INTERNATIONAL MONETARY FUND

Use of Windfall Gold Sale Profits—Further Considerations

Prepared by the Finance and Strategy, Policy, and Review Departments

(In collaboration with the Legal Department)

Approved by Andrew Tweedie and Reza Moghadam

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Executive Summary

In April 2011, Executive Directors held a preliminary discussion on the use of the profits of SDR 6.85 billion from the Fund's limited gold sale. They noted their expectation that at least SDR 4.4 billion of the profits would be placed in an endowment within the Investment Account, and affirmed their support for the 2009 financing package for low-income countries (LICs), including the distribution to the Fund's membership of up to SDR 0.7 billion from the profits linked to gold sales, with the expectation that most members will return equivalent funds to the Poverty Reduction and Growth Trust (PRGT).

There was a wide range of views among Directors on the three main options presented for the windfall of SDR 1.75 billion, but no consensus favoring a single option. The main options presented included use of resources linked to the windfall to boost the capacity of the PRGT, counting the windfall towards precautionary balances, or investing the windfall profits as part of the Investment Account's endowment. Many Directors indicated that they could support a combination of two or more of the main options.

The three main options involve important trade-offs. The financial policy implications of the three options can be measured by (i) the impact on the steady-state self-sustained capacity of the PRGT after 2014; (ii) the date at which precautionary balances are projected to reach the indicative target of SDR 15 billion; and (iii) the projected income from the endowment at an assumed 3 percent real rate of return. A decision to put the funds to work toward multiple purposes would imply that progress toward each individual policy goal would be more limited.

A sequenced approach may strike a more effective balance between the competing objectives. If the Board chooses to delay a decision on the ultimate use of the gold windfall, it could be appropriate to retain the entire windfall as part of general reserves (but not count it as precautionary balances) and to return to the issue in, say, a year's time. This would provide time to take account of the next review of precautionary balances as well as the LIC facilities review.

A pending issue is the timing of the distribution of up to SDR 0.7 billion aimed at mobilizing SDR 0.5–0.6 billion for PRGT subsidies. This paper suggests that the Fund proceed with adoption of the relevant Board decision on the distribution in 2011, once the lower end of the target for bilateral subsidies has been met, either in conjunction with a decision on the use of the windfall or on a standalone basis. In any event, the actual distribution would be made only after satisfactory assurances had been received regarding members' contribution of broadly equivalent amounts as PRGT contributions.

During the April discussions, some Directors indicated a desire to explore a number of other options aimed at supporting LICs (including increasing concessionality of PRGT credits, or augmenting the Post-Catastrophe Debt Relief (PCDR) Trust). Some of these issues will be taken up in the context of the LIC facilities review in 2012. Financing any options targeted at LICs using the windfall profits would require a distribution to members and return of broadly equivalent resources as LIC-related contributions.

I. INTRODUCTION

1. **In April 2011, Executive Directors held a preliminary discussion on the use of the profits of SDR 6.85 billion from the Fund's limited gold sale**.[1] They noted their expectation that at least SDR 4.4 billion of the profits would be placed in an endowment within the Investment Account (IA). They also affirmed their support for the 2009 financing package for LICs, including the distribution to the Fund's membership of up to SDR 0.7 billion of profits linked to gold sales, with the expectation that most members would return equivalent funds as PRGT subsidy contributions. Directors offered preliminary views on three main options for the use of the remaining "windfall" profits of about SDR 1.75 billion—using resources linked to the windfall as part of a strategy to boost the capacity of the PRGT, using it to increase precautionary balances, or adding the windfall profits to the endowment. They also discussed other options aimed at supporting LICs.

2. **The Board's discussion produced a wide range of views on the three main options presented, and there was no consensus on any single option**. It was clear, however, that there was no significant support for the use of windfall profits to provide grants or outright debt relief to LICs.[2] Many Directors indicated that they could support combinations of two or more of the three main options. Directors also noted that any final proposals on the use of the windfall profits would have to take into account the financial position of the Fund.

3. **The Board agreed to revisit the potential uses of the windfall profits by the time of the 2011 Annual Meetings**. This paper provides further information on the three main options, in addition to the other possible initiatives to assist LICs that were presented to the Board in April. It also examines the trade-offs and resource implications of possible combinations of these options.

4. **The Board has also taken decisions on the disposition of net income from gold sales consistent with the outcome of the initial discussion on the use of the gold profits**. During the April 2011 discussion of the Fund's income position,[3] the Board agreed to place SDR 0.6 billion of the FY 2011 gold profits in special reserves. Along with FY 2010 gold profits of SDR 3.8 billion previously placed in the special reserve, placements in this reserve from gold profits now total SDR 4.4 billion. Consistent with the purposes of the gold endowment, to generate long term income for the Fund, these amounts placed in the special

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[1] See *IMF Executive Board Considers Use of Gold Sale Profits,* Public Information Notice (PIN) No. 11/48 (4/08/11) http://www.imf.org/external/np/sec/pn/2011/pn1148.htm and *Use of Gold Sale Profits—Initial Considerations and Options* (3/16/11) http://www.imf.org/external/np/pp/eng/2011/031611.pdf.

[2] CSOs generally support using gold profits to provide support to LICs.

[3] See *Review of the Fund's Income Position for FY 2011 and FY 2012* (4/07/11) http://www.imf.org/external/np/pp/eng/2011/040711.pdf. Consistent with the approach taken in FY 2010, it was also noted that the gold profits placed in the reserves would be excluded from computation of the Fund's precautionary balances.

reserves, which correspond to profits from the sales of gold at a price of US$850 per ounce, are not available for a future distribution to the membership. The remaining SDR 2.45 billion in gold profits, which corresponds to the SDR 0.7 billion under the strategy agreed in 2009 for LIC financing and the windfall profits of SDR 1.75 billion, were placed in the general reserve, pending a Board decision on the use of the windfall and the timing of a distribution of the SDR 0.7 billion for LIC financing. The gold profits placed in the special reserves and the general reserves are currently not taken into account for purposes of calculating the Fund's precautionary balances.

5. **A pending issue for the Board to consider is the timing of the already endorsed distribution of up to SDR 0.7 billion aimed at mobilizing SDR 0.5–0.6 billion for PRGT subsidies as part of the 2009 LIC financing package covering the period 2009–14**. Based on current projections, these subsidies could be needed by end-2013, and it is uncertain how long it will take to complete the process of obtaining resources from the membership following this distribution. The paper therefore suggests that the Fund proceed, either in conjunction with a decision on the use of the windfall or on a standalone basis, with adoption of the relevant Board decision on the distribution of this portion of the gold profits (as noted below, the actual distribution would be made only after satisfactory assurances had been received regarding members' contributions of broadly equivalent amounts as PRGT contributions).

6. **The paper is organized as follows**. Section II discusses the financial and policy implications of the three main options, as well as the trade-offs between different combinations of those options. This section also explores the alternative options of counting the windfall towards precautionary balances or continuing the current practice of not considering it to be part of precautionary balances (in either case, the FY11 net income from those profits has already been placed in general reserves as noted earlier, and the windfall profit would remain in the IA as it is now). Both approaches would allow for the possibility of a distribution for the benefit of LICs or for other purposes at some future time. Section III discusses the timing and other operational issues related to the distribution of profits from gold sales agreed by the Board under the 2009 LIC architecture and financing reforms. Section IV provides additional information on some of the secondary options in support of LICs (specifically, extending interest rate relief or providing greater concessionality on PRGT lending) that some Directors wished to explore further. Section V concludes and suggests issues for discussion.

II. Main Options and Combinations of Options

7. **For the Board's earlier discussion, staff presented three main options for the use of the windfall profits from gold sales, estimated at SDR 1.75 billion**.[4]

[4] The main options were presented in paragraphs 14–31 in *Use of Gold Sale Profits—Initial Considerations and Options* (3/16/11) http://www.imf.org/external/np/pp/eng/2011/031611.pdf.

- The first option would be to use resources linked to the windfall profits as part of a strategy to narrow, if not close, the large projected gap in the Fund's capacity to assist LICs by boosting the self-sustained capacity of the PRGT after 2014 by over 50 percent. This would involve the same distribution-and-return mechanism contemplated for the use of SDR 0.7 billion in gold profits already endorsed by the Board.

- The second option would be to retain the profits in the IA and as part of the general reserves as they are now, but additionally count them towards precautionary balances to emphasize their ability to protect against financial risks, including increased credit risks that the Fund faces in light of its increased lending since the global financial crisis.

- The third option would be to not only retain the profits in the IA as they are at present, but to place them in the IA gold endowment once it is created, with a view towards investing these resources as a permanent part of the Fund's financing structure to help ensure a sustainable and diversified income base.

8. **The three main options involve important trade-offs**. The financial policy implications of the three options can be measured by (i) the impact on the steady-state self-sustained capacity of the PRGT after 2014; (ii) the date at which precautionary balances are projected to reach the indicative target of SDR 15 billion;[5] and (iii) the projected income from the endowment at an assumed 3 percent real rate of return. There are also important operational considerations, including the timing of decisions in the context of some uncertainty and the challenges related to leakage from a possible distribution. Further—and as noted by Directors during the April discussion—any final proposals concerning the use of the windfall profits would need to take into account the financial position of the Fund.

A. Main Options

Option 1: Use Resources Linked to the Windfall to Boost the Capacity of the PRGT

9. **Subsidy resources for PRGT lending, while sufficient in the near term if the 2009 financing package is fully implemented, are projected to fall well short of longer-term demand**. Current projections suggest that the 2009 LIC financing package (see Box 1) would be adequate to meet demand through 2014, as originally envisaged. However, the PRGT's capacity to finance concessional lending would fall sharply thereafter, and would be well below the lower bound of projected longer-term demand.[6] While subject to a high degree of

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[5] See *Review of the Adequacy of the Fund's Precautionary Balances* (8/25/10) http://www.imf.org/external/np/tre/risk/2010/082410.htm.

[6] See *Demand Projections for the Fund's Concessional Resources* (3/16/11) http://www.imf.org/external/np/pp/eng/2011/031611a.pdf.

uncertainty, staff projections suggest that longer-term loan demand could range between SDR 1.1–1.9 billion per year, significantly exceeding projected available resources of about SDR 0.7 billion per year under the "self-sustained" PRGT after 2014. Absent additional subsidy resources, which could be mobilized either through the use of windfall profits or higher bilateral contributions, a sustainable concessional financing framework would have to rely on lower concessionality or lower access levels.

Box 1. Status of Fund-Raising Efforts for the 2009 LIC Financing Package

In the discussions leading up to the reform of the Fund's concessional financing framework in 2009, staff projected resources needed to fully subsidize lending over the medium term through 2014 (SDR 11.3 billion) at SDR 2.5 billion in end-2008 NPV terms. With available resources at the time of SDR 1.0 billion, additional **subsidy resources** of SDR 1.5 billion needed to be mobilized.

The Board agreed on a financing package comprising a combination of sources that broadly covered the SDR 1.5 billion target:

- a transfer of resources from the PRGT Reserve Account (SDR 0.62 billion);
- new bilateral contributions (SDR 0.2–0.4 billion);
- delaying reimbursement to the GRA for PRGT administrative costs for three financial years, FY 2010–12 (SDR 0.15–0.20 billion); and
- use of resources linked to gold sales profits (SDR 0.5–0.6 billion, after an assumed leakage of 10 percent of the distribution of SDR 0.6–0.7 billion gold sales profits to members).

The Board has endorsed the transfer of resources from the Reserve Account to the PRGT Subsidy Account, and the transfer will take place when these resources are required. Fund-raising efforts for bilateral subsidy resources are ongoing, though commitments to date of SDR 154.5 million provided by 23 lenders have not yet reached the lower bound of the target range. A number of large traditional donors have not yet made pledges. The estimated costs of administering the PRGT of SDR 38.4 million in FY 2010 and SDR 46.4 million in FY 2011 have been transferred from the Reserve Account to the PRGT General Subsidy Account.

Significant progress has been made on raising **loan resources** for the PRGT. Of the SDR 10.8 billion targeted, 13 lending agreements for SDR 9.46 billion have been put in place and a further commitment for SDR 350 million from one lender has brought the total to SDR 9.8 billion.

10. **During the April 2011 discussion, many Directors supported a strategy to use resources linked to the windfall gold profits to bolster the PRGT's longer-run concessional lending capacity**. Distributing the entire windfall in this context could boost the PRGT's self-sustained capacity by about 50 percent, to SDR 1.1 billion (in nominal terms), the lower end of the longer-term demand projection. Directors stressed, however, that any use of gold resources should not undermine current fund-raising efforts to support the PRGT's medium-term lending capacity. Moreover, a key challenge under Option 1 is that it would require a distribution of resources to members with a prior agreement that most would return

them for the benefit of the PRGT, similar to the mechanism already envisaged for the distribution under the medium-term financing package through 2014 (see Section III).

11. **The 2009 financing package sought to raise lending capacity to SDR 11.3 billion during the period 2009–2014.**[7] This included a sharp rise in lending capacity to SDR 2.7 billion per year for two years in the initial aftermath of the crisis and a decline to about SDR 1.5 billion in the medium term (Table 1—upper panel). The self-sustained capacity of the PRGT beginning in 2015 was projected at about SDR 0.7 billion per year, based on the agreed financing package.

Table 1. Scenarios of Medium Term Concessional Lending to LICs

Commitments	Actual annual average 2000–08[1/]	Projections 2009	2010	2011	2012	2013	2014	**Total (2009–14)**	Sustainable lending capacity beyond 2014
Projections at the time of the 2009 LIC reforms									
In billions of SDR	0.7	2.7	2.7	1.5	1.5	1.5	1.5	**11.3**	0.70
In billions of US$[3/]	1.0	4.0	4.0	2.3	2.3	2.3	2.3	**17.0**	
High Demand Scenario[2/]									
In billions of SDR	0.7	2.5	1.2	1.4	2.1	2.1	2.1	**11.3**	0.70
In billions of US$[3/]	1.0	3.7	1.8	2.1	3.1	3.1	3.1	**17.0**	
Lower Demand Scenario[2/]									
In billions of SDR	0.7	2.5	1.2	1.4	1.5	1.5	1.5	**9.6**	0.80
In billions of US$[3/]	1.0	3.7	1.8	2.1	2.3	2.3	2.3	**14.3**	

Source: Finance Department.

[1/] Excluding the relatively high level of lending committed to Pakistan in the aftermath of 9/11, and to Liberia in 2008 following arrears clearance.

[2/] Actual outcomes for High and Lower Demand Scenarios for 2009 and 2010.

[3/] Assuming exchange rate of US$1.5 per SDR.

12. **Lower-than-expected demand over the recent past has raised the lending capacity of the PRGT for the years 2012–14 and could lead to a modest increase in the PRGT's self-sustained capacity**. New lending commitments to LICs in 2009, at SDR 2.5 billion, were broadly in line with projections, but LIC demand has since fallen back more rapidly than was assumed, reflecting in part the rapid economic recovery of many LICs after the global crisis.[8] Staff's latest projections suggest PRGT demand in 2011 could be about SDR 1.4 billion, up from SDR 1.2 billion in 2010 (Table 1—middle panel).

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[7] See *Update on the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Member Countries* (04/01/11) http://www.imf.org/external/np/pp/eng/2011/040111.pdf.

[8] See *Emerging from the Global Crisis—Macroeconomic Challenges Facing Low-Income Countries* (10/06/10) http://www.imf.org/external/np/pp/eng/2010/100510.pdf for a discussion of LICs' countercyclical response and IMF financial support that helped ease the impact of the crisis and facilitated the recovery.

- These projections would be consistent with lending capacity of about SDR 2.1 billion per year from 2012–2014, which is about 50 percent higher than annual demand in 2010–2011. Under this "high demand" scenario, the self-sustained capacity after 2014 would remain at SDR 0.7 billion per year (unchanged from what was assumed under the 2009 financing package).

- Alternatively, if demand were to remain at a lower level of about SDR 1.5 billion per year, slightly above annual demand in 2010–2011, the remaining unused subsidy resources assumed under the 2009 package would support a slightly higher self-sustained capacity beginning in 2015. Under such a "lower demand" scenario, total PRGT lending through 2014, at SDR 9.6 billion, would fall below that assumed in the earlier financing package (Table 1—bottom panel). The additional unused subsidy resources could support additional self-sustained lending of about SDR 0.1 billion, starting in 2015.

13. **Option 1 could help place the Fund's concessional financing framework on a more sustainable footing, limiting the need for further bilateral fundraising and maintaining the Fund's ability to provide concessional support to LICs**. Self-sustained capacity, starting in 2015, would increase to SDR 1.1 billion under the high-demand scenario, and to SDR 1.2 billion under the lower-demand scenario (Table 2). This may substantially eliminate the need for future fund-raising drives and could become the basis of a sustainable and self-financed concessional financing framework for the Fund. Without the windfall, further periodic fundraisings would clearly be needed in the future. Should these fund-raising drives fail to generate new subsidy resources comparable in scale to the gold windfall, the Fund would likely need to reduce its overall support to LICs through lower access levels or less concessional financing terms, or both. In light of LICs' increased exposure to global volatility and the already low level of concessionality of PRGT credit, these would be difficult choices.

Table 2. Projected Outcomes of Main Options[1/]
(In billions of SDRs, nominal terms)

	Option 1		Option 2	Option 3
	Windfall transferred to Reserve Account[2,3/]		Windfall transferred to precautionary balances (pb)	Windfall kept in the endowment
	1A. High demand scenario	1B. Lower demand scenario		
Projected Reserve Account (RA) subsidization capacity of PRGT loans (per annum)[1/]	1.10	1.20	0.70	0.70
In percent of estimated demand[4/]	*73*	*80*	*47*	*47*
Size of the endowment	4.40	4.40	4.40	6.15
Timing for reaching the indicative precautionary balances target of SDR 15 billion	FY15	FY15	FY14	FY15
Net income buffer in the steady state (in SDR millions)[5/]	71	71	71	131

Source: Finance Department.

[1/]Assumes the ratios of ECF/SCF/RCF commitments of 45/40/15 and subsidization from the RA starting in 2015 for high demand scenario and in 2017 for lower demand. As of end-December 2010. total resources in the RA amounted to SDR 3.967 million.

[2/]Assumes the windfall profit of SDR 1.58 billion (after leakage of 10 percent) would be placed in the RA at end-2012.

[3/]High demand scenario assumes SDR 2.1 billion concessional lending per year over 2012–14, while lower demand scenario assumes SDR 1.5 billion over this period.

[4/]Mid-point of long-term demand estimates (SDR 1.1 billion and SDR 1.9 billion, respectively, for high and lower demand scenarios). See *Use of Gold Sale Profits--Initial Considerations and Options* (3/16/11).

[5/]Under the Fund's Medium-Term Income and Expenditure Framework, net income buffer equals operational income less expenses. Assumptions include reaching the steady state by FY20, a nominal rate of return of 5 percent and a nominal payout rate of 3 percent for the endowment. See *The Consolidated Medium-Term Income and Expenditure Framework* (4/14/11).

Option 2: Count the Windfall Profits towards Precautionary Balances

14. **Credit risks facing the Fund remain elevated in the context of sharply increased lending**. Under currently approved arrangements, total commitments now amount to SDR 206 billion, up from SDR 171 billion in April at the time of the initial discussion on the use of gold profits, and much higher than the commitments of SDR 144 billion in September last year when the Board discussed the adequacy of precautionary balances.[9] The projections for credit outstanding now indicate a peak of SDR 107 billion to be reached in FY 2013, compared with previous projected peaks of SDR 94 billion and SDR 78 billion in April 2011 and September 2010, respectively. Moreover, the risk remains that Fund lending could rise significantly above these elevated levels. Counting the windfall profits towards precautionary balances would help emphasize their availability to mitigate this elevated exposure to credit risks.[10]

15. The significantly higher credit risks to the Fund due to its sharply higher lending since the global financial crisis could argue for counting all or part of the windfall as precautionary balances, under Option 2, which many Directors favored in the April discussion. Based on staff's assumptions, counting the entire windfall towards precautionary balances would bring forward the target date for reaching the indicative target of SDR 15 billion by about 1 year, to FY 2014.[11] The work plan proposes a further review of precautionary balances in early 2012.

16. **Implementing this option would not preclude a later decision to use the windfall for a different purpose, including a distribution**. This option would not involve a distribution to members (resources would remain in the IA), and would allow the Board to decide at a later date on the ultimate placement of the windfall after the upcoming LIC facilities review. A delay of one year for example, to end-2012, would also allow a final decision to be taken based on additional information regarding the Fund's income outlook, LIC demand for concessional financing, Fund lending and the adequacy of precautionary balances. Any decision to reduce the amount of precautionary balances would depend on an assessment of their adequacy at that time.

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[9] *Review of the Adequacy of the Fund's Precautionary Balances* (8/25/10) http://www.imf.org/external/np/tre/risk/2010/082410.htm.

[10] The GRA net income from the windfall profits has already been placed in the general reserves as noted earlier and, as such, is available for any purpose for which general reserves may be used, including to meet credit and other operational losses.

[11] The timing projection does not take into consideration the possible use of part of the current balance in the SCA-1 (which is part of the Fund's precautionary balances) for arrears clearance purposes.

Option 3: Add the Windfall to the Endowment

17. **The Board has already indicated that SDR 4.4 billion of gold sale profits should be placed in the gold endowment within the IA and invested pursuant to an endowment strategy once such an endowment is established**. An endowment of this amount is consistent with the underlying assumptions at the time agreement was reached in April 2008 on key elements of the new income model. During the initial discussion of the windfall profits in April 2011, many Directors saw merit in further boosting the endowment by adding some or all of the windfall profits to it, with a few considering that this option should be pursued only after precautionary balances reach an adequate level. This option would provide a larger buffer to help further ensure a sustainable and diversified income base, as envisaged under the new income model.

18. **The income projections have been updated to include the latest Fund lending under currently-approved GRA arrangements**. While the large volume of crisis-related lending has increased the medium-term income projections, over the longer run the steady state projections, based on a working assumption of a 3 percent real rate of return on the endowment, still show only a modest positive income-expenditure position. Adding the full amount of the windfall to the endowment would increase that buffer from current projections of about SDR 70 million to about SDR 130 million per year (Table 3). As noted below and in the earlier discussion, placement of the additional profits in the endowment would be assumed to be permanent, which in turn would effectively preclude their subsequent use for other purposes, including those set out in Option 1.

19. **Work is ongoing on developing proposals for the rules and regulations that will underpin the endowment**. The next discussion is scheduled for late August, and will cover possible portfolio structures, a return target, and governance arrangements for the new endowment. Staff proposes a 3 percent real rate of return target, which will require a more broadly diversified portfolio. A 3 percent payout remains the *long-run* working assumption for the endowment income projections, though staff recognize that there will be periods of under- and over-performance relative to this assumption.

B. Combining Options

20. **As noted during the April 2011 discussion, the three main options are not mutually exclusive**. Options could be combined in varying proportions to effect different combinations of outcomes. Many Executive Directors indicated they could support a combination of two or more options, with Directors also noting the importance that final proposals on use of the windfall take into account the financial position of the Fund. Allocating portions of the estimated windfall of SDR 1.75 billion to the various options changes the estimated outcomes of the key variables: projected subsidization capacity of the PRGT after 2014; timing for reaching the target level of precautionary balances; and the size and steady state income from the endowment. The results are sensitive to a number of important underlying assumptions including rates of return on invested assets in the endowment and Trusts and the path of interest rates.

21. **The financial implications of these combinations are linear proportions of the three main options**. Table 3 gives a broad sense of the key trade-offs of varying proportions of the full amount of the endowment under each of the three options. For example, allocating half of the windfall to the endowment (Option 3) and the other half for distribution/return for the benefit of LICs (Option 1), would raise the projected steady state income buffer to SDR 101 million per year (from SDR 71 million with no transfer) and increase the self-sustained capacity of the PRGT to SDR 0.90 billion per year (from SDR 0.70 billion), still well below the lower bound of the longer-term demand projections.[12]

Table 3. Sensitivity of Targets to Proportional Allocations of Windfall Profits
(In billions of SDRs, nominal terms and Fiscal Year)

	Reserve Account[1/]	Precautionary Balances	Endowment
	Projected RA subsidization capacity of PRGT loans (per annum)	Timing for reaching the precautionary balances target of SDR 15 billion	Net income buffer in the steady state (per annum)
Full allocation of windfall	1.10	FY14	131
In percent of expenditures in the steady state			*16*
Fifty percent allocation	0.90	FY14	101
In percent of expenditures in the steady state			*12*
Zero allocation	0.70	FY15	71
In percent of expenditures in the steady state			*9*

Source: Finance Department.

[1/] Based on high demand scenario.

22. **A sequenced combination of options may strike a more effective balance between the competing objectives than a simple partition of resources**. An important difference between the options is the timing of needs. Option 2 would have an important short-term benefit in clarifying the resources available to meet increased credit risk, whereas there is no short-term need to enhance the income buffer (Option 3) or replenish the PRGT assuming the 2009 financing package is completed. Conversely, the longer-term financing gap is most severe for the PRGT, whereas precautionary balances may well continue to accumulate rapidly and reach an appropriate level in a few years. Another important difference between the options is that decisions under Option 1 would be considered irrevocable since any distribution to members could not be reversed; a decision to place the windfall in the endowment under Option 3 is also assumed to be permanent, given the nature of the endowment. By contrast, there would be some flexibility under Option 2 to decide later on a distribution of the windfall for the benefit of LICs or to place the amounts in the endowment, although such a decision would need to be based on an assessment that the remaining precautionary balances would be

[12] The projected timing for reaching precautionary balances of SDR 15 billion would remain in FY 2015.

adequate. An alternative sequenced option is to maintain the status quo with net income representing the windfall profits having been placed in general reserves but not counted as part of precautionary balances. This may have merits in the event that there still is no consensus on the other options. It would maintain maximum flexibility without precluding any future options.

III. Distribution of Profits Relating to PRGT Financing

23. **As noted above, the Board has previously endorsed using a portion of the gold profits as part of a strategy to secure PRGT subsidy resources necessary to support concessional lending to LICs during 2009–14**. Using gold profits for this purpose requires a distribution of the profits to members, in proportion to their quota shares, and a return of broadly equivalent amounts by the members to the PRGT as contributions. It would be important to have strong ex-ante assurances from the membership of a high return rate to ensure that LICs benefit from the distribution as intended. As with the recent fundraising for Liberia's debt relief, the actual mechanism envisaged would involve a Board decision to distribute resources to members, with the distribution to be made only after the Fund has received satisfactory assurances that resources equal to a minimum threshold (see below) of the proposed distribution amount would be provided by members as PRGT subsidy contributions.[13] The actual contributions to the PRGT would be expected to commence shortly after the distribution is effected (indeed—and again reflecting the Liberia approach—members could be given the option under the decision to authorize that their portion of the distribution be transferred to the PRGT immediately as a subsidy contribution once the distribution is made). In order to raise the agreed amount of SDR 0.5–0.6 billion (in end-2008 NPV terms), a distribution of SDR 0.6–0.7 billion has been considered reasonable, based on an assumed 10 percent "leakage" rate.

[13] As noted in *Use of Gold Sale Profits—Initial Considerations and Options* (3/16/11) http://www.imf.org/external/np/pp/eng/2011/031611.pdf and previous papers discussing this strategy, the Fund is authorized to make distributions to members either from annual net income pursuant to Article XII, Section 6(a) (which requires a Board decision by a majority of the votes cast), or from the Fund's general reserves pursuant to Article XII, Section 6(d) (which requires a Board decision adopted by a 70 percent majority of the total voting power).

24. **As discussed in previous papers, to minimize the leakage associated with a distribution, a high minimum threshold of 90 percent is proposed**. The Liberia fund-raising exercise demonstrated that attaining a threshold of this magnitude is feasible. The combined quota share of all 102 members who consented in 2008 to return amounts equivalent to some or all of the SCA-1 balances and deferred charges to assist in Liberia's debt relief was about 91 percent of total quotas (Table 4).

Table 4. IMF Quota Shares of Country Groups

Country Groups	Country groups quota share 1/ (In percent)
G-20	66.4
Other EU	13.4
Other advanced	3.7
PRGT eligible	4.3
Other members	12.2
Total	100.0
of which: Liberia contributors	*91.5*

Source: Finance Department

1/ Quota as per post-2008 reform (second round) effective on March 3, 2011.

25. **The time required to finalize a distribution-and-return operation is highly uncertain**. As a point of reference, mobilization of resources for the PRGF-HIPC Trust took several years in total. The Managing Director sent initial requests to members in spring 1996, and received pledges of about SDR 1.5 billion by fall 1999. The pledges included commitments to return SCA-2 balances that were to be distributed by the Fund, as well as other bilateral contributions. Most of these contributions were received by 2003. In contrast, the financing package for Liberia's arrears clearance took significantly less time to complete. Sufficient pledges to return equivalent amounts of members' SCA-1 and deferred charges were obtained within about three months of management making the formal request, and most resources were received within a year of the distribution, although some residual outstanding pledges remain more than three years later. The much faster process in the case of Liberia may partly reflect the very specific purpose of this financing effort. In addition, the process noted above, of early adoption of a decision that made a distribution contingent upon adequate assurances, may have helped expedite receipt of a critical mass of support from the membership.

26. **Given that the membership has already endorsed the 2009 financing package, it seems reasonable to assume that the process of receiving the contributions will be completed faster than the PRGF-HIPC fundraising**. However, it cannot be assumed that this will be done as quickly as in the case of Liberia. On balance, it would seem prudent to initiate the process in 2011, rather than to delay it further. This would involve a decision to distribute the agreed amount, say, SDR 0.7 billion, conditioned on the receipt of satisfactory assurances that contributions equal to 90 percent of this amount would be provided to the PRGT as subsidy contributions**.** If the distribution and return process commences in 2011, it could reasonably be expected that satisfactory assurances would have been received (and thus the distribution made) by mid-2012, with the Fund receiving the actual contributions over the next one to two years. This would be consistent with current expectations that the additional resources will be needed to cover lending commitments beginning in late 2013. As noted, it would also be important to ensure that initiation of the distribution process does not undermine

the current bilateral fund-raising efforts. Thus, the process could be initiated only once the lower end of the SDR 0.2–0.4 billion target for subsidy resources has been met (pledges currently total SDR 155 million). Additional efforts to reach this target could be made over the period of the Annual Meetings.

27. **If the Board were to decide now to allocate all or part of the windfall profits to generate resources to support LICs under Option 1, the two distributions could be combined**. Given the complex processes that may be required to effect distribution of the windfall profits and a return of equivalent amounts—formal consents would be required from each member, and in some cases this may require parliamentary approval or inclusion in the annual budget cycle—it may be preferable from an operational perspective to have a single transfer, rather than two transfers at different times. However, if there still is no consensus on use of the windfall profits, staff would propose to proceed with a Board decision regarding the distribution already endorsed in connection with the 2009 financing package, in order to ensure that these resources are available in a timely manner, as discussed above.

IV. Other LIC-Related Issues

28. During the April 2011 discussion, some Directors indicated a desire to explore several other options aimed at supporting LICs. These options included using resources linked to a portion of the windfall profits to augment the PCDR Trust,[14] finance Fund technical assistance for LICs,[15] or extend interest relief on PRGT lending or otherwise increase its concessionality. Implementation of any of these options would require a distribution to members as set out under Option 1, followed by a return of contributions of broadly equivalent amounts for the specified LIC-related purposes. To the extent that donor resources were diverted towards such objectives under a modified Option 1, the self-sustained capacity of the PRGT would be correspondingly reduced. In each of the options, it is important that any distribution-and-return operation should provide *additional* funding to ongoing bilateral financing efforts, and not substitute for it.

Interest Rate Relief

29. **One question is whether the temporary interest forgiveness under the PRGT should be extended beyond 2011**. The temporary interest relief was adopted as part of the 2009 LIC reform and financing package and was aimed at providing exceptional relief in the context of the global financial crisis. On this basis, zero interest applies to all outstanding

[14] The PCDR Trust was established in June 2010 and initially financed by SDR 280 million of the Fund's own resources. Of this amount, SDR 178 million was provided to Haiti in July 2010, eliminating Haiti's entire outstanding debt to the IMF.

[15] Technical assistance is currently financed from both the Fund's internal resources and through bilateral donor contributions. IMF gross administrative expenditures for capacity building (technical assistance and training) over 2008–2012 averaged about US$230 million, of which about US$50 million was provided though Administered Accounts on behalf of donors.

PRGT credit through end-December 2011, when the interest forgiveness will expire and the new interest rate mechanism adopted under the 2009 LIC facilities reform will apply. Under the reforms, PRGT interest rates are subject to periodic Board reviews to take account of developments in world interest rates.[16]

30. **Given the current low level of SDR interest rates, formally extending the interest relief is likely to have very little impact**. Under the new LIC facilities architecture, ECF, RCF, and SCF interest rates would normally be adjusted if warranted by the prevailing SDR rate based on a pre-defined mechanism. The interest rate structure was initially set at 0.0/0.0/0.25 percent for ECF/RCF/SCF loans, respectively, with the first review to be completed by December 31, 2011.[17] Following the next review, the ECF and RCF loans would almost certainly continue to carry a zero interest rate, while interest on SCF loans would most likely carry a 0.25 percent interest rate.[18] Moreover, the original justification for the exceptional interest relief no longer applies as most LICs (including those with SCF and ESF credit) have experienced a robust economic recovery from the global crisis. It is proposed to take up these issues in a separate Board paper in the context of the PRGT interest rate review before the end of 2011 prior to the expiration of the current temporary interest relief period.

Concessionality of PRGT Credit

31. **Another issue is whether PRGT loans should be made more concessional, at least for the poorest and most vulnerable LICs**.[19] Given low benchmark interest rates and the ten-year maturity profile of most PRGT credit, the Fund's financial support to LICs is currently less concessional than that of most development agencies. In view of the uncertain growth and debt sustainability outlook for the poorest and most vulnerable LICs, it may be appropriate to explore the case for higher concessionality, at least for a sub-set of PRGT-eligible members.

However, increasing concessionality would reduce the self-sustained capacity of the PRGT, and hence the Fund's ability to meet new financing needs in future crises and shocks. It is expected that the issue of concessionality of PRGT lending will be taken up by the Board during the 2012 LIC facilities review.

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[16] See *IMF Reforms Financial Facilities for Low-Income Countries,* Public Information Notice (PIN) No. 09/94 (7/29/09) http://www.imf.org/external/np/sec/pn/2009/pn0994.htm.

[17] The framework provides for rates ranging from zero percent for ECF and RCF loans and 0.25 percent for SCF loans when the SDR interest rate is equal to or less than 2 percent, to 0.50 percent (ECF and RCF) and 0.75 percent (SCF) when the SDR rate exceeds 5 percent.

[18] An earlier estimate of the cost of extending interest rate relief on all PRGT credits for a further 3 years was about SDR 70 million (*Use of Gold Sale Profits—Initial Considerations and Options* (3/16/11)) http://www.imf.org/external/np/pp/eng/2011/031611.pdf, assuming that SDR interest rates would increase from their historically low levels. To the extent that the current very low rates persist, the subsidy costs could be lower.

[19] Currently loans under the ECF and the RCF are repaid over 10 years, with a 5 ½ year grace period, while SCF loans have an 8 year maturity, with 4 years grace.

V. Conclusions and Next Steps

32. **If the Board wished, decisions could be taken in the near term to implement any of the three main options, individually or in combination**.[20] At the April 2011 discussion, there was significant support for each of the main options, but no consensus on any single option. The options are not mutually exclusive, and a decision to put the funds to work toward multiple purposes is one possible route, the downside being that progress toward each individual policy goal would be more limited. In addition, a decision under Option 1 would be considered irrevocable once the dividend is paid, while one under Option 3 would be assumed effectively to be permanent as noted above.

33. **If there is still no consensus on one or more of the above options, there may be merit in continuing the current approach for the time being**. Accordingly, the entire windfall would remain in the general reserve but not be taken into account for purposes of calculating the Fund's precautionary balances. The Board could also agree to return to the issue of the ultimate use of the windfall in, say, one year's time. Such a sequenced approach would also allow time for greater clarity to emerge regarding the global outlook and the credit risks faced by the Fund, the Fund's income, the adequacy of precautionary balances, and the evolution of demand for concessional financing.

34. **A related issue remains when to initiate the distribution of the part of the gold profit already agreed under the 2009 financing package**. On balance, staff proposes that this process be initiated in 2011, once the lower end of the SDR 0.2–0.4 billion target for bilateral subsidy resources has been met. This would seem prudent given that it is likely to take some time to secure the necessary commitments and ultimately the actual contributions. One drawback with this approach is that there would need to be a second distribution, if the Board were to decide later that resources linked to all or part of the windfall profits should be used for the benefit of LICs.

[20] Under Option 1, a distribution to members can be made as a distribution (reduction) of the general reserve (which as noted earlier requires a Board decision adopted by a 70 percent majority of the total voting power). For Option 2, no formal Board decision is required to count the windfall as precautionary balances. Likewise, no new Board decision regarding the use of the profits would be required to implement Option 3 other than the already contemplated decisions to adopt the requisite rules and regulations for the IA and place the profits in the endowment portfolio.

Issues for Discussion

- What are Directors' views on the options for use of the windfall profits presented in this paper?

- If there still is not sufficient consensus on one or more of the options, would Directors see merit in maintaining the windfall profits in the general reserve (but not counted as precautionary balances) and returning to the issue in, say, a year's time?

- If a decision on the use of the windfall profits is delayed, would Directors support adoption of a Board decision to distribute the part of the gold profits already endorsed under the 2009 financing package in 2011 as soon as the lower end of the SDR 0.2–0.4 billion target for bilateral subsidy contributions has been met? In this context, do they agree that a minimum threshold of 90 percent should be established for assurances that would need to be provided for PRGT subsidy contributions before the distribution is effected?

- Do Directors agree that the issue of whether to extend interest forgiveness on PRGT loans is best considered in the context of the scheduled review of PRGT interest rates in late 2011, and that broader questions regarding PRGT concessionality should be discussed as part of the 2012 LIC facilities review?