INTERNATIONAL MONETARY FUND

# Use of Gold Sale Profits—Initial Considerations and Options

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## Executive Summary

**In December 2010, the Fund concluded the limited gold sale (403 metric tons) approved by the Board in September 2009**. The main purpose of the sale was to generate profits to fund an endowment that would diversify the Fund's income sources away from lending income. In addition, the Board agreed in July 2009, before approving the sale, to a strategy pursuant to which resources linked to the gold sale would contribute to boosting the Fund's concessional lending capacity.

**Total profits from the gold sale were SDR 6.85 billion**. The profits significantly exceeded those assumed in April 2008 when agreement was reached on the key features of the new income model, and in July 2009 at the time of the discussions on a financing package to support reform of the Fund's concessional lending activities. This reflects the substantial increase in the market price of gold throughout the period of the gold sales.

**With the gold sale complete, it is timely for the Board to revisit the issues relating to the use of the profits**. This paper seeks to provide a basis for initial Board consideration of this topic. It focuses primarily on the options for use of the windfall profits above a price of US$935 per ounce, which was the average price required to generate resources for the endowment at the assumed gold price underlying the new income model and to implement the agreed strategy to provide SDR 0.5–0.6 billion in resources linked to gold sales as part of the 2009 concessional financing package. These windfall profits are about SDR 1.75 billion.

**The paper identifies three broad options for use of the windfall profits**: These include an active policy that would boost the Fund's capacity to assist low-income countries (LICs), or alternatively, under a more passive approach, the Fund could leave the profits in the Investment Account (IA) to further strengthen the Fund's financial position. The first option would be to use resources linked to the gold sale to narrow, if not close, the large projected gap in the Fund's capacity to assist LICs in future crises and periods of stress beyond 2014. This would involve the same distribution mechanisms as contemplated for the use of SDR 0.5–0.6 billion agreed in July 2009. A second option would be to keep the profits in the IA and count them towards precautionary balances to protect against financial risks, including increased credit risks. A third, and to some extent the default, option contemplated under the new income model discussions would be to add the profits to the IA gold endowment as a permanent part of the Fund's financing structure to help ensure a sustainable and diversified income base.

**The above options are not mutually exclusive**. Different combinations are possible, including adding the windfall to precautionary balances initially given the heightened uncertainties over the impact on the Fund's balance sheet of crisis-related lending, but with a view to subsequently using related resources to boost the Fund's concessional lending capacity once these uncertainties have abated.

**Several other options are also considered**. These include building on previous decisions by providing additional interest relief on Poverty Reduction and Growth Trust (PRGT) credits or augmenting the Post-Catastrophe Debt Relief (PCDR) Trust. Other possibilities for using resources linked to the gold sale in support of LICs are also briefly reviewed.

## I. Introduction

1. **This paper considers the use of profits from the Fund's limited gold sale**. The gold sale was completed in December 2010, and generated total profits of SDR 6.85 billion. The paper reviews the original rationale for the sale, and the discussions so far on use of the profits, including the establishment of a gold endowment—a central element of the Fund's new income model—and use of resources linked to the gold sale to boost the Fund's concessional lending capacity. Given that the gold sale generated additional windfall profits over and above those envisaged at the time of the earlier discussions, the main focus of the paper is on possible options for use of the remaining windfall profits.

2. **The paper is organized as follows**. Section II revisits the rationale for the gold sale and the agreements in place on use of the profits, and remaining decisions required to implement those agreements. Section III considers issues related to the use of the profits including possible options for use of the windfall, while Section IV concludes and provides issues for discussion. Based on Directors' views on these issues, staff would come back to the Board with specific proposals.

## II. Background

3. **In April 2008, the Executive Board endorsed the key features of a new income model for the Fund**. A central element of the new income model was the establishment of an endowment to be funded by the profits from a limited sale of gold.[1] This approach was based on the principles set out in the report of the Committee of Eminent Persons (CEP).[2] Under the new income model, the Fund would no longer rely primarily on lending to finance its diverse activities, and instead would have new and more robust sources of income, including an endowment funded by limited gold sales. As part of the new income model, the Board of Governors approved an amendment of the Articles in May 2008 to expand the investment authority of the Fund, which will allow the Executive Board to adopt new rules to establish an endowment.[3]

4. **The Executive Board held a series of discussions in the lead up to approval of the above amendment**. Directors supported the CEP proposal for a sale of Fund gold that would

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[1] See *Report of the Managing Director to the International Monetary and Financial Committee on a New Income and Expenditure Framework for the International Monetary Fund* (4/9/08).

[2] The Managing Director appointed the CEP in May 2006 to study the sustainable long-term financing of the Fund's running costs and make recommendations. See *IMF Managing Director de Rato Appoints Committee of Eminent Persons to Study Sustainable Long-Term Financing of IMF Running Costs*, Press Release No. 06/100 (5/18/06).

[3] Resolution No. 63-3 of the Board of Governors.

be strictly ring-fenced, and limited to the gold that the Fund had acquired since the Second Amendment of the Articles of Agreement (403 metric tons, or one-eighth of total holdings).[4] They also agreed that the profits would be placed in the IA and invested in an endowment with the objective of generating investment returns to contribute to the Fund's income while preserving their long-term value.

5. **Further discussions were held in 2009, when the Board agreed to use part of the resources linked to gold sales for assisting LICs during the global financial crisis**. This followed a request by the G-20 Heads of State at the London Summit that, consistent with the new income model, additional resources from the agreed gold sales be used to boost the Fund's concessional lending capacity, reflecting a broad international consensus that the Fund should sharply step up its financial assistance to LICs during the crisis. The financing package that was eventually agreed involved mobilizing resources to raise the Fund's concessional lending capacity to US$17 billion through 2014. This package included agreement on the use of resources linked to gold sales to generate subsidies of SDR 0.5−0.6 billion in end-2008 NPV terms.[5] It was agreed that, in the first instance, this strategy would involve the use of profits arising from gold sales at an average price above the US$850 per ounce assumed in the new income model.

6. **The gold sales were initiated in October 2009 and concluded in December 2010**.[6] The sales were conducted in line with modalities agreed by the Executive Board in September 2009 as part of the decision approving the sale, including strong safeguards to avoid causing disruption of the gold market. All sales were based on market prices. Following an initial period reserved exclusively for off-market sales to official holders, a phased on-market sale was initiated in February 2010. During the total period of the sales, market prices increased from less than US$1,000 per ounce to close to US$1,400 per ounce. As a result, the average price obtained of US$1,144 per ounce was significantly above the previous assumptions. The sale generated total proceeds of SDR 9.54 billion, of which SDR 2.69 billion represented the book value and SDR 6.85 billion represented the profits.

7. **Certain limited actions have been taken with respect to the gold profits to date, in line with the existing decisions**. In April 2010, the Board decided to place an amount of

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[4] This gold is treated separately in the Fund's accounts, i.e., it is not subject to the options provided in the Articles for the disposition of gold through restitution to countries that were members at the time of the Second Amendment at the price of SDR 35 per ounce. This different accounting and legal treatment provided a natural limit to the amount to be sold.

[5] See *IMF Reforms Financial Facilities for Low-Income Countries,* Public Information Notice No. 09/94 (7/29/09) and *IMF Announce Unprecedented Increase in Financial Support to Low-Income Countries*, Press Release No. 09/268 (7/29/09) and IMF Factsheet *Financing the Fund's Concessional Lending to Low-Income Countries*.

[6] See *IMF Concludes Gold Sales* Press Release No. 10/509 (12/21/10).

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the FY 2010 net income equivalent to the total profits earned from gold sales in FY 2010 of SDR 3.8 billion in the special reserve (which is the portion of the Fund's reserves that is not available for subsequent distribution).[7] This reflected an assumption that profits at least up to a price of US$850 per ounce will be placed in a permanent IA endowment to generate long-term income for the Fund. The FY 2010 gold sales profits were initially retained in the General Resources Account (GRA). Following the entry into force of the investment authority amendment on February 18, 2010, the total profits of SDR 6.85 billion were transferred to the IA on March 2, 2011, as required under the amendment, where they are being invested on an interim basis pursuant to the current IA rules and regulations pending the adoption of decisions related to the endowment. The placement to reserves and the transfer of the profits to the IA does not restrict the Board from taking future decisions on the use of the profits, but distributions to members from reserves can only be made from the general reserve.

## III. Use of the Gold Profits

8. **As noted, the Board has already considered the use of part of the gold profits**. This includes distribution of SDR 0.6–0.7 billion to generate the agreed PRGT subsidies of SDR 0.5–0.6 billion in end-2008 NPV terms.[8] The question arises as to whether that portion of profits in excess of the April 2008 assumed price of US$850 per ounce and the amount agreed for PRGT subsidies should be used for a purpose other than investment in the gold endowment.[9] These issues are addressed in turn before considering the options for using the windfall profits.

### A. Minimum Size of the Gold Endowment

9. **The current projections regarding the gold endowment are based on assumed profits at an average sales price of US$850 per ounce**. As discussed above, this was the price assumed when the new income model was agreed in April 2008, and was used subsequently for the purpose of defining windfall profits during the 2009 discussions on the LIC financing package, in the FY 2010 income discussions, and in the staff's latest estimates of the Fund's steady state income position. While the SDR equivalent has varied during this period depending on the US$/SDR exchange rate, staff's latest calculations (based on the weighted average exchange rate prevailing during the period of the gold sales) suggest that an endowment consistent with an average sales price of US$850 per ounce would be

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[7] See *Review of the Fund's Income Position for FY 2010 and FY 2011* (4/14/10).

[8] See *IMF Reforms Financial Facilities for Low-Income Countries,* Public Information Notice No. 09/94 (7/29/09).

[9] As noted when the key elements of the new income model were endorsed by the Executive Board in April 2008, assets of the IA derived from gold profits, like other GRA-derived assets in the IA, are transferable to the GRA for "immediate use" in the Fund's operations and transactions, including for immediate distribution to members pursuant to Article XII, Sections 6(a) and 6(c).

SDR 4.4 billion. It is envisaged that decisions to establish the endowment and allocate profits to it will be taken in the context of the adoption of the new rules and regulations to implement the expanded investment authority of the Fund, which are expected to be adopted in the coming months.

### B. Agreed Strategy Under the 2009 LIC Financing Package

10. **The agreed use of resources linked to gold proceeds was part of a broader financing package aimed at raising SDR 1.5 billion in PRGT subsidy resources**. Other elements of the package included the transfer of SDR 0.62 billion from the Reserve Account (RA), delaying the resumption of PRGT reimbursement to the GRA for three years (SDR 0.15–0.2 billion), and new bilateral contributions of SDR 0.2–0.4 billion all in end-2008 NPV terms. Significant progress has been made in mobilizing new bilateral contributions, with pledges so far totaling SDR 151 million from 22 members, and staff is continuing discussions with other members aimed at achieving the agreed goals. [10]

11. **Use of resources linked to gold sales to generate PRGT subsidies requires an indirect transfer mechanism**. Resources related to the gold sales profits would be distributed to members in proportion to quotas and those members would be requested to return the resources (or broadly equivalent amounts) as subsidy contributions.[11,12] It would be important to minimize the leakage in this process by seeking satisfactory assurances from members, prior to the distribution of any resources, that they will return the resources to the Fund as bilateral contributions.

12. **In earlier discussions, it was considered possible to limit the leakage to, say, 10 percent**. On this basis, the amount of the distribution of resources linked to gold proceeds was estimated at about SDR 0.6–0.7 billion in end-2008 NPV terms. Generating profits sufficient to cover this amount plus the original assumption for the gold endowment was estimated to require an average gold sales price of US$935 per ounce. Alternative options were also considered in the event that the gold sales price fell short of this level. These included allowing for transfers of income from the endowment or further delaying reimbursement to the GRA of the PRGT expenses.

13. **With the gold sale complete at an average price well above US$935 per ounce, the Board could now decide to proceed with the proposed decisions on a distribution and related transfers**. One consideration in this regard is the importance of not undermining

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[10] See *Update on the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Countries* (9/21/10).

[11] IMF Factsheet *Financing the Fund's Concessional Lending to Low-Income Countries* (9/15/10).

[12] Distributions to members can be made either as a distribution (reduction) of the general reserve (which requires a Board decision with a 70 percent majority of the total voting power) or distribution of net income determined at the end of a financial year (which requires a Board decision with a majority of total votes cast).

on-going efforts to mobilize new bilateral contributions in line with the SDR 0.2–0.4 billion target. Also, some of the options discussed below could involve an additional, larger distribution. Depending on the outcome of discussions on this paper, staff could come back to the Board with specific proposals.

## C. Options for the Use of the Remaining Windfall Profits

14. **Based on the above assumptions, the remaining windfall profits are estimated at SDR 1.75 billion.** Three broad options for use of the windfall are identified below. One option would actively make use of resources that are currently in the IA to boost the PRGT's capacity to assist LICs. The other two, more passive, options would retain the profits in the IA, at least for the time being, to further strengthen the Fund's financial position. Other possible uses are also identified, in case the Board wishes to explore any of these options further.

### Main Options for the Use of the Windfall Profits

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

15. **The 2009 LIC financing package more than doubled the Fund's concessional lending capacity through 2014, but this capacity would fall sharply thereafter**. As noted above, the agreed package aimed to support commitments during 2009–14 of US$17 billion, or SDR 11.3 billion, equivalent on average to about SDR 1.9 billion a year. This was consistent with the medium-term demand projections prepared at the time (demand was projected to be frontloaded, reflecting the impact of the crisis).[13] However, the PRGT's lending capacity would then drop sharply to SDR 0.7 billion after 2014 (equivalent to SDR 0.5 billion in constant SDR terms), based on the current envisaged strategy of subsidizing the Fund's concessional lending on a "self-sustained basis" through income on the resources of the RA, which currently stand at about SDR 4 billion.[14,15]

16. **Updated total demand projections for 2009–14 remain broadly unchanged, albeit with a less front-loaded commitment profile** (Table 1). New PRGT concessional lending commitments amounted to SDR 3.7 billion in 2009–10, and the latest projections point to demand of about SDR 2.0 billion for 2011. While this is somewhat below the earlier

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[13] See *The Fund's Facilities and Financing Framework for Low-Income Countries* (2/25/09).

[14] The Reserve Account would provide security to loan providers against PRGT credit risk, and income generated on the account would subsidize PRGT loans.

[15] The annual lending capacity of the self-sustained PRGT assumes that an eventual expansion of the investment authority over PRGT assets will help to generate an average margin of return of 90 basis points above projected levels for the derived 6-month SDR interest rate.

projections for 2009–11 made at the time of the reform,[16] the global outlook remains highly uncertain and LICs could be vulnerable to the impact of increased food and fuel prices in the near term. As a result, financing demand for 2012–14 is expected to be somewhat higher than projected earlier (by about SDR 0.4 billion a year), and thus the financing package approved by the Board in July 2009 still appears appropriate to cover medium-term needs.

**Table 1. Projections of Concessional Lending to LICs, 2009–14**

| Commitments | Actual annual average 2000–08 1/ | Actual 2009 | Actual 2010 | 2011 | 2012–14 | **Total 2009–14** |
|---|---|---|---|---|---|---|
| In billions of SDR | 0.7 | 2.5 | 1.2 | 2.0 | 5.7 | **11.3** |
| In billions of US$ 2/ | 1.0 | 3.7 | 1.8 | 3.0 | 8.5 | **17.0** |
| *Memorandum item: Projections at the time of the LIC reforms* | | | | | | |
| In billions of SDR | 0.7 | 2.7 | 2.7 | 1.5 | 4.5 | **11.3** |
| In billions of US$ 2/ | 1.0 | 4.0 | 4.0 | 2.3 | 6.8 | **17.0** |

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

2/ Assuming exchange rate of US$1.5 per SDR.

17. **However, staff projections suggest that longer-term demand would be well above the PRGT's capacity beyond 2014**. While inevitably subject to a high level of uncertainty, staff projections suggest that loan demand could average between SDR 1.1–1.9 billion a year through 2034, equivalent to SDR 0.9–1.4 billion in constant SDR terms (see Supplement).[17] These projections take into account several factors that are expected to reduce demand over time, including improved macroeconomic conditions in many LICs, increased demand for nonfinancing programs, more episodic use of Fund financial support, the winding down of the Heavily Indebted Poor Countries (HIPC) Initiative, the expanded use of PRGT/GRA blend arrangements, and graduation of countries from PRGT eligibility (although the latter will not have a significant effect on total demand until around 2024).[18] However, the projections also reflect several trends that go in the opposite direction, notably the growing size of LIC economies and greater exposure of LICs to shocks resulting from their continued integration into global goods and capital markets and the increased volatility of commodity prices, which is expected to raise demand for "shock mitigation" financing in stress periods.

[16] While a large majority of LICs used Fund resources, access levels were moderate in many cases, reflecting strong macroeconomic buffers prior to the crisis and a robust domestic policy response. See *Emerging From the Global Crisis: Macroeconomic Challenges Facing Low-Income Countries* (10/5/10).

[17] In 2010 SDRs, using a deflator of two percent to account for expected inflation.

[18] Also, more than half of the countries (most of them in Sub-Saharan Africa) currently eligible for concessional financing would likely still be PRGT eligible in 2035, given their very low per capita income levels (see Supplement for details).

18. **The PRGT's capacity would thus fall far short of what would be needed to help meet LICs' financing needs in future systemic crises or shock periods**. The current "self-sustained" concessional lending capacity of the PRGT would fall well below the lower bound of plausible longer-term demand projections. In relation to PRGT-eligible countries' GDP (taking into account expected graduations), the concessional lending capacity for 2015–24 would only be 29 percent of the historical lending volume (2001–10), and only 21 percent of projected lending during 2009–14. Moreover, as LICs are becoming increasingly exposed to global volatility, the variability of demand for IMF concessional financing will likely continue to rise, implying the need for a larger PRGT financing capacity for a given level of long-run average demand.

19. **Resources linked to the remaining windfall profits could be used to boost the capacity of the PRGT by over 50 percent**. This would require the same indirect transfer mechanism as discussed above for the existing SDR 0.5–0.6 billion commitment, under which a distribution would be made to the membership on the understanding that members would return broadly equivalent amounts as contributions to PRGT subsidies. It would again be important to minimize leakage by seeking satisfactory assurances from members, prior to the distribution of any resources, that they would return an equivalent amount of resources as contributions to the PRGT. Making the same assumption as above that contributions equivalent to 90 percent of the distribution are returned, the PRGT's self-sustained annual concessional lending capacity would increase to SDR 1.1 billion. This would be broadly adequate to meet the lower end of projected LIC demand for concessional loans during the period 2015–34, thereby reducing the potential need for the Fund to seek bilateral subsidy resources from members in the future.

**Option 2**: **Add the Windfall Profits to Boost Precautionary Balances**

20. **The sharp rise in Fund lending associated with the crisis has significantly increased its exposure to credit risks**. Precautionary balances play an important role in the Fund's framework for mitigating those risks and protecting the value of reserve assets that members place with the Fund. The Board last reviewed the adequacy of precautionary balances in September 2010.[19] At that time, most Directors considered it prudent to raise the indicative target for precautionary balances over the medium term to SDR 15 billion, while a few preferred to revisit this issue when the existing target of SDR 10 billion has been reached. Currently, precautionary balances are SDR 7.32 billion, well below the target.[20]

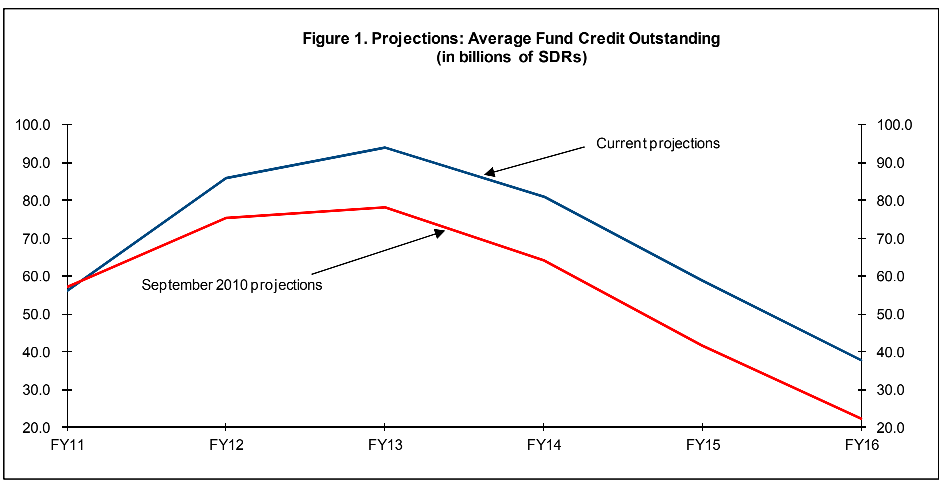
[19] See *Review of the Adequacy of the Fund's Precautionary Balances* (8/24/10).

[20] The FY 2010 gold profits placed in the special reserve were excluded from precautionary balances due to their envisaged use to fund an endowment to generate long-term income for the Fund. See *Review of the Fund's Income Position for FY 2010 and FY 2011* (4/14/10).

21. **Credit risks have increased further since the last review**. Total commitments now amount to SDR 171 billion, up from SDR 144 billion in September, and credit outstanding is projected to peak at SDR 94 billion compared with SDR 78 billion previously (Figure 1). Moreover, significant uncertainties remain about the potential size of future demand for Fund credit. In comparison, the latest projections for reserve accumulation under existing policies suggest that precautionary balances will not reach SDR 10 billion until FY 2013, while it would take until FY 2016 to reach the indicative target of SDR 15 billion.

22. **Adding the windfall profits to precautionary balances would significantly strengthen the Fund's reserves held to protect against credit and other financial risks**. The level of precautionary balances would increase by 24 percent to SDR 9.07 billion, and the current timetable for reaching the above targets would be brought forward by about one year. Such a move would be beneficial in current circumstances given the sharp increase in Fund credit and commitments outstanding, and the continued uncertainties over potential future demands.

23. **The option would entail placing (or retaining) amounts equivalent to these profits in the "reserves" or "non-endowment" portfolio of the IA and counting them towards precautionary balances**. No formal Board decision is required to count this portion of the gold profits as precautionary balances.




**Option 3**: **Add the Windfall to the Endowment**

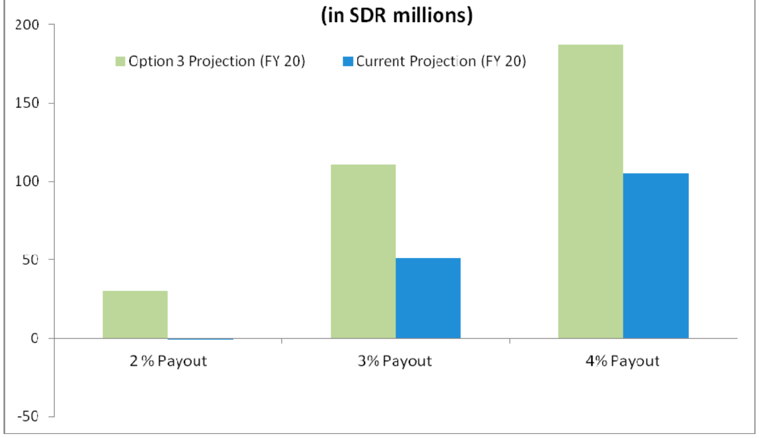
24. **The original discussions on the new income model envisaged that all the profits from the gold sale would be transferred to the endowment**. The amendment to expand the Fund's investment mandate already requires that all profits from the limited gold sales be transferred to the IA, and, as noted, this was done on March 2, 2011, following the entry into force of the amendment. No new Board decision regarding the use of the profits would be required to implement this option other than the already contemplated decisions to adopt the

requisite rules and regulations for the IA and place profits in the endowment portfolio (see below) (the Board would also need to decide as part of the upcoming decisions on the disposition of net income for FY 2011 whether to place income equivalent to the gold profits in FY 2011 to the special or general reserve). This could be viewed in some respects as the default option contemplated under the new income model discussions, though, as noted, the concept of a windfall profit was already recognized by the Board in the context of the 2009 discussions on the LIC financing package.

25. **This option would significantly boost the size of the endowment and provide a larger buffer to help ensure a sustainable and diversified income base**. Adding the remaining windfall to the endowment would increase its size by about 40 percent, from SDR 4.4 billion to SDR 6.1 billion. While higher crisis-related lending has substantially strengthened the Fund's near-term income position, current estimates of the steady state position (after lending income has fallen back to low levels) show a relatively modest positive income-expenditure position in the baseline scenario, which assumes an endowment funded with gold sale profits at an average price of US$850 per ounce and a pay-out ratio of 3 percent (consistent with the original projections prepared for the new income model in 2008). These estimates are subject to significant uncertainties, and are sensitive to assumptions regarding the level of interest rates, the US$/SDR exchange rate, and the rate of investment returns. At the recent discussion of asset allocation under a broadened investment mandate, Directors called for further work on the long-term return target for the endowment.

26. **Thus, while the Fund's steady state income position has not changed significantly since the new income model was agreed, there would be clear benefits from adding the windfall to the endowment**. When the new income model was agreed, staff projections suggested that the Fund's income-expenditure position would be in balance, but with little margin for adverse developments (including the risk of lower investment returns from the endowment). A modest buffer for such developments is now projected, and adding the windfall to the endowment would provide a larger buffer. This effect is illustrated in Figure 2, which compares estimates of the steady state position with an endowment of SDR 6.1 billion and SDR 4.4 billion, respectively, under alternative assumptions for the payout ratio.

**Figure 2. Steady State Net Operational Income (in SDR millions)**



27. **As noted, no new decisions would be required under this option** besides those already envisaged under the on-going work program for the Executive Board to formulate an investment strategy for, and adopt new rules and regulations to govern, the IA gold endowment. Decisions on these rules and regulations require a 70 percent majority of the total voting power. Pending these steps, the windfall profits are to be invested pursuant to the current IA rules and regulations (unless the Board were to decide to adopt a separate interim strategy for investment of the gold profits pending adoption of the endowment strategy). Separately, and as part of the upcoming decisions on the disposition of FY 2011 net income, the Board could also decide to transfer an amount equivalent to the full windfall profits to the special reserve, in line with the intended permanent nature of the endowment in the Fund's financing structure.

### Combination of the Three Main Options

28. **The above options are not mutually exclusive**. Different combinations could also be considered, for example, where part of the additional windfall was used to add to the endowment and the rest was used to boost the capacity of the self-sustained PRGT. Also, a decision to initially add the windfall to precautionary balances would not preclude a subsequent decision (which could also be signaled in advance) to use the same resources to boost the PRGT's lending capacity through the distribution and return mechanism once the current uncertainties over crisis-related GRA loan demands have abated. If it was decided to use part or all of the windfall to boost LIC financing capacity, this could be combined with the existing commitment through a single larger distribution once the required assurances from members are obtained. Such an approach could have advantages over a two-step decision, which would involve two separate distributions, and therefore two potentially protracted processes to obtain the needed assurances from members, who may in some cases need to obtain legislative approval.

### Other Potential Uses of the Windfall Profits

29. **Other options for using part of the windfall profits to assist LICs could also be considered, possibly combined with one or more of the above approaches**. These approaches, including the extension of interest relief and topping up the PCDR, would require use of the same indirect mechanism as discussed above for a transfer to generate PRGT subsidies. Possible options that would build on previous Board decisions are:

- ***Additional interest relief***: The financing package approved in July 2009 provided for interest relief on all PRGT credits through end-CY 2011 to provide exceptional support to LICs in the global crisis. Consideration could be given to extending the period of relief for a further 3 years to assist LICs in the context of significant uncertainties in the ongoing global recovery.[21] This additional relief, estimated at

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[21] Alternatively, a more systematic approach to interest relief could involve a policy that would trigger Board consideration of possible suspension of interest payments on PRGT credit in periods of systemic crises.

about SDR 70 million, could also be seen as a means of providing some additional assistance to LICs as the 2015 deadline for reaching the Millennium Development Goals (MDGs) approaches.[22]

- ***Replenish the resources available for PCDR***: The PCDR Trust was funded with an initial transfer of the surplus from the Multilateral Debt Relief Initiative (MDRI) Trust and, following provision of debt relief to Haiti, the balance in the PCDR Trust is now only SDR 102 million. At the time of approval of the PCDR Trust it was recognized that additional funding would be needed to ensure that the trust had adequate resources to deal with a future catastrophe, and this funding would need to be available before debt relief could be committed; "many Directors noted that it may be appropriate to consider options for facilitating members' contributions to the PCDR Trust using part of the profits from on-going gold sales."[23] . By way of illustration, a transfer, say, of SDR 100 million would augment resources in the PCDR Trust to a level that would allow it to meet the cost of debt stock relief for a "large" future case.[24]

30. **Another, more far-reaching, option could be to provide higher concessionality on PRGT credit to the poorest LICs**. While the Fund's unique role in providing temporary balance of payments support justifies the use of less concessional financing terms than for longer-term development assistance, consideration could be given to providing somewhat higher levels of concessionality to the poorest LICs in light of their inherent fragilities. This would have a similar rationale as the new blending policy, which differentiates effective financing terms based on per capita income.

31. **Other possible uses of the windfall could be also be envisaged, but these are generally less efficient ways of utilizing scarce concessional resources to support LICs**. All of these options would require use of the indirect transfer mechanism through a distribution to members, subject to satisfactory assurances that the resources would be returned for the agreed use.

- ***Create a post-MDRI debt relief mechanism***: Some observers have suggested that debt relief under the HIPC Initiative and MDRI may have been insufficient to address LICs' debt vulnerabilities. However, a recent staff analysis suggests that, while

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[22] Assuming the 2009 financing package is completed, the extension could be temporarily funded using available subsidy resources in the General Subsidy Account, provided the Account is reimbursed (through the indirect mechanism) for the cost of the extension by early 2014.

[23] *IMF Executive Board Establishes a Post-Catastrophe Debt Relief Trust,* Public Information Notice (PIN) No. 10/92, (7/21/10).

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[24] See Table 1, Hypothetical and Potential Cost of PCDR Support, *Proposal for a Post Catastrophe Debt Relief Fund,* (4/22/10).

several LICs face elevated debt vulnerabilities, most are expected to be able to reduce debt vulnerabilities substantially through a combination of existing debt relief mechanisms, sustained economic growth and diversification, fiscal consolidation strategies, and increased concessionality of financing terms on the creditor side. Some form of debt relief in isolated cases cannot be excluded, given the hazard of large negative shocks (e.g., in the case of Haiti), but the share of IMF debt is likely to be small in most cases (in contrast to the growing importance of private sector and nontraditional creditors) and, in a post-HIPC/MDRI context, it should not be presumed that Fund and PRGT debt would necessarily be subject to all future debt relief operations. More generally, while debt relief can create fiscal space, debt service is only one (and rarely the most immediate) component in LICs' financing needs, and hence debt relief is a relatively inefficient way to target those most in need.

- ***Provide Fund financial support as grants rather than concessional loans***: Some have argued that the Fund should switch to providing grants rather than loans to LICs, given their low income level, development needs, and debt vulnerabilities. However, this would undermine the Fund's unique role in helping countries adjust to temporary shocks/imbalances. For a given amount of available subsidy resources, concessional loans are a far more efficient way of providing this type of liquidity support than grants. Specifically, concessional loans can leverage the Fund's scarce subsidy resources by 4–5 times and thereby channel more support to those countries that have the most immediate needs. Grants would also undermine the division of labor with Multilateral Development Banks (MDBs) and donors, which are responsible for longer-term development assistance, where grants can be appropriate. Finally, if the windfall was distributed to LICs in the form of grants, fresh donor resources would be needed to meet future demand for PRGT support.

- ***Technical assistance for LICs***: Fund technical assistance (TA) is provided across the membership with assistance for LICs additionally being supported by donor contributions. However, a large one-off distribution to members to fund a special administered TA account for the benefit of LICs could undermine other donor contributions (i.e., not based on Fund distributions), which remain critical for a sustainable TA financing mechanism.

- ***Debt relief for arrears cases***: Currently, the Fund does not have resources to provide debt relief to the protracted arrears cases of Sudan, Somalia, and Zimbabwe. Attempting to lock up scarce resources for debt relief at an uncertain future date, however, could result in significant leakage and would not benefit LICs more broadly. The approach developed for Liberia's debt relief, including financing modalities, could provide a useful framework for Sudan and Somalia at an appropriate time.

## IV. Conclusion and Issues for Discussion

32. **This paper considers issues relating to the use of the profits from the limited gold sale**. Of the total profits of SDR 6.85 billion, previous Board discussions suggest that at least SDR 4.4 billion should be used to create an endowment as part of the new income model, and SDR 0.6–0.7 billion should be used as part of the 2009 LIC financing package, involving a distribution to members based on satisfactory assurances that the equivalent resources will be returned to provide subsidy contributions for the PRGT. This leaves a remaining windfall of about SDR 1.75 billion.

33. **The paper identifies three main options for use of the remaining windfall**. A case can be made for all three options, and a choice between them would involve an assessment of their relative merits. In particular, judgments are needed regarding the priority that should be assigned to using the windfall actively to boost the Fund's concessional financing capacity to allow it to better meet the projected needs of LIC members over the longer-term versus a further strengthening of the Fund's financial position, through increased precautionary balances or a larger endowment. As discussed, these options are not necessarily mutually exclusive and different combinations could be considered. Other possible options for use of part of the windfall are also discussed.

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

- Do Directors agree that at least SDR 4.4 billion of the proceeds from the gold sale, equivalent to the profits up to US$850 per ounce as assumed in the new income model discussions, should be used to fund an endowment with the objective of generating investment returns to contribute to the Fund's income while preserving the long-term value of these resources?

- Do Directors agree that at least SDR 0.6–0.7 billion of the profits should be used to generate resources for PRGT subsidies in line with the agreed strategy under the 2009 LIC financing package?

- How do Directors assess the relative merits of the alternative options identified in this paper for use of the remaining windfall profits of about SDR 1.75 billion?

- If Directors support using resources linked to part or all of the remaining windfall to boost the Fund's capacity to support LICs, which options do they prefer? Would they favor proceeding now with a decision to distribute the full amount to members upon receipt of satisfactory assurances, or would they favor a different strategy on timing of the distribution?