

**COMMITTEE TO STUDY  
SUSTAINABLE LONG-TERM  
FINANCING OF THE IMF**

Final Report

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**January 31, 2007**

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*Executive summary*

This report attempts to identify an income model that would be more appropriate for the various activities undertaken by the Fund, and would be more responsive to evolving conditions in the world economy and in the role of the Fund itself.

An important feature of the income model favored by the Committee is that it relies on diverse sources of revenue. This is not just expedience. It is a reflection of the multiplicity of functions of the Fund. The provision of public goods, the resolution of financial crises, and capacity building are different, if related, tasks, and each of them has rather different natural funding models.

The Committee's mandate did not include a review of the Fund's administrative expenditures. The Committee notes, however, that new revenue measures cannot be considered in isolation from what shareholding countries view as the Fund's mission, and the costs implied by that mission. It has therefore proceeded on the assumption that new revenue measures will be evaluated in conjunction with a careful review of the appropriate level of Fund expenditures by Fund Management and the Executive Board. The Committee notes that spending restraint remains of central importance, and new revenue sources should not lead to the creation of new missions.

The main findings of this report are:

1. Surpluses from financial intermediation should not systematically be looked to for covering the public good and capacity building activities of the Fund. The intermediation charge for borrowers should be stable, predictable, and related to the broader credit environment.
2. Periodic levies on Fund members, despite some attractions, may not be a practical way of financing the Fund's public good activities.
3. The Committee believes that the Fund could generate additional revenue by expanding its investment activities, within strict limits to avoid excessive use. Recommended measures include a relaxation of the currently restrictive mandate on the investment of the Fund's reserves and the investment of part of the Fund's stock of usable currencies.
4. The creation of an endowment, whose income could be used to help cover administrative expenses, has several attractions, and has the support of the Committee.
5. The most likely source of financing for such an endowment would be the proceeds from a limited sale of Fund gold, which should be ring-fenced to exclude further sales. Gold sales have some well-known drawbacks, but the Committee accepts

they could form part of a package approach, subject to strong safeguards to limit their market impact, e.g., they need to be coordinated with the existing and possible future central bank gold agreements.

6. Charging for services provided directly to members would probably yield only modest amounts. However, the Committee supports charges in principle and believes that charges might help to rationalize demand and enhance the efficiency of providing these services, even if donors helped to defray costs for countries unable to afford the charges.
7. The Committee believes that the measures it recommends would be sufficient to set the Fund's finances on a sustainable basis for some time to come. It cannot, however, be excluded that future income needs will be greater (or smaller) than currently foreseen. Further action may therefore become necessary in the future.
8. In light of the time required for approval and implementation of the new revenue model, the Committee believes that consideration of the issue should start at once. The Committee also recommends that its proposals be viewed as a package rather than as individual measures to be implemented independently from one another.
9. The Committee believes that, in the event that the Fund starts generating resources in excess of what is necessary to cover its running costs and the accumulation of all necessary reserves, the Fund should institute a dividend policy to redistribute these resources to members in proportion to quotas.

Please refer to Appendix 1 for a quantified enumeration of the income options proposed by the Committee.

## ***I. Introduction***

The IMF has recently been reviewing its medium-term strategy, in the light of proposals put forward by the Managing Director in 2005 and 2006.<sup>1</sup> These proposals cover reforms in several major areas, including Fund activities, governance, and finances. With regard to this last, an important challenge is to reconcile the activities projected in the medium-term strategy with a budget outlook that projects a low level of Fund revenue for some time to come.

Against this background, the Managing Director established the *Committee of Eminent Persons to Study Sustainable Long-term Financing of IMF Running Costs*<sup>2</sup> ('The Committee') on 18 May 2006, in order to identify and assess the full range of income-generating options available and to make specific recommendations for one or more income models that would generate sustainable long-term financing of the Fund's running costs.

The IMF's current financing model relies primarily on interest income derived from lending to fund the whole range of its activities. These include not only financial intermediation, but also multilateral and bilateral surveillance, crisis prevention, research and statistics, technical assistance and capacity building, and the accumulation of prudential reserves, among others.

While this business model has served the Fund well over the years, fully covering running costs and allowing the build-up of strong financial reserves, its shortcomings are becoming apparent. A rapid reduction in credit outstanding to borrowing members has resulted in a drop in Fund income and a base-case projection that intermediation income will fall further. It is already the case that the income derived from lending is not sufficient to cover the Fund's projected operating expenses, unless the intermediation margin were to be raised to unsustainable levels. More importantly, the relationship between a single revenue source and the increasingly diverse range of Fund activities has other important deficiencies, which are enumerated below.

Given shortcomings in the current revenue model, the Committee has based its appraisal of additional income-generating options on an assessment of the appropriate relationship between the Fund's income sources, on the one hand, and its various activities and expenditures, on the other.

This constitutes a broad approach to the Committee's mandate. It is important to be clear at the outset, however, of the topics that have *not* been covered in the Committee's work. One is any detailed consideration of the role of the Fund in the international monetary system. The subject of the Fund's medium term mandate is being dealt with by the Executive Board, International Monetary and Financial Committee, and Board of

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<sup>1</sup> See the IMF website for further background at <http://www.imf.org/external/np/exr/ib/2006/041806.htm>.

<sup>2</sup> See Appendix 2 for the Committee's *Terms of Reference* and Appendix 3 for the Members of the Committee.

Governors. The outcome of this review will naturally have implications for the Fund's expenditures, and hence for the revenues needed to finance them. Clearly the level and character of revenues should be such as to enable the Fund to meet its designated responsibilities. At the same time, Fund Management and the Executive Board should ensure appropriate discipline on administrative expenditures, accountability vis-à-vis agreed priorities, and should limit the temptation to take on unrelated or low-priority expenditures.

The Committee has not attempted to recommend the precise amounts to be raised from individual revenue sources. In part, this is because the Fund's future budget needs cannot be foreseen accurately at the present time, and will become clearer only as the medium term strategy's implementation unfolds. In part too, it is because the precise implementation of a new revenue model is the responsibility of the Fund's Executive Board. The Committee's objective has been to review the broad considerations bearing on the desirability of particular revenue sources. Nevertheless, in the course of this review, certain illustrative calculations of the potential yield of various revenue sources have been attempted.

## ***II. The nature of the revenue problem***

At the current rate of charge, revenue from lending activities is already proving insufficient to cover the Fund's administrative expenditures.<sup>3</sup> This situation is expected to persist over the medium term.<sup>4</sup> Such projections are inevitably subject to a wide margin of error, but the Committee accepts them as central estimates. The Committee notes that in the near-to-medium term, the projected financing gap could be covered by running down reserves, which have built up substantially in recent years. (Reserves currently stand at SDR 5.9bn.)<sup>5</sup> It should be noted, however, that from a policy perspective, the primary purpose of reserves is to mitigate the effects of potential future credit losses.

Moreover, while drawing down reserves could cover expenditure shortfalls in the short to medium term, it could not do so indefinitely if the current low-credit environment persists. Nor would reliance on financing from reserves address the many other deficiencies of the current revenue model. Thus, in view of the complexities involved in reaching consensus among the Fund's membership on new revenue measures, and

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<sup>3</sup> For ease of reference, the Fund's General Resources Account (GRA) credit operations are referred to in this report as lending. In fact, GRA credit does not involve loans, but rather exchanges of assets with borrowing members providing their currencies to the Fund in exchange for equivalent amounts of a freely usable currency or SDRs.

<sup>4</sup> See Appendix 4 for further detail on the Fund's projected income sources and uses through 2010.

<sup>5</sup> Reserves comprise the Fund's accumulated retained earnings in the Special and General Reserves. An Investment Account was established in June 2006 and funded with an amount equivalent to the Fund's reserves (SDR 5.9 billion). The Fund also holds a precautionary account—the SCA-1—which is held to mitigate the risk posed to the Fund by the existence of arrears, and is by its terms only contingently available to the Fund. It is to be fully refunded to contributors when there are no arrears remaining, and may also be partially or fully refunded at such earlier time as the Fund may decide. Balances held in the SCA-1 are not eligible for investment in the Investment Account.

obtaining approval for their implementation, work toward shaping an alternative revenue model should commence immediately. A suitable income model for the Fund should accommodate both high and low credit environment scenarios.

A robust income model should also correct for certain weaknesses in the current model that are now becoming increasingly apparent, viz.:

1. It is highly concentrated, as revenue derives primarily from a single source, i.e., Fund lending.
2. It lacks economic logic, in that a single revenue source finances a wide range of activities, some of which would more appropriately be financed in other ways.
3. It lacks predictability, with revenue levels depending on the widely fluctuating financing needs of borrowers.
4. It lacks flexibility and scalability to respond to changes in the nature of its mandate, whether reduced or increased.
5. It is arguably inequitable, because the intermediation margin on lending has funded the growth of the Fund's other activities.
6. It has the curious feature that the Fund's financial well-being depends on it being unsuccessful in its primary mission, which is to prevent financial crises.

Given these weaknesses, the Committee views its recommendations as a comprehensive package, rather than a series of individual measures that could be effective on a standalone basis. It is important that the desire to produce a readily practical solution not limit the initiative to a narrow set of measures that fails to meet the broader objectives of fairness, accountability, predictability and durability. The need for a sound income structure is reinforced by the uncertainty regarding the future evolution in the composition of the Fund's activities.

### ***III. Alternative revenue model***

In assessing alternative revenue options, an important objective of the Committee has been to address the deficiencies just noted.

To facilitate the process of linking sources and uses of funds, the Committee believes it is helpful, conceptually, to think in terms of three broad categories of Fund activities: credit intermediation (i.e., Fund lending from the General Resources Account (GRA)), the provision of public goods (i.e., oversight of the international monetary system, multilateral surveillance, cross-country statistical information and methodologies, general research, general outreach, bilateral surveillance, regional surveillance, and standards and codes and financial sector assessments), and bilateral services (i.e., technical assistance, external training, and financial assistance to low income countries under the PRGF).<sup>6</sup>

Grouping uses of funds (and the related costs) in this way provides direction as to how much revenue is needed for each category of expenditure, and who should pay. It helps

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<sup>6</sup> Appendix 5 provides some analysis by the Fund staff on the breakdown of these activities.

to identify cross-subsidies in the existing revenue system, as well as their implications for cost-sharing. And it might potentially provide an element of fiscal restraint on future spending initiatives, if no corresponding sources of revenue are identified.

*Credit intermediation* is a major function of a financial institution such as the IMF. It would normally be accepted that the cost of providing this service should be covered out of an intermediation margin. In competitive equilibrium, this margin is determined by market forces. The Fund does not, of course, operate in the same way as a commercial lender, but some of the same principles apply. The margin should be predictable and set at a reasonable level based on a broad measure of external credit conditions.

Insofar as the Fund is providing a *public good* to the world economy, the beneficiaries are all member countries, and it makes sense for the burden of supporting these activities to be widely spread (broadly in proportion to quotas). It is therefore appropriate for the Fund's public good activities to be financed by means which derive proportionately from resources provided by all members.

Where *bilateral services* are provided, much of the benefit accrues to the receiver of the service, and economic efficiency would normally suggest charging for benefits received. If, for broader public policy reasons, the Board wished to defray the costs of these activities for those members that cannot afford them, more direct methods of financing could be found. Even in this case, however, some mechanism for linking the cost and benefit of the service would be desirable.

The Committee recognizes that expenses incurred for credit intermediation, the provision of public goods, and bilateral services overlap in practice and cannot easily be disentangled.<sup>7</sup> For example, surveillance aimed at improving the functioning of the monetary system in normal times provides the informational basis for conditional lending in crisis situations. Capacity-building that benefits primarily individual countries, such as the Fund's recent work with central banks on financial preparedness for an outbreak of avian flu, can help avoid situations in which spillover effects engulf other countries. And member countries often rely on Fund technical assistance to implement measures that form part of the programs which are supported by the Fund's lending activities.

For this reason, the Committee does not believe in a mechanical application of this framework. Nevertheless, recognition of the different roles played by the Fund has important implications for the business model that should underpin its financing. In particular, it suggests that a variety of different revenue sources should be employed, including not just intermediation revenue, but also those that are more suited to financing public goods and bilateral services.

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<sup>7</sup> Note also that these categories do not map directly to the legal framework under the Articles. For example, the Articles make surveillance mandatory, but financial sector and other standards and codes assessments, which most would classify as a mandatory public good, are in fact part of the Fund's discretionary technical services (similar to training and other kinds of bilateral technical assistance).

The following sections review the income options that the Committee has identified and reviewed in conjunction with the three categories of activity cited above, viz., credit intermediation, public goods, and bilateral services.

#### ***IV. Credit intermediation***

The intermediation margin earned by the Fund on GRA lending presently constitutes the Fund's primary source of revenue. It is by definition the difference between what is charged to the borrower and what is paid to the lender, either of which can be adjusted to affect the margin. As a general principle, the Committee believes that, on a long-term basis, lending should yield enough to cover intermediation costs, as well as the build-up of reserves, but should not have the objective of continuing to fund the whole range of IMF activities. The margin should also be set at a level that discourages prolonged reliance on IMF funding, when market funding is available.

Although the Committee does not, in general, favor the use of the intermediation margin to cover the Fund's non-financial activities, it has nevertheless looked separately at the issues involved in determining remuneration and charges.

##### *a. Lending rate, or 'rate of charge' in IMF terminology*

As noted in the introduction to this section, the Committee does not believe charges on borrowers should be varied so as to meet an income target for the Fund. While setting charges is the prerogative of the Executive Board, the Committee believes the following principles are appropriate in reaching decisions on this matter:

- (1) The rate of charge should cover both the costs of intermediation and the accumulation of reserves, which are needed to mitigate the effects of credit losses for GRA activities.<sup>8</sup>
- (2) Its fluctuation should be kept within a band, i.e., with a cap and a floor. While in a purely market oriented world, the Fund would charge borrowers the risk free rate plus a risk premium, the Fund is a public policy institution, with a cooperative character and policy conditionality applied to borrowers. The rate of charge should thus be set at a reasonable level in alignment with broader credit conditions (e.g., long-term average market credit conditions), with occasional adjustments, when deemed appropriate depending on market conditions.

These characteristics would ensure that revenues from Fund lending would be sufficient to cover the costs involved in its financial activities, without exposing users of Fund credit to unnecessary uncertainty about potential charges.

In addition, the Committee believes that the possibility of applying a premium on the basis of the duration of a member's borrowing deserves consideration by the Executive

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<sup>8</sup> This excludes the buildup of reserves for PRGF lending, which are provided for in other ways.



Board. This would be an extension of the Fund's current practice of charging more for programs involving higher levels of access to its resources.

*b. Creditor remuneration, or 'rate of remuneration' in IMF terminology*

One way to generate revenue through credit intermediation would be to lower the rate of remuneration to creditors. The Committee does not favor this option, as it believes the risk-free rate (i.e., the SDR rate) is the appropriate minimum at which member countries should be expected to extend credit. In addition, the amount of additional revenue raised would fluctuate along with the level of Fund credit. As a revenue source, therefore, this option would not be powerful in a low-credit environment and do nothing to alleviate volatility derived from fluctuations in the Fund's lending activities.

***V. Income sources to cover the provision of public goods***

Public goods, by definition, cannot be financed by market mechanisms. And, as has been argued above, it is inappropriate for their provision to be financed by an uncertain income source, the burden of which falls on a subset of members. It is thus desirable that new income sources be found to cover the provision of such goods, and that these sources be both stable and predictable, so as not to jeopardize the essential functions of the IMF. The Committee has considered three potential sources of income: periodic charges levied on member countries; investment operations; and the creation of an endowment, the income from which would be used to defray administrative costs. Note that within all of these, and in the context of ongoing efforts to adjust the basis of determination of quotas, the Committee sees no reason to depart from the reliance on quotas as the basis for distributing costs.

*a. Periodic levies*

One way of generating a stable source of revenue for the Fund would be for it to seek to collect annual, or other periodic levies from its members, much like some other public international organizations, such as the United Nations or the OECD (though not, in general, other multilateral financial institutions). These levies would be related to members' quotas and, in most countries, be subject to parliamentary approval procedures.

The Committee recognizes this proposal has certain positive attributes but, for practical reasons, does not, on balance, favor it. It is important that the advice of the Fund be seen to be fully impartial, and not related to its own financing needs. Subjecting the Fund's administrative expenditure to national budgetary procedures might indirectly threaten the independence of the Fund's policy advice.

While national approval of levies to support the Fund's activities might seem to strengthen accountability, the Committee notes that other channels of accountability to its national members are in place. These include the annual review of the Fund's budget by the Fund's Executive Board. In addition, periodic reviews of quotas, and quota increases,

as well as occasional amendment of the Articles of Agreement, are in most countries subject to review by national legislatures.

An alternative way of achieving a result similar to quota-based levies would be to reduce the proportion of member country balances that is remunerated, in effect reducing interest expenditures by an amount exactly equal to the stream of revenues that would result from periodic charges. In the Committee's view, this would amount to a concealed levy. The Committee therefore does not favor it on transparency grounds.

*b. Investment operations*

A second potential source of income to finance the provision of public goods by the Fund would be through expanded investment operations. There are various ways in which the Fund could use its balance sheet to generate income.

- i. By broadening the investment mandate for existing reserves – The Committee believes that the Fund should consider liberalizing its investment policies, which are currently more conservative than those of the World Bank and other AAA-rated multilateral development banks (MDBs).

In particular, the Committee considers that the Fund could take more duration risk than it presently does, given the absence of refinancing risks. Returns could also be increased by expanding the universe of instruments in which the Fund may invest, in line with the policy followed by the MDBs. The World Bank, for instance, can invest in government and agency obligations (AA- and above), asset-backed securities (AAA only), and time deposits with commercial banks.

The potential returns from a less restrictive investment mandate will of course depend on conditions in the capital markets at the time. Based on returns achieved at the MDBs on their portfolios of liquid investments, the Committee believes that, under normal market conditions, it should be possible to increase net yields by as much as 50 basis points over time, if the duration benchmark were to be extended and credit policy liberalized in line with that of the World Bank. On a reserve portfolio of SDR 6 billion, this would produce additional income of SDR 30 million.

- ii. Use of currencies subscribed by member countries to generate resources by investing a portion in interest-bearing securities.
  - a) The Fund could use a part of the quota resources subscribed by members to invest in higher-yielding marketable securities. When members' quota subscriptions are used in Fund lending operations, creditor members currently receive remuneration equal to the adjusted SDR rate.<sup>9</sup> If these resources could be invested by using the same investment

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<sup>9</sup> The SDR rate is a weighted average of 3-month money market rates in the four largest currencies.

mandate that is currently applied to the Investment Account, which currently yields the SDR interest rate plus about 50 basis points, then, at today's market, each SDR 1 billion of investment would yield SDR 5 million of additional revenue. An investment of SDR 20 billion might therefore yield some SDR 100 million in annual income.

An attractive feature of this financing option is that it uses resources that members have already committed to provide to the Fund for lending to countries experiencing financing difficulties. The absence of such borrowers implies greater success in crisis avoidance, and at the same time liberates resources for expenditures for crisis prevention and other public goods. The Committee favors this option.

It is important that the quota resources used to fund market investments should be retained in liquid securities, in case they are needed for lending to member countries. Though market liquidity for the securities likely to be in the portfolio is unlikely to be a constraint, it is always possible that if a portion of the portfolio needed to be liquidated to generate lendable resources, this may result in the realization of a mark-to-market loss.

Funding investment operations through quotas also carries burden-sharing implications. If the current financial plan defines eligibility, those members who are not part of the financial plan might be seen as not shouldering any burden. In order to increase the equity of this proposal, a requirement could be envisaged that a portion of the quotas of all members be available for investment, subject to the Fund's liquidity needs.

A possible objection to investment operations is the potential conflict of interest, or perception thereof, to which it could give rise, since the Fund might have access to privileged information in the context of its surveillance activities. The Committee believes that this concern could be removed or alleviated by outsourcing investment activities (as is currently done for the Investment Account), or by establishing appropriate Chinese walls, should the decision be taken to manage this activity internally.

- b) Additional income could be realized from this source if the Fund's investment policy were liberalized, as recommended in section b.i. above, adding an estimated 50 bps to the returns yielded under the current mandate. This would double the returns from a given volume of investment. For example, an investment of SDR 10 billion might therefore yield up to SDR 100 million in annual income.

- iii. Use of Fund's credit to borrow in markets – The Fund could use its credit standing to borrow in the markets and reinvest at higher rates, earning a spread. The Committee does not favor this option, as it would be outside the Fund's core mandate. It views the creation of another “preferred creditor status” borrower as undesirable. Setting up this kind of treasury operation is expensive, moreover, and because the Fund lacks in-house expertise, it might have to be outsourced. Finally, borrowing in the markets constitutes an inherently riskier activity than the use of quota reserves because it carries refinancing risk.
- iv. Reserve management for central banks – The Fund could undertake to manage central bank reserves on behalf of member countries, receiving asset management fees. The Committee does not support this option, as the Fund has no existing expertise in this area. Other IFIs (e.g. the BIS and the IBRD) already provide these services to member countries, and private sector asset managers offer their services to virtually all central banks. Moreover, it is not clear that the Fund could generate substantial fee income in this way, given the substantial infrastructure required and competitive fees charged by private asset managers. The Fund would also need to set aside some capital against operational risks and invest substantial resources in recruiting high quality asset managers, both of which would be costly.

*c. Endowment*

A third way to provide funding for public goods would be through the creation of an endowment, with the prospect that income from the endowment would not be subject to the same drawbacks as periodic levies, discussed above. In the Committee's view, this could be an important and appropriate source of income for the Fund, provided that resources for the creation of the endowment can be generated in an equitable way, and that the long-term real value of the endowment can be preserved. If the real rate of return were, say, 3%, each SDR 1 billion of resources would generate SDR 30 million per year, without diminishing the real value of the endowment.

The Committee can see two possible sources for such an endowment.

- i. Government appropriations – The Fund could request a one-time contribution from members to create the endowment. As in the case of periodic charges, this would require a parliamentary approval process. The Committee notes the uncertainty relating to potential support for contributions of this magnitude, though this is for member countries themselves to judge.
- ii. Gold sales – An alternative potential source of funds for an endowment would be proceeds from gold sales. The Fund currently holds 103.4 million ounces (3,217 metric tons) of gold, most of which is carried in its balance sheet at SDR 35 per ounce.

If gold sales are undertaken, this would convert non-income-generating into income-generating assets. Use of gold would be relatively equitable among Fund members, as the Fund's gold holdings are, in a broad sense, the joint property of the membership.<sup>10</sup>

Gold provides fundamental strength to the Fund's balance sheet as well as to that of its members. The fact that gold holdings have a substantial component of unrealized value can be seen as a reserve against unforeseen contingencies. Taking into account the role of gold in the balance sheet of the Fund, it would be important that any gold sales be carried out in a way that does not undermine this source of strength, and avoids causing disturbances to the functioning of the gold market.

A key requirement would thus be that any sales of gold be limited in amount, and coordinated with central bank gold agreements, current and future. IMF gold sales should not add to the announced volume of sales from official sources. A further requirement would be that gold sales be carefully managed so as to strictly limit their potential market impact. The Committee believes it would be useful to create an internal committee to handle the practical aspects of implementation (timing, modalities etc, of any sales) within the framework of the central bank gold agreements in order to preserve market stability. In all matters related to gold sales, public communication would have to be handled with great care.

A relevant consideration is that, while the total stock of gold has not changed recently, a portion of the holdings (about 400 tons) represents gold sold and repurchased in the 1999-2000 off-market operations. This gold is now treated separately in the Fund's accounts. Given this different accounting and legal treatment, restricting sales to this portion of the Fund's gold would provide a natural limit to the amount of gold to be sold. (See Appendix 6 for a further discussion of the accounting and other implications of using this part of the Fund's gold.) At a price of USD 500 per ounce, this gold has a market value of approximately SDR 4.4 billion.<sup>11</sup> Investment of the proceeds of its sale would yield approximately SDR 130 million per year, assuming a real rate of return of 3%.

A final requirement would be to make sure that spending from a gold-financed endowment did not materially weaken the Fund's financial position. To this end, the Committee believes that the endowment should have a prescribed pay-out ratio that preserves its real value over time. In other words, that part

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<sup>10</sup> To the extent that the gold in question is gold that the Fund held at the time of the Second Amendment, this gold represents primarily the proceeds of contributions of countries that were members at the time of the Second Amendment. It is for this reason that one of the options provided in the Articles for the disposition of this gold is restitution to these members at the price of SDR 35 per ounce.

<sup>11</sup> For 12,965,649 ounces (403 metric tons) at a price of USD500 per troy ounce, based on a two-year average using World Gold Council prices (London pm quotes) calculated in October 2006.

of the annual investment income that compensates for inflation should be retained in the appropriate Account.

Many important practical questions would need to be addressed in the creation and management of an endowment. Chief among these are (a) the governance structure, which should facilitate professional management of investment funds and promote accountability, transparency and performance; (b) the spending rate which will, in conjunction with realistic return assumptions, determine the required initial asset base; (c) the strategic asset allocation, which will derive from the targeted spending rate and the desired balance between the endowment's twin investment objectives of capital preservation and return generation; and (d) a robust risk-control framework. Moreover, the IMF would have to develop an interim financing plan for the period until the endowment is funded. The Committee recognizes the importance of these questions, but does not discuss them further here.

## *VI. Charging for services*

The Committee accepts that bilateral services represent a fundamental contribution of the Fund to the well-being of many of its member countries in particular, and to the global community in general. However, the Committee is also of the view that charging for bilateral services is a practice that has positive aspects. This is not so much for the revenue that would be generated, but to help ensure that the providers and beneficiaries of technical assistance take a disciplined approach to its costs and benefits. It would also enhance IMF transparency and accountability in the provision of such services. Of course, such services also incorporate some of the features of a public good, which means that this issue has to be approached very carefully.

Charging for services rests on the sound economic principle of using price to help measure value and balance supply and demand. It thus constrains what might otherwise be an unlimited demand. It also helps both to discourage excessive intellectual dependency of low-income countries on Fund technical assistance and promote usage of domestic service providers. Finally, charging would benchmark IMF expenditures relative to that of other multilateral financial institutions and outside providers of similar services.

Charging for services would seem an obvious solution in the case of certain beneficiaries. With others, however, especially low and lower-middle income countries, which together account for 80% of the attributable costs of the Fund's technical assistance,<sup>12</sup> the Committee recognizes that there may be public policy reasons for not discouraging the use of capacity-building services. Some countries simply cannot afford to pay for technical assistance, the provision of which may be important in poverty reduction and

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<sup>12</sup> Total costs for bilateral services amounted to approx. SDR 143 million in FY2006, of which SDR 117 million was attributed to TA and SDR 26 million to external training. Of the total SDR 143 million, SDR 58 million can be allocated directly to recipient countries. The remainder cannot currently be ascribed to specific countries by the Fund's information systems (including leave entitlements, travel costs, certain program costs (e.g., resident representatives), personnel overheads, and building overheads).

growth efforts, and in the prevention of future crises, with all their harmful spillover effects.

In some cases, bilateral donors might be willing to defray the costs of needed technical assistance. In any event, the Committee considers it a useful discipline for the full costs of the services to be identified, and billed transparently.

The Committee recommends that Fund management work on a proposal for the introduction of charges for bilateral services and the identification of the full costs of these services on the basis of the principles outlined above.

As noted earlier, the Fund's main financial assistance to low-income members (PRGF concessional lending and HIPC Initiative/MDRI debt relief) is not part of its GRA credit intermediation function, but rather a discretionary service. In earlier times, the PRGF-ESF Trust reimbursed the GRA for the administrative costs incurred by the Fund in providing concessional lending, but the Fund has waived the reimbursement of these costs in recent years. The relevant costs can be significant (averaging around SDR 55 million currently). Consistent with the principle that credit intermediation should not be used to finance other IMF activities, the Committee is of the view that the GRA should not absorb these administrative costs, and that the practice of waiving reimbursement should be terminated. Rather—and as discussed for other bilateral services—the PRGF Trust could pay these costs and/or donor resources could be sought to defray them.

## ***VII. Voluntary contributions***

An additional source of funding could be voluntary contributions, which have been made in the past, and have usually been earmarked for special projects or purposes. Voluntary contributions would most likely be tapped to pay for bilateral services, but could conceivably be attributed to the provision of public goods. Such funding, however, is liable to be lumpy and unpredictable, and should thus not be considered as a stable and sustainable source of revenue.<sup>13</sup>

## ***VIII. A World in which the Fund has Renewed Surpluses***

This report would not be complete without consideration of the implications of a world in which renewed lending activity by the Fund generated substantial surpluses in its overall budget. While this is not foreseen in the Fund staff's central scenario, such a turn of events cannot be excluded. In these circumstances, the problem of inadequate income would be replaced by its inverse, which would be all the larger if the new income sources that the Committee has proposed were in effect.

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<sup>13</sup> In the past, approximately SDR 20 million of donor funds have been mobilized annually for the provision of TA. In addition, substantial donor resources have been mobilized over a period of time to subsidize concessional lending and to finance HIPC Initiative debt relief assistance (SDR 5 billion on an as-needed basis).

It follows from the Committee's view that the Fund's budget should be insulated from the consequences of fluctuations in lending activity, that excess income from this source should not go into additional current expenditure or unwarranted expansion of the Fund's activities. A part should of course be devoted to building reserves against potential credit losses. But when no additional reserve accumulation is needed, the Committee believes that it would be appropriate to seek ways in which excess resources could be redistributed to members. Doing so would preserve the logic of the linkage between income sources and expenditure categories, and would reassure those who consider that accumulation of excess resources by the Fund cannot be justified.



## Appendix 1

### Income Options Proposed by the Committee

Description	Key Assumptions	Additional Potential Annual Income
<p><b>1. Investment operations<sup>1</sup></b></p> <p><i>a. Broaden investment mandate for existing reserves</i> Extend portfolio duration beyond current 1-3 year benchmark index, and expand the universe of instruments in which the Fund may invest, in line with the policy followed by the MDBs.</p> <p><i>b. Use of quota resources for investment</i> Utilize quota resources subscribed by members to invest in marketable securities (similar to current use of quota resources in the Financial Transactions Plan, but for investment rather than lending operations).</p>	<ul style="list-style-type: none"> <li>▪ Additional investment return of 50 basis points.</li> <li>▪ Investment of 10 percent of quotas (about SDR 20 billion), with an incremental return (above cost of financing) of 50 basis points under current investment mandate to 100 basis points under a broadened mandate.</li> <li>▪ Cost of financing would be the SDR interest rate.</li> </ul>	<p>SDR 30 million</p> <p>SDR 100–200 million</p>
<p><b>2. Endowment</b></p> <p><i>Gold sales</i> Sales of gold acquired after the Second Amendment, i.e., 400 metric tons (12.9 million ounces) and investment of the proceeds.</p>	<ul style="list-style-type: none"> <li>▪ Average selling price of \$500<sup>2</sup> per ounce of gold and a real investment return of 3 percent.</li> </ul>	<p>SDR 130 million</p>
<p><b>3. Charging for services</b></p> <p>Charging for services provided directly to members.</p>	<ul style="list-style-type: none"> <li>▪ Impact on demand from the introduction of charges and the amount of donor contributions for low-income countries are uncertain.</li> </ul>	<p>Uncertain, but likely to be modest.</p>
<p><b>4. Re-imbursement of PRGF-ESF Trust expenses</b></p> <p>Eliminate Board waiver on reimbursement to the GRA for the costs of administering PRGF-ESF operations.</p>	<ul style="list-style-type: none"> <li>▪ Expenses currently borne by the Fund reimbursed from the PRGF-ESF Trust.</li> </ul>	<p>SDR 60 million</p>

<sup>1</sup> An amendment of the Fund's Articles would be required to (a) expand the universe of instruments in which the Fund may invest, in line with the policy followed by the MDBs, and (b) invest quota resources subscribed by members.

<sup>2</sup> Based on a two-year average using World Gold Council prices (London pm quotes) calculated in October 2006.

## **Appendix 2**

### **Terms of Reference for Committee of Eminent Persons To Study Sustainable Long-Term Financing of the IMF**

#### **I. Background**

1. The IMF relies primarily on the income from its credit operations associated with crisis resolution to meet the costs of running the Fund. This financing model has generated adequate income in the past, but only in an environment of significantly higher Fund credit than at present. It also implies heavy reliance on the charges paid by borrowing countries to finance the broad range of activities of the Fund.
2. The Fund welcomes the recent reduction in Fund credit as a sign of success in its core mandate to promote global financial stability and crisis prevention. But the associated drop in income also points to the need for the Fund to broaden its income base. As noted in the Managing Director's Review of the Fund's Medium Term Strategy (MTS), the Fund must secure a predictable and stable source of income to finance its central role in the global financial system, including its surveillance activities and provision of technical assistance.
3. The Fund's Executive Board agreed in March of this year on a two-pronged strategy to adapt the Fund's financing model to changing circumstances and future needs. First, to meet the immediate financing needs for FY 2007, it agreed on a package of measures, including notably establishment and activation of the Investment Account, a pause in the accumulation of reserves, and the use of the Fund's existing reserves to meet remaining income shortfalls, together with continued budgetary restraint.
4. The second and more critical long-term aspect of the strategy is to ensure a lasting and sustainable solution to the institution's income needs. The approach was endorsed by the Fund's International Monetary and Financial Committee (IMFC) at its April meeting this year, when it requested that the Managing Director develop proposals for more predictable and stable sources of income.

#### **II. The Current Income Model**

5. The current income model, which has been in place since 1981, operates on a cost-plus basis. Under this rules-based system, the basic rate of charge on credit outstanding has been set at the start of each financial year at the level needed to cover the Fund's funding and operating costs, and generate a "net-income target" of five percent of reserves. Apart from the income earned on the Fund's reserves (SDR 6 billion), which were recently invested in a separate Investment Account, the main source of income has been the charges and fees on Fund credit financed from the General Resources Account. The Fund's credit to its low-income country members takes place largely through a separate trust (the PRGF-ESF Trust) at subsidized interest rates and does not contribute to the Fund's income (though, under current decisions, the expenses associated with these activities are part of the Fund's running costs).

6. Since 1997, the Fund also levies surcharges above the basic rate of charge on large balances (in excess of 200 percent of quota) and credit under the Supplementary Reserve Facility (SRF). Until the current year, income from surcharges has not been used to meet the Fund's running costs, but added directly to reserves.

7. The current model therefore relies mainly on the income derived from credit operations associated with crisis resolution to (i) meet funding costs, (ii) cover the expenses of running the Fund, including its surveillance activities and provision of technical assistance, and (iii) build up reserves. This financing mechanism is not tenable in a low-credit environment.

8. Measures to establish a more robust and diversified income base need to be identified. The Fund is severely restricted in its financing activities by its Articles of Agreement. Unlike other international financial institutions, the Fund can use its quota resources only for balance of payments adjustment credit. The other main asset of the Fund, substantial gold holdings, can be used but only in very limited circumstances and subject to an approval by an 85 percent majority of the total voting power. The development of new financing sources will thus require near unanimous support among the membership.

### **III. The Committee**

9. Against this background, the Managing Director is establishing a committee of eminent persons. The Committee will consist of Mohamed A. El-Erian, Alan Greenspan, Tito Mboweni, Guillermo Ortiz, Hamad Al-Sayari, Jean-Claude Trichet, Zhou Xiaochuan, and will be chaired by Andrew Crockett.

10. The main task of the committee will be to identify and assess the full range of options available and to make specific recommendations for one or more income models that generate sustainable long-term financing of the Fund's running costs. The focus of the committee will be on longer-term changes to the way the Fund finances its core activities, such as surveillance and capacity building, within the evolving framework of its principal lending operations. The committee will work under the assumption that the Fund's medium-term running costs are defined by its mandate under the MTS, which envisages a decline in real expenditures over the next three years. On the whole, any new income model will need to provide a predictable and stable source of income and accommodate the Fund's costs.

11. Important issues that the committee is invited to address include:

- a. The effectiveness and desirability of the current linkages between income and expenditure;
- b. The extent to which the Fund should rely on its credit operation activities to cover its running costs and accumulate reserves;
- c. The available options for alternative sources of income to help meet the Fund's running costs, including:

- ⇒ Whether the Fund should sell part of its gold holdings and invest the proceeds to generate income that could be used to fund its activities;
- ⇒ The scope for generating income from the Fund's non-lending activities;
- ⇒ The desirability of introducing periodic mandatory assessments on the membership in proportion to quotas;
- ⇒ The possibility of drawing on the Fund's quota resources to generate investment income; and
- ⇒ Whether new financial structures should be considered and what amendments to the existing framework would be required.

12. The Committee's recommendations, which will need the endorsement of the Executive Board and the Board of Governors, should take into account the need to obtain broad support among the Fund's membership for changes to the existing financing model. The Committee is expected to present its report to the Managing Director before the end of the first quarter of 2007. The Committee's work will be supported by Fund staff.

### Appendix 3

#### **Members of the Committee and their alternates**

- Andrew Crockett (Chairman) *Daniel Zelikow*  
*Nicole Genberg*
- Mohamed A. El-Erian *Karen Parker Feld*
- Alan Greenspan
- Tito Mboweni *Jason Milton*
- Guillermo Ortiz *Javier Guzmán Calafell*
- Hamad Al-Sayari *Abdullah Alhmeed*
- Jean-Claude Trichet *Boris Kisselevsky*
- Zhou Xiaochuan *Zheng Wufu*

The Committee would like to thank the IMF staff for its support in preparing background documentation and analysis, as well as the appendices. Key staff members include:

- Michael G. Kuhn Director, Finance Department
- Sean Hagan General Counsel and Director, Legal Department
- Masood Ahmed Director, External Relations Department
- Andrew Tweedie Deputy Director, Finance Department
- Hector Elizalde Deputy General Counsel, Legal Department
- Chris Hemus Division Chief, Finance Department
- Rhoda Weeks-Brown Assistant General Counsel, Legal Department
- George Kabwe Senior Accountant, Finance Department

The Committee would also like to thank the BIS and the Reserve Bank of Australia for their logistical support in arranging for the Committee's meetings.

## Appendix 4

### **Projected Income Sources and Uses (FY2007–FY2010)**

(In millions of SDRs, except where indicated)

	FY2007	FY2008	FY2009	FY2010
<b>A. Income sources</b> 1/	<b>590</b>	<b>535</b>	<b>510</b>	<b>451</b>
Margin for the rate of charge (108 basis points)	137	93	82	60
Surcharges	98	64	56	27
Service charge (50 basis points on purchases) 2/	21	10	--	--
Investment and other income 3/	334	368	372	364
<b>B. Administrative and capital expenses</b> 4/	<b>659</b>	<b>659</b>	<b>674</b>	<b>696</b>
Administrative budget	608	619	635	655
Capital and depreciation expense	51	40	39	41
<b>C. Income surplus/shortfall (A-B)</b>	<b>-69</b>	<b>-124</b>	<b>-164</b>	<b>-245</b>
<u>Memorandum Items:</u>				
Fund credit outstanding (average in SDR billions)	12.7	8.7	7.6	5.5
SDR interest rate path (in percent)	3.9	4.4	4.5	4.6

1/ Updated for advance repayments through November 30, 2006.

2/ Includes commitment fees, which are refundable (if purchases are made) so income is only generated if phased purchases are not made.

3/ Comprises Investment Account income and the implicit return on the Fund's interest-free resources (primarily the SCA-1); over the medium term, the positive effect of rising interest rates is offset by the financing cost of absorbing the income shortfalls.

4/ Assumes the FY08-09 administrative and capital expenditures remain consistent with the medium-term budget, and assumes a U.S. dollar/SDR exchange rate of 1.50 for FY08–FY10.

NB: Table provided by the IMF Staff.

## Appendix 5

### The Fund's Output Costs

#### Background

1. This note provides information on the allocation of the Fund's administrative expenditures to specific Fund activities, including technical assistance.
2. All expenditures authorized under the administrative budget are allocated to the delivery of specific outputs using the Fund's financial information systems.<sup>1</sup> The need to develop mechanisms that assess the costs of delivering the Fund's various outputs was first identified in an external evaluation of the Fund's budgetary practices in 2000–2001. The reform program then outlined, and subsequently progressively implemented, focused on a shift toward a medium-term and output-oriented budget framework, that would enable the prioritization of activities, within an overall strategy for the Fund.
3. A comprehensive framework for allocating the costs of service delivery, support services, and governance both to outputs and by country, regional, or global recipient (see Box 1) is now in place. Some further refinements, however, to deepen the granularity, and to improve the precision, of the cost allocation system are underway.

#### **Box 1. Classification of the Fund's Expenditures by Purpose**

**Service delivery costs** are those incurred directly in the delivery of the Fund's outputs—global monitoring, country specific and regional monitoring, country program and financial support, and capacity building.

**Support costs** are those associated with the provision of administrative and management support to the delivery of the Fund's outputs or the administration of the Fund. Examples include human resources services, corporate legal services, administration of the payroll, and accounting operations.

**Governance costs** are defined as all costs of the Board of Governors, the Office of Executive Directors, the Managing Director and the Deputy Managing Directors, the Independent Evaluation Office, and the Secretary's Department.

4. The starting point for the allocation of costs to outputs is the classification of the Fund's activities into four key output areas (KOAs)—global monitoring, country specific and regional monitoring, country program and financial support, and capacity building—a

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<sup>1</sup> The IMF financial year runs from May 1 to April 30; FY 2005 refers to the 12 months ending April 30, 2005.

classification, which was most recently reviewed and revised in FY 2006.<sup>2</sup> The four KOAs are then broken down into 12 constituent outputs which can be further subdivided into output components.<sup>3</sup>

5. The assignment of administrative expenditures authorized by the annual budget to the individual outputs (and by aggregation to the four KOAs) is undertaken as follows:

- **Personnel expenditures** (salaries and staff benefits) incurred on staff, expert, and contractual time. These expenditures account for over 70 percent of administrative expenditures and therefore staff time is a significant input to the cost allocation system. Staff time involves delivery of the specific 12 outputs (i.e., service delivery), support services, and governance as described in Box 1. A new Time Reporting System (TRS) was introduced in FY 2005.
- **Travel expenditures** are coded under the Travel Information Management System (TIMS), with each code uniquely tied to a service delivery output, support services, or governance.
- **Buildings and other expenditures.** A coding system is used to allocate these expenditures, where possible, to the direct delivery of the 12 outputs or to governance; the remainder is classified as expenditures on support services and allocated on a broad per staff/contractual employee basis.

6. Staff (including contractual) costs plus associated travel directly linked to service delivery (i.e., excluding support and governance) account for some two thirds of total administrative expenditures. Like most such cost allocation systems, however, the greater challenge lies not in measuring or allocating these direct variable costs, but in the identification and assignment of support and governance costs to specific outputs.

7. A number of further refinements are currently under development. They are, however, not expected to make a significant difference to the percentage share figures presented in the tables below. These refinements include:

- a more precise allocation of certain support costs to outputs;
- establishing and allocating governance costs (some 9 percent of total administrative expenditures) to outputs;

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<sup>2</sup> The Fund's outputs were originally structured into five categories: policy development, research, and operation of the international monetary system; standard setter/provider of standardized information; bilateral and regional surveillance; use of Fund resources; and capacity building services.

<sup>3</sup> A more detailed description of the cost allocation methodology and of the new output classification can be found on the IMF website. See *The FY 2007–FY 2009 Medium-Term Administrative and Capital Budgets*, available at <http://www.imf.org/external/np/pp/eng/2006/033106.pdf>



- strengthening the underlying financial, human resource, and budget IT infrastructure, through the introduction of a new Enterprise Data Warehouse approach, that will be operational for the next financial year; and
- adding codes to capture new activities (for example to capture the cost of new initiatives under the Medium-Term Strategy).

### Allocating the FY 2006 Administrative Expenditures by Output

8. Table 1 presents the allocation of the Fund's FY 2006 administrative expenditures by the four key output areas and the 12 constituent outputs—this is the current standard presentation of administrative expenditures incurred in delivering the Fund's outputs.<sup>4</sup>

Table 1. FY 2006 Administrative Expenditures Outturn by Output: IMF Classification  
(In millions of dollars)

Key Output Areas and Outputs	Total	Percent
<b>Global Monitoring</b>	<b>128.5</b>	<b>13.8</b>
Oversight of the international monetary system	31.4	3.4
Multilateral surveillance	27.2	2.9
Cross-country statistical information and methodologies	30.0	3.2
General research	13.9	1.5
General outreach	26.1	2.8
<b>Country specific and regional monitoring</b>	<b>281.7</b>	<b>30.3</b>
Bilateral surveillance	221.7	23.8
Regional surveillance	18.5	2.0
Standards and codes and financial sector assessments	41.4	4.5
<b>Country programs and financial support</b>	<b>220.6</b>	<b>23.7</b>
Generally available facilities	130.7	14.0
Facilities specific to low-income countries	90.0	9.7
<b>Capacity Building</b>	<b>213.7</b>	<b>23.0</b>
Technical assistance	175.8	18.9
External training	37.9	4.1
Total excluding governance	844.5	90.8
Governance	85.8	9.2
Total administrative expenditures (on a gross basis)	930.3	100.0

Source: Office of Budget and Planning.

<sup>4</sup> Because the output structure was revised in FY 2006, data for earlier years are only comparable at the KOA/primary output level.

9. Table 2 provides an alternative breakdown of administrative expenditures that corresponds to a classification based on the Articles of Agreement. Table 3 presents the breakdown of administrative expenditures as requested by the Committee. Specifically:

- Table 2 presents gross administrative expenditures divided into three categories, that correspond to the three broad groups of activities authorized for the Fund under its Articles of Agreement. Surveillance outputs relate to activities that are mandatory for the Fund and member countries under Article IV of the Articles of Agreement. The category General Resources Account (GRA) lending activities covers the provision of credit mainly to middle-income member countries, using resources in the GRA. Expenditures authorized under Article V, Section 2 (b) cover other financial and technical services that the Fund provides on a voluntary basis mainly to members.
- Table 3 provides a different classification of expenditures that is as close as possible to the three categories of Fund activities, identified in the Committee's information request (i.e., "public goods, credit intermediation, and bilateral services").

Table 2. FY 2006 Administrative Expenditures Outturn by Output:  
Classification Based on the Articles of Agreement  
(In millions of dollars)

Key Output Areas and Outputs	Total	Percent
<b>Surveillance</b>	<b>368.8</b>	<b>39.6</b>
Oversight of the international monetary system	31.4	3.4
Multilateral surveillance	27.2	2.9
Cross-country statistical information and methodologies	30.0	3.2
General research	13.9	1.5
General outreach	26.1	2.8
Bilateral surveillance	221.7	23.8
Regional surveillance	18.5	2.0
<b>GRA Lending</b>	<b>130.7</b>	<b>14.0</b>
Generally available facilities	130.7	14.0
<b>Article V. 2(b)</b>	<b>345.1</b>	<b>37.1</b>
Technical assistance	175.8	18.9
External training	37.9	4.1
Facilities specific to low-income countries	90.0	9.7
Standards and codes and financial sector assessments	41.4	4.5
Total excluding governance and outreach	844.6	90.8
Governance	85.8	9.2
Total administrative expenditures (on a gross basis)	930.3	100.0

Source: Office of Budget and Planning.

Table 3. FY 2006 Administrative Expenditures Outturn by Output:  
Committee's Proposed Classification  
(In millions of dollars)

Key Output Areas and Outputs	Total	Percent
<b>Public goods</b>	<b>410.1</b>	<b>44.1</b>
Oversight of the international monetary system	31.4	3.4
Multilateral surveillance	27.2	2.9
Cross-country statistical information and methodologies	30.0	3.2
General research	13.9	1.5
General outreach	26.1	2.8
Bilateral surveillance	221.7	23.8
Regional surveillance	18.5	2.0
Standards and codes and financial sector assessments	41.4	4.5
<b>Credit intermediation</b>	<b>220.6</b>	<b>23.7</b>
Generally available facilities	130.7	14.0
Facilities specific to low-income countries	90.0	9.7
<b>Bilateral services</b>	<b>213.7</b>	<b>23.0</b>
Technical assistance	175.8	18.9
External training	37.9	4.1
Total excluding governance	844.5	90.8
Governance	85.8	9.2
Total administrative expenditures (on a gross basis)	930.3	100.0

Source: Office of Budget and Planning.

10. With respect to the classification in Table 2, it should be noted that Article V, Section 2 (b) covers a very broad and diverse range of activities. In particular, in addition to capacity building services (i.e., technical assistance and training), this category also includes (i) assessments of members' observance of standards and codes in various areas, including under the Financial Sector Assessment Program (FSAP); and (ii) most of the Fund's lending and other financial assistance to low-income members (i.e., PRGF-ESF, HIPC and MDRI).

11. More generally, the classification presented in Table 2 (i.e., pursuant to the Articles) provides a framework for assessing the approaches to the financing of administrative expenditures, that would be permissible under the current Articles. Thus, for example, the Fund could not charge members a fee for surveillance activities under Article IV, as it is mandatory for both the Fund and the member that these activities be carried out. Further, while differentiations could be made, for example, as to the group of members that could be required to pay for voluntary services under Article V, Section 2 (b), or as to the categories of services for which members would be required to pay, any such differentiation cannot be

discriminatory, but rather must be on the basis of criteria that are relevant to the particular services.

12. From a policy perspective, the bilateral services provided by the Fund also contain public good elements. The clearest example is the Fund's work on standards and codes and FSAPs, which is a bilateral service, but considered a public good under the Committee's classification. Similarly, technical assistance provided to members has public good elements, particularly to the extent that they complement the Fund's surveillance activities.

### **Receipts**

13. The Fund receives financing from external parties that help cover its administrative expenditures. In FY 2006, the Fund received close to \$60 million of such financing, which covered around 6.5 percent of gross administrative expenditures of \$930 million. Over half of these receipts comprise donor financing for technical assistance. The remainder relates to user fees (e.g., for publications), reimbursements for specific services (e.g., jointly provided library services with the World Bank), and other miscellaneous income categories. The Fund also receives additional contributions in kind (e.g., office space) in some of its overseas offices, regional training centers, and resident representative posts.

### **Longer-Term Cost Projections**

14. In April 2006, the Board approved a net administrative budget for the Fund for FY 2007 and indicative net administrative budgets for FY 2008 and FY 2009.<sup>5</sup> These net budgets are predicated on a budget policy of zero-real growth for FY 2007 and 1 percent real reductions—with the nominal aggregates set by reference to an external deflator—in each of FY 2008 and FY 2009. If the difference between movements in the external deflator and in the Fund's own costs follows recent patterns, it is likely to have the effect of squeezing the real administrative resource envelope by a further 0.5–1 percent each year.

15. Projections of cost by major categories of expenditure (see Annex I) are input-driven and there is currently no forward looking assessment of the budgeted expenditure by output. Work is underway to see how far the next rolling medium-term budget, which will cover the FY 2008–FY 2010 period, can be formulated on a more output-oriented basis.

### **Technical Assistance**

16. The resource allocation plan (RAP) is the principal mechanism used by area and functional departments to allocate and prioritize TA resources across countries and policy

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<sup>5</sup> Under the medium-term budget framework introduced this year, the Executive Board approves a net budget and a limit on gross administrative expenditures based on an upper estimate for receipts. The focus on the net vis-à-vis the gross expenditures was introduced to strengthen the link between the administrative budget and its financing through the Fund's operational income.

initiatives. Table 4 shows TA resource allocation and delivery in FY 2006 and projections for FY 2007. The bulk of TA is delivered by Fund staff, but some 26 percent of field delivery is provided by experts hired on a contractual basis for short- or long-term assignments. The data are based on time spent by staff and experts on TA activities at headquarters and in the field, including time spent on direct administration and management of TA (which accounts for about one-third of the total administrative costs of TA).

17. In FY 2006, 429 person-years of TA were delivered; a figure of some 444 person-years is projected for FY 2007. External donors financed some 50 percent of total TA delivery in the field in FY 2006. More than 80 percent of the Fund's TA is directed at low-income and lower-middle-income countries.

Table 4. Technical Assistance Resources and Delivery (FY 2006–2007)  
(In person-years)<sup>1</sup>

	FY 2006	FY 2007 <sup>2</sup>
<b>IMF technical assistance budget</b>	<b>341.1</b>	<b>335.9</b>
Staff	258.7	257.1
Headquarter-based consultants	23.7	27.7
Field experts	58.7	51.1
<b>External technical assistance resources</b>	<b>88.1</b>	<b>108.5</b>
UNDP	5.0	8.2
Japan	45.6	54.0
Other co financiers	37.6	46.3
<b>Total technical assistance resources</b>	<b>429.2</b>	<b>444.4</b>
<b>Technical assistance regional delivery</b>	<b>290.9</b>	<b>305.3</b>
Africa	82.7	92.8
Asia and Pacific	59.8	63.4
Europe	37.3	35.3
Middle East and Central Asia	56.3	58.7
Western Hemisphere	40.5	43.3
Regional and interregional	14.4	8.2
Reserve	...	3.6
<b>Technical assistance management and administration</b> <sup>3</sup>	<b>138.3</b>	<b>139.1</b>
<b>Total technical assistance delivery</b>	<b>429.2</b>	<b>444.4</b>
<b>Total technical assistance delivery by Fund department</b>	<b>429.2</b>	<b>444.4</b>
Fiscal Affairs Department	100.2	105.3
Monetary and Financial Systems Department	125.7	117.7
Statistics Department	54.3	60.4
IMF Institute	80.7	80.7
Legal Department	20.0	35.3
Other <sup>4</sup>	48.3	45.1

Source: IMF Office of Technical Assistance Management.

1/ A person-year of technical assistance represents 260 days.

2/ FY 2007 figures are projections.

3/ Indirect technical assistance, including technical assistance policy, management, evaluation, and other related activities.

4/ Includes the Policy Development and Review Department, the Technology and General Services Department, the International Capital Markets Department, the Office of Technical Assistance Management, the Finance Department, the Human Resources Department, and all area departments.

NB: Appendix prepared by the IMF staff.

Table 5. Gross and Net Administrative Budget by Major Expense Category, FY2006-FY2009  
(In millions of U.S. dollars)

	FY 2006				FY 2007				FY 2008				FY 2009			
	Budget	Percent Share	Outturn	Percent Share	Projection	Percent Share	Percent increase Budget to Outturn to Budget	Projection	Percent Share	Percent increase Budget to Budget	Projection	Percent Share	Percent increase Budget to Budget	Projection	Percent Share	Percent increase Budget to Budget
I. Personnel 1/	658.6	70.3	666.6	71.7	696.0	71.0	5.7	4.4	722.6	72.2	3.8	744.4	72.6	3.0		
Salary	394.7	42.1	392.6	42.2	404.3	41.2	2.4	3.0	420.6	42.1	4.0	429.4	41.8	2.1		
Benefits and Other Personnel Expenditures 2/	263.9	28.2	273.9	29.4	291.7	29.8	10.5	6.5	302.0	30.2	3.5	315.0	30.7	4.3		
II. Travel	99.4	10.6	94.2	10.1	99.4	10.1	0.0	5.5	101.9	10.2	2.5	104.4	10.2	2.5		
III. Building and Other Expenses	177.9	19.0	169.6	18.2	178.8	18.2	0.5	5.4	172.8	17.3	-3.4	172.2	16.8	-0.3		
IV. Contingencies/ Planning Reserve	1.0	0.1		0.0	1.0	0.1			3.0	0.3	200.0	5.0	0.5	66.7		
V. Annual Meeting					5.0	0.5										
Gross Budget	937.0	100.0	930.3	100.0	980.2	100.0	4.6	5.4	1,000.3	100.0	2.1	1,026.0	100.0	2.6		
VI. Receipts	-60.9	...	-56.0	...	-68.3	...	12.1	21.9	-70.7	...	3.5	-73.2	...	3.5		
Net Budget	876.1	...	874.4	...	911.9	...	4.1	4.3	929.6	...	1.9	952.8	...	2.5		

Source: Office of Budget and Planning.

1/ The personnel expenditures are adjusted for variations in the number of working days each year. In a normal year there are 260 working days. There are 261 days in FY 2007 and 263 days in FY 2008. FY 2009 is a normal year.

2/ The estimates for FY 2007 include \$5 million for staff restructuring. This expenditure is assumed not to recur in FY 2008 and FY 2009.

## **Appendix 6**

### **Accounting Implications and Potential Income from Sale of Gold Acquired after the Second Amendment**

Gold acquired after the Second Amendment amounts to 12,965,649 ounces (403 metric tons) compared to total IMF holdings of 103,439,916 ounces (3,217 metric tons). This gold, with an average cost of SDR 207 per ounce and thus a total book value of SDR 2,685 million, comprises 12,944,253 ounces from the 1999–2000 off-market gold transactions with Mexico and Brazil and 21,396 ounces from Cambodia accepted in payment of overdue obligations in 1992.

There are important differences both under the Fund’s Articles of Agreement and for the Fund’s balance sheet between the sale of gold held by the Fund on the date of the Second Amendment and gold acquired by the Fund after that date.

- Profits from sales of gold acquired after the Second Amendment can be realized directly in the General Resources Account (GRA). As part of net income, it could be placed to reserves and an equivalent amount of currencies could be transferred from the GRA to the Investment Account, thus broadening the Fund’s investment and income base. Profits from sale of gold held at the Second Amendment must be placed to the Special Disbursement Account (SDA), but could be invested and transferred to the GRA for “immediate use” in operations and transactions.
- Post-Second Amendment gold is not subject to “restitution” at the Second Amendment price of SDR 35 per ounce. This is because, under the Articles, the restitution option is only available for the sale of pre-Second Amendment gold to countries that were Fund members at the time of the Second Amendment—reflecting the fact that this gold is derived mainly from quota payments that had been made by these members.
- Sales of post-Second Amendment gold would automatically reverse the balance sheet effects that resulted from the Fund’s receipt of this gold in lieu of currencies.<sup>1</sup> Sales of pre-Second Amendment gold would not have such an automatic effect since, as noted above, the profits of such sales would need to be placed to the SDA and could only be transferred to the GRA for immediate use in operations and transactions.

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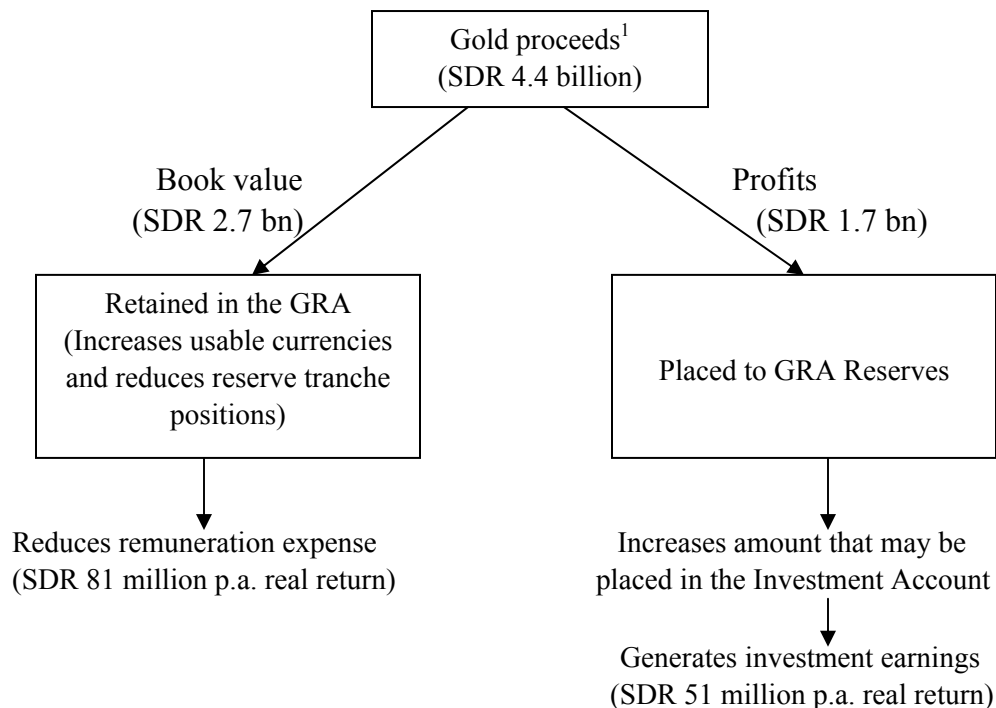
<sup>1</sup> Excluding capital gains, such a sale would increase the Fund’s holdings of currencies in the GRA to where they would have been had the Fund not received the post-Second Amendment gold, which in turn would commensurately lower members’ reserve tranche (restoring them to where they would have been but for the Fund’s receipt of this gold) and the Fund’s remuneration expense. Capital gains (profits) from gold sales would also temporarily increase the Fund’s currency holdings and reduce members’ reserve tranche positions, pending eventual transfer to the Investment Account.



- Limiting sales to gold acquired after the Second Amendment is a natural form of ring-fencing. The amounts comprise a small portion of the Fund's total gold holdings, which also helps minimize the impact on the gold market owing to the relatively modest amount of sales.

Sales of the 403 metric tons of gold acquired after the Second Amendment could generate annual income in the order of some SDR 130 million, assuming a gold price of \$500 and a 3 percent real investment return. The income would arise from two sources: (i) reduced remuneration costs as a result of lower reserve tranche positions, as discussed above, and (ii) income following transfer to the Investment Account of currencies equal to the gold profits (excess of gold price over the book value of SDR 207 per ounce). See Figure 1 below.

Figure 1. Sale of Gold Acquired after the Second Amendment (403 metric tons)



<sup>1</sup> Assumes sale of 12.9 million ounces (403 metric tons) of gold at US\$500 per ounce and real investment returns of 3 percent.

The table below summarizes the effect on the Fund's balance sheet.

Table 1. Balance Sheet Effect of Gold Sales at US\$500 per ounce  
(in SDR billions)

	Assets			Equity/1
	Gold Holdings	Usable Currencies	Investment Account	GRA Reserves
Gold sales	-2.7			
Sale proceeds:				
Corpus		+2.7		
Profits		+1.7		+1.7
Transfer to the Investment Account		-1.7	+1.7	
<b>Net changes to the balance sheet</b>	<b>-2.7</b>	<b>+2.7</b>	<b>+1.7</b>	<b>+1.7</b>

/1 GRA reserves comprise the Fund's retained earnings and in an accounting sense are akin to equity or capital.

NB: Appendix prepared by the IMF staff.