Center for Global Development

Gold for Debt: What's New and What Next?

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CGD Notes

Introduction and a brief history

In 2002 we two proposed that some of the IMF's gold be used to help address the debt problem of some of the world's poorest countries.[1] The idea of using the IMF gold to provide help to those countries was not new. During the period 1976-1980 sales of IMF gold provided $3.3 billion to help finance highly concessional loans – well below the cost to recipients of conventional IMF loans – to low income countries.[2] And in 1999, the Board of the IMF authorized off-market transactions in gold to help finance IMF participation in the internationally agreed HIPC (Heavily Indebted Poor Country) initiative. The off-market transaction kept the gold off the open market, avoiding resistance in such gold-producing countries, rich and poor, as Canada, Ghana, South Africa, Uganda and the United States who feared that putting IMF gold on the market would lower gold prices.[3]

Since 1999, the last time IMF gold was tapped, three things have changed.

- First, the price of gold has risen – by about 50 percent – and that has eased the fears of gold-producing countries.[4] Indeed Canada and South Africa have endorsed gradual and limited gold sales for debt relief. This month IMF management reported to the Board the results of its assessment of the market situation, concluding that the IMF could sell 13 to 16 million ounces (of its current holdings of 103 million ounces) over a reasonable period of time, and within the current limits agreed among Central Banks for their gradual sales of their gold, without disrupting the gold market.

- Second, the evidence has hardened that many countries, despite benefiting from the HIPC program of debt relief, still have unsustainable debt burdens. That reflects what in retrospect were excessively optimistic projections of their exports, their additional need for new loans, and their growth.

- Third, donor countries are seeking as many ways as possible to increase their aid to the poorest countries, in order to fulfill their commitment that lack of external financing not impede developing countries' efforts to meet the Millennium Development Goals – to halve poverty, reduce infant mortality, ensure all boys and girls complete primary school, and more.

These changes, along with continuing pressure from the activist development community, are no doubt behind the recent UK proposal for additional use of gold to relieve poor country debt. We anticipate that at the 2005 spring meetings of the IMF and the World Bank, and at the G-8 Summit it is hosting in July, the United Kingdom government will be garnering support for some version of Chancellor Gordon Brown's recent proposal for 100 percent debt relief for the poorest countries, financed by IMF gold sales to cover IMF debt, and by new contributions from donors to fully finance remaining debt service owed to the World Bank and the regional development banks.

Why gold for debt makes sense

The IMF champions transparency. But its own balance sheet fails the test. Its assets include one that is overvalued, namely its loans to the world's poorest countries which are fundamentally uncollectible, and one that is undervalued, its gold reserves. The IMF values this gold on its balance sheet at roughly $9 billion, on the basis of historical cost. At the current market price of about $425 per ounce, its gold assets are worth closer to $45 billion.

A more transparent global institution

The IMF acquired most of the gold under its original 1944 Articles of Agreement. Gold had long been the basis for the international monetary system, and thus the basis of reserves for the Fund. Following the collapse of the Bretton Woods monetary reserve system – typically termed the "gold standard" – in 1971, the IMF kept the gold as something of a rainy day fund.

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Except for the sales and off-market transactions noted above, the gold has remained an asset that, for practical purposes, reduces the exposure of the rich world's central banks to the risk they would have to rescue the IMF in the event of a default of major debtors or a global financial crisis. Mobilizing IMF gold for debt would help to make the IMF's balance sheet more transparent.

An appropriate use of a global resource

Gold sales would reduce the gold price slightly from what it otherwise would be. The real issue, though, has to do with the IMF's assets. Sale of IMF gold would reduce the comfort level of the world's central bankers. The tradeoff is a simple one, however, between central bankers sleeping slightly less well at night on the one hand, and the potential to reduce global poverty and misery on the other. Selling IMF gold constitutes a transformation of a sterile stockpile into a productive resource. The gold is not only, or even primarily, a "Fund" asset but a global resource – justifiably allocated to fulfill a global commitment and address a recognized global challenge.

What next?

The IMF could raise about $7 billion by selling around 16 million ounces – about 15 percent – of its current gold. We propose that sales up to that amount be authorized for two purposes. The first is to write off 100 percent of the debt to the IMF owed by all countries that are currently benefiting from the HIPC initiative (having at least reached "decision point"), *and* have income per capita below $500. This is similar to the UK proposal, but restricts the full write-off to countries that have passed muster in terms of their economic performance; had an undue debt burden prior to HIPC relief; and are extremely poor. Because of their low average income levels, these are the countries that, in retrospect, could not service much if any debt – and in the future, until their income levels rise substantially, should receive most aid transfers in the form of outright grants. About 20 countries fall into this category, including Malawi, Nicaragua, and Burkina Faso. (It excludes a few countries, including Bangladesh and Nigeria, that are equally poor but have not accumulated enormous debts to the IMF and the other multilateral institutions – in the case of Bangladesh because its debt levels are low, and in the case of Nigeria because its debt is mostly to the bilateral creditors.) We estimate that this would cost no more than $3 billion.[5, 6]

The second is to insure the beneficiary countries, for 10 years, against the financial and fiscal risks of events beyond their control. These include such external shocks as drought, floods, a collapse in the price of a key export (coffee or peanuts) or an increase in the price of a key import (oil). Low-income countries are particularly susceptible to natural disasters and sharp international price changes that shrink export earnings and increase import costs. Insurance in the form of an automatic grant transfer would be used to cover debt service they might still owe, or to sustain their own expenditures on ongoing investments in health, education, roads and other infrastructure – without resort to inflation financing or new borrowing. That would reassure local as well as foreign investors that the public sector's debt burden and fiscal stance would remain manageable, as long as overall economic policies remained reasonably sound. And 10 years provides a reasonable window within which countries can take the policy steps critical to diversifying their economies and shoring up fiscal confidence – to better manage shocks on their own.

In 2002 we suggested that such an insurance facility might cost $5 billion over 10 years. In fact it is impossible to cost such a facility ex ante. It is not unreasonable, however, to imagine IMF shareholders creating such a facility, and agreeing to finance it up to some point – such as $5 billion – by the intermittent sale of IMF gold. Indeed, such an approach is fully consistent with the IMF's core mission of helping countries prevent and manage financial and other shocks.

The role of the United States

Using gold is not the only way to relieve poor country debt. The rich countries could finance a write-off directly from new contributions – as they are committed to do for World Bank and other multilateral debt. But a gold sale at the IMF requires approval of 85 percent of the members' votes. The U.S. holds 17 percent of the votes, so its agreement is necessary.

The UK proposal is receiving some support in Europe. But in the U.S., Congressional leaders have expressed concern about gold sales (invoking the reduction in the IMF balance sheet). That has probably contributed to the U.S. Treasury's reluctance to support the initiative. Treasury officials are also no doubt concerned that any request to Congress for approval of any IMF transactions would open a Pandora's Box of complaints and concerns about the IMF. The U.S.

Treasury is also, with some justification, insistent that any new steps on debt relief be linked to an agreement to replace loans to the poorest countries with grants.

Time for a deal

We believe it is time for the U.S. to take leadership – forging with the UK and other European allies a deal. Gold sales can be limited and gradual – to ensure gold markets are not disrupted. They can be used to add to grant transfers (in the form of additional debt write-offs) to the very poorest countries – an idea the U.S. has championed. They can be used to help well-run poor countries manage future shocks, giving them time to diversify their economies and creating the conditions for private sector-led investment.

For the poorest countries with the most debt, dealing with their IMF obligations will not be sufficient in itself – to ensure their remaining debt is sustainable or to guarantee economic growth and poverty reduction. But it would help. And it makes sense. The world has, after all, committed to the entirely manageable challenge of reducing global poverty – and it has a global resource to help meet that challenge.

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[1] See Birdsall and Williamson (2002) *Delivering on Debt Relief. From IMF Gold to a New Aid Architecture.* Washington, DC: Center for Global Development, available at www.cgdev.org/Publications/index.cfm?PubID=42. See also Birdsall and Deese (2002) "Delivering on Debt Relief" available at www.cgdev.org/Publications/index.cfm?PubID=31.

[2] The facility that makes these loans has, since 1999, been called the Poverty Reduction and Growth Facility (PRGF).

[3] The IMF has also sold gold for other reasons, including replenishing its coffers, financing operational deficits, and to reduce the role of gold in the international monetary system. See www.imf.org/external/np/exr/facts/gold.htm

[4] Based on the percent change in the average gold price in 1999 to the first four months of 2005.

[5] A 100 percent debt write-off for all HIPC eligible countries with per capita income less than $500 would cost closer to $4 billion.

[6] The decision point countries have received about $410 million in new, highly concessional IMF loans, which are included in the $3 billion in the text above; and the completion point countries have received approximately $395 million in new IMF loans since their completion point dates– which numbers are not included in the $3 billion.

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