased. The World Gold Council reports that 2008's gold supply was down 9.7% from a year earlier and has fallen by 16.9% over the last two years.[30] Explains Ross Norman, director of The Bullion Desk: "Gold mine production is failing to keep up with burgeoning investment demand, and the supply deficit has meant that gold prices have quadrupled since 2001."[31]

This increased demand combined with a decrease in supply, leads to more open space for an IMF gold sale and reduces concerns over problems in the market. This, combined with the space available within the Central Bank Gold Agreement, should alleviate concerns over a decrease in the price of gold.

One potential additional concern with this proposal: selling beyond the 403.3 tons proposed by the IMF would subject the gold to the possibility of restitution – the gold in theory could be returned to original member countries. The IMF's current proposal would only sell the gold not subject to restitution – exactly 403.3 tons. This proposal would cover so-called "pre Second Amendment gold," which is money held by the IMF prior to August 31, 1975. The possibility of restitution is unlikely, as it takes an Executive Board decision with support from an 85 percent majority and has only happened once before – between 1975 and 1980 one-third of the IMF's gold was restituted or auctioned off following an agreement to reduce the role of gold in the international monetary system. The current political climate also makes the redistribution of IMF gold back to member countries more unlikely, as governments advocate for more contributions to the institution and there is a growing public clamoring for action to mitigate the impact of the crisis on the poorest nations.

Proposal for Use and Structure of the Debt Relief and MDG Trust Fund

We estimate that the sale of IMF gold would raise $10 billion by the end of 2015 – just in time for the deadline to achieve the Millennium Development Goals -- for the Debt Relief & MDG Trust Fund.

Starting in mid-2009, funds could be raised at a rate of $1.67 billion per year over six years. To help respond to the immediate crisis, by the end of 2009, $540 million could be available for poor country debt relief from the IMF. And the best part is that these funds would not require additional contributions by Northern taxpayers, when aid budgets are projected to be under tremendous strain.

We propose that the Debt Relief and MDG Trust Fund could be drawn upon and used for three purposes: (1) expanded low-income debt cancellation from the IMF; (2) transfer to IDA and the African Development Fund for expanded debt cancellation; and (3) the clearance of protracted arrears.

We find that the Debt Relief and MDG Trust Fund could finance debt relief from the IMF for up to 12 low-income

29 Reuters, "Gold Forecast to hit US$1000," February 5, 2009.
30 Ram, Vidya, "IMF Won't Take the Shine Off Gold," Forbes, April 8, 2008.
31 Ibid.

countries that are not eligible for the Heavily Indebted Poor Countries (HIPC) initiative, but are eligible for "IDA-only" assistance from the World Bank and meet strict standards on transparency and accountability. The fund could also help finance debt cancellation for some of these same 22 needy countries to IDA and the African Development Bank, if funds were transferred to the World Bank and AfDB. This is the same set of countries that was identified in the Jubilee Act for Responsible Lending and Expanded Debt Cancellation in the US Congress, which passed the House of Representatives in April 2008.

Of the 22 potentially eligible countries (see appendix 2 for more details on which countries would meet eligibility criteria), we estimate that 8 would be immediately eligible for relief based on their good performance on transparency and accountability measures as estimated by the World Bank: Cape Verde, Samoa, Vietnam, Kenya, Mongolia, Lesotho, Moldova, and Vanuatu. The remaining 14 countries (Angola, Bangladesh, Burma (Myanmar), Cambodia, Djibouti, Kiribati, Kyrgyz Republic, Maldives, Nigeria, Solomon Islands, Tajikistan, Tonga, Republic of Yemen, and Zimbabwe) would need to demonstrate accountability, transparency and good public financial management before becoming eligible.

We estimate that over six years, the fund will accumulate $10 billion, which is enough to finance expanded debt cancellation for up to 12 countries to the IMF, to finance a transfer to IDA and the African Development Fund which could finance debt cancellation for up to 8 of the eligible 24 countries to IDA (see Appendix 3 for details) and 7 countries to the AfDB.

This could have a huge impact on some of the world's most impoverished countries. Kenya, for instance, would see $825 million in debt payments over the next five years wiped out with this proposal. This would enable significant investment in health, education, infrastructure and other urgent social needs.

This proposal assumes that funds generated from the sale of IMF gold could be transferred to IDA and the African Development Fund to finance debt cancellation to IDA and the AfDB. While this would be unprecedented, such a proposal has been made before, including by Jonathan Sanford, a specialist in international political economy at Congressional Research Service, who argued in 2004 that proceeds from IMF gold sales could be transferred to IDA for the purpose of shoring up HIPC finances. Writes Sanford: "The World Bank and IMF have essentially the same membership. If their governing boards wish to institute a gold-to-HIPC resource transfer, they can easily find ways within their basic rules to accomplish that end." Sanford points out that the World Bank management would have many reasons to support the plan and that for the IMF, such a move would demonstrate its concern about the needs of poor countries.[32]

The AfDB is particularly in need of external assistance to finance its part of the debt cancellation. Some of these nations also owe debt to the Asian Development Fund, and while we support cancellation of these debts, we have not included the estimated costs because the MDRI does not currently include ADF debts.

The fund could also be drawn upon when the international community deems the countries with protracted arrears to the IMF and who are eligible for HIPC may re-enter into negotiations from the fund. It is unlikely with the possible exception of Zimbabwe, that Sudan or Somalia would be ready any time soon to re-engage with the IMF, but were this to happen, this pool of funds could be used. See Appendix 1 for more information on this aspect of the proposal.

32 Jonathan E. Sanford, "IMF Gold and the World Bank's Unfunded HIPC Deficit," Development Policy Review, 22 (1): 31-40.

APPENDIX 1. Proposed Country Eligibility Criteria

In order to speed progress towards the achievement of the Millennium Development Goals (MDGs), the proposed country eligibility in this report is based on eligibility identified in the Jubilee Act for Responsible Lending and Expanded Debt Cancellation (HR 2634). This legislation would potentially make up to 22 additional poor nations eligible for debt cancellation beyond those nations which already qualify for the Heavily Indebted Poor Countries (HIPC) initiative of the World Bank and IMF. To qualify, additional nations must qualify for "IDA-only" assistance from the World Bank, avoid gross violations of human rights and excessive military expenditure, and demonstrate the ability to manage released funds effectively and transparently for poverty alleviation. Based on provisions in the act, we estimate that initially 8 nations – listed below – would become eligible quaterly under the terms of this legislation.

To determine which countries have effective budget execution and good public financial management, we propose a system which evaluates a country's scores within the World Bank's Country Policy and Institutional Assessment (CPIA) framework, looking specifically at a country's CPIA ratings on public sector management and budget and financial management.

Our proposal, based upon a similar plan used by the UK government, to asses eligibility for the UK MDRI, would make countries eligible based on their CPIA ratings primarily in Public Sector management and financial management. Based on these criteria, an initial review indicates that the following 8 countries would be quickly eligible for debt relief: Cape Verde; Samoa; Vietnam; Kenya; Mongolia; Lesotho; Moldova; and Vanuatu. As more countries meet standards on transparency and public financial management, they could also become eligible. This would serve as a positive incentive for countries to improve their public financial management practices in order to access relief.

The United Kingdom is currently delivering debt service relief under the "United Kingdom Multilateral Debt Relief Initiative" based on a similar set of criteria.

Indeed, three of these countries – Cape Verde, Lesotho, and Moldova – were identified by the IMF in its recent analysis as being at risk of severe "debt distress" in light of the current crisis.[33]

33 IMF March 2009, op cit.

APPENDIX 2. A Possible Scenario for Expanded LIC Debt Relief Financed by IMF Gold

We now will illustrate one possible way for debt cancellation to be made available to the eligible countries. We estimate that over six years, the Debt Relief and MDG Trust Fund will accumulate $10 billion, which is enough to finance expanded debt cancellation for up to 12 countries to the IMF, to finance a transfer of funds to IDA, which could finance debt cancellation for up to 8 of the eligible 22 countries to IDA, finance a transfer of $1.87 billion to the African Development Bank, possibly financing debt cancellation for seven African countries, and finance the payment of arrears to the protracted arrears countries if needed.

The total debt stock owed to the IMF by all 12 countries with IMF debt is estimated at $1.58 billion (see appendix 3). The total stock owed by all the countries to the AfDB is $1.87 billion. While we did not have access to the NPV debt data for these countries to these institutions, we note that the debt stock figures overestimate the cost to cancel these debts, making this projection a conservative estimate that is higher than the actual cost.

The cost to cancel debt to the World Bank for the first 8 countries is estimated at $8.22 billion. In the case of IDA, the figures assume a continuation of the current practice which is to forgive debt service payments as they fall due rather than an upfront cancellation of the debt stock. See chart 3 below for how we arrived at this estimate.

The stock of arrears held by Sudan, Somalia, and Zimbabwe is $1.994 billion. The IMF figure is debt stock rather than NPV, and the arrears figure are also stock figures. These figures are meant to be illustrative rather than a precise estimate of the actual costs to cancel.

Each year the trust fund will acquire $1.67 billion in profit (which excludes the original value of SDR35 per ounce) by selling 67 tons of gold at $825 an ounce (the 12 month price prediction by Goldman-Sachs) , all of which will be put directly into the fund.

Table 1. Possible Scenario for Use of Debt & MDG Trust Fund

	Total Cost*	2009-2010	2010-2011	2011-2012	2012-2013	2013-2014	2014-2015	**TOTAL**
Gold Profits Per Year		1672.16	1672.16	1672.16	1672.16	1672.16	1672.16	**10032**
IMF Debt Cancellation for 6 Countries Eligible Immediately (Debt Stock)	539.3	539.3						
AfDB Debt Cancellation for 4 Countries Eligible Immediately (Debt Stock)	630	630						
IMF Debt Cancellation for 7 Countries (eligible starting 2012) (Debt Stock)	1040.6			520.3		520.3		
AfDB Debt Cancellation for 4 countries (eligible starting 2012) (Debt Stock	1242			621		621		
IDA Debt Cancellation for 8 Countries Eligible Immediately (NPV)	8220	502.86	1672.16	530.86	1672.16	530.86	1672.16	**6581.06**
Remainder/Protracted Arrears (Debt Stock)	1994	Timeline unknown						
TOTAL	**13665.9**							

*Data in US$ Millions

As the chart indicates, in the first year (indeed if implemented by mid-2009 by January 2010), the Trust Fund could finance 100% debt stock cancellation for IMF debts of the first 6 eligible countries that have IMF debt. The fund could also initiate its first transfer to the African Development Bank and to IDA for payment of some of the debts of these initial eight countries to IDA. In year 2, funds would be transferred to IDA. In year 3, we expect several of the remaining potentially eligible nations to become eligible and the IMF debt could be cancelled to these nations along with an additional transfer to IDA and the AfDB. In year 4, funds would be transferred to IDA. In year 5, more nations would likely become eligible for debt cancellation from the IMF and funds could used to cancel those debts. In year 6, funds would be transferred to IDA and the AfDB. There would still be a need for additional funds to finance IDA cancellation for the eight countries. But it is highly unlikely that all potentially eligible countries would become eligible over the six year time frame because several have significant governance challenges, so we are not concerned that we fall slightly short of the identified amount of funds needed in this proposal.

Other sources of finance could be mobilized to fill the financial gaps for the eligible countries to possibly 14 low-income countries that we propose receive debt cancellation from the World Bank – possibly World Bank reserves, and/or additional donor contributions to IDA.

Table 2. Debt Stock owed to the IMF and World Bank

Country	IMF	World Bank	AfDB
8 Initially Eligible Countries			
Cape Verde	12.3	205	106
Kenya	159	2,663	347
Lesotho	35	271	177
Moldova	95	370	
Mongolia	35	277	
Samoa	0	64	
Vanuatu	0	13	
Vietnam	203	3,187	
Sub-total	539.3	7050	630
14 Additional Countries in Need of Debt Cancellation			
Angola	0	319	33
Bangladesh	308	8688	
Cambodia	0	462	
Djibouti	18.7	120	87
Kiribati	0		
Kyrgyz Rep.	178	565	
Maldives	5.9	64	
Myanmar (Burma)	0	752	
Nigeria (2006)	0	2,074	786
Solomon Islands	0	43	
Tajikistan	127	308	
Timor-Leste*	0	0	
Tonga	0	13	
Yemen	292	1689	
Zimbabwe	111	915	336
Sub-total	**1040.6**	**16012**	**1242**
TOTAL	**1579.9**	**23062**	**1872**

*While technically eligible, Timor-Leste does not have any debt

Data in US$ Millions, represents 2005 debt stock

Source: World Development Finance 2007

Table 3. Projected IDA Debt Service for Initial 8 Eligible Countries

	2009	2010	2011	2012	2013	2014	2015	2016	2017	TOTAL
		(IDA 15)			(IDA16)			(IDA 17)		
Debt Service for 8 Countries Eligible Immediately	1457	1457	1457	585	585	585	698	698	698	**8220**

Source: World Development Finance, 2007

Data in US$ Millions

APPENDIX 3. Protracted Arrears

In addition to paying for debt cancellation, the trust fund created from gold sales could also mobilize funds for countries eligible for the Heavily Indebted Poor Country (HIPC) Initiative, but have not yet qualified due to their high levels of protracted arrears. Writes the IMF, "As the costs for providing debt relief to these countries were not included in the original financing framework of the HIPC Initiative and the MDRI, additional financing would need to be identified and secured when these countries are ready to clear their arrears to the Fund and embark on the HIPC Initiative."[34]

The money could serve as a positive incentive for change: once countries complied with international standards for accountability and transparency and had a change in leadership and otherwise met the conditions for receiving debt relief from the IMF and World Bank, they would know that money was there to cover their arrears so they could become eligible for debt cancellation.

Cases of Protracted Arrears owed to the IMF

Country	Arrears to IMF
Somalia	353.33
Sudan	1512.88
Zimbabwe	127.87
TOTAL	**1994.08**

*Converted from SDRs, Numbers in US$ Millions
Source: IMF Annual Report 2008: Making the Global Economy Work for All.

The countries currently in protracted arrears are Somalia, Sudan, and Zimbabwe. Sudan and Somalia are both HIPC eligible. Zimbabwe is currently not eligible for the initiative, but it is anticipated that the country will be re-valuated once it reengages with the international community.[35] The three countries hold a total of $1.99 billion in arrears.

Again, the countries would only receive this money when the government changed and constructed accountability and transparency measures.

Liberia provides a case in point for the urgency of such a fund to be put in place to help cover the arrears. Liberia's uphill battle with the IMF to clear the nation's arrears for debt cancellation took two years. The country, devastated by two decades of civil conflict, operated on a budget of $86 million a year, yet had to await the international community to work out a deal to pay $1.5 billion in arrears to the World Bank, IMF, and African Development Bank before receiving any debt relief or new funding from the international community. It took two years to mobilize the international community to come up with the funds to clear Liberia's arrears since it could not do so itself. This system prevents even a country with strong international support and a democratic government from ever getting out of the cycle of poverty and debt. The new trust fund would solve this problem.

34 IMF, "Update on the Financing of the Fund Concessional Assistance and Debt Relief to Low-Income Member Countries," April 11, 2008.

35 IMF, "Proposed Reforms to the Exogenous Shocks Facility (ESF)—Background Information on Financing of PRGF-ESF Operations," September 8, 2008.

While expanded debt cancellation is an immediate necessity in these economic times, the payments of protracted arrears are a long-term goal. The protracted arrears cases – Somalia, Sudan, and Zimbabwe— are not likely to reengage in the international community in the short term. As mentioned before, they require serious governmental, human rights, and transparency changes before any debt relief is seen. However, it is important that the Debt & MDG trust fund set aside funds for their future reengagement as this should serve as a strong incentive for the three countries to improve human rights, transparency, and public financial management standards.