



International Monetary Fund (IMF): Financial Reform and the Possible Sale of IMF Gold

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Summary

The International Monetary Fund faces a unique set of challenges in the current economic environment. With the continuing growth in the emerging market economies, the demand for IMF assistance has shrunk dramatically. In order to prevent a future need for an IMF-bailout, many emerging market countries are accumulating vast amounts of foreign exchange reserves. In 2006, IMF Managing Director Rodrigo de Rato created a panel of “eminent persons” to advise the IMF about reform of its income model, given the lower demand for IMF lending. The panel proposed the creation of an endowment that would be funded either with quota resources or through the sale of gold from the IMF reserves. This has raised questions among Members of Congress about the benefits of selling IMF gold and the presumed need for reform of the IMF’s income model. This report discusses these issues and will be updated as events warrant.

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Decreasing IMF Finances

As the IMF enters its seventh decade, it faces a broad range of challenges—most pressing of which is its deteriorating balance sheet. Outstanding IMF credit has decreased from a peak of \$82 billion in 1999 to \$20.4 billion in 2006, over half of which is lent to Turkey.¹ These are the lowest loan levels the IMF has seen in 25 years.² Many of the IMF’s middle-income and developing country borrowers, including Thailand, Russia, Argentina, and Brazil, have been repaying their IMF loans early. These early payments may also signal that, with the emergence of a new class of creditor nations including China and many Persian Gulf countries, developing country borrowers no longer view IMF loans as attractive. Furthermore, some prefer not to put themselves in a position where they must take the IMF’s policy advice as a condition for access to IMF loans.

Total IMF resources at the end of May 2007 were \$340 billion, of which \$248 billion were usable resources. However, the IMF possesses only a small portion of this total. Therefore, it cannot invest money from its quota resources in order to raise money to fund its operations.³ With a decline in lending has come a decline in operating revenue, with the IMF reporting a small shortfall in its FY2007 budget.

Compounding the IMF’s fiscal challenges, many emerging market economies are rapidly accumulating central bank reserves in order to avoid having to borrow from the IMF in the future (**Table 1**). Additionally, were a major financial crisis to occur, it is unclear how effective the IMF would be in shoring up the financial markets. Every day, over \$2 trillion changes hands in world currency markets. In the 1970s and earlier, the IMF could loan countries enough money to defend their currencies against short-term speculative pressure. Most experts agree that the IMF could no longer do this today and, if it were to lend \$30 billion to a medium size country to help it defend its currency against widespread perceptions that it was overvalued, the money from the IMF loan would be lost very quickly and the country would be forced to devalue anyway.⁴ Experts generally agree that the IMF must now work with market forces rather than against them if it wishes to help countries deal with currency or balance of payments crises.

Table 1. Ratio of Reserves to Imports of Goods and Services

	1999	2000	2001	2002	2003	2004	2005	2006	2007
Emerging Markets and Developing Countries	46.3	44.7	49.5	55.3	60.5	62.7	66.4	71.4	75.1
Regional Groups									
Sub-Saharan	28.7	33.6	33.2	31.2	28.0	34.7	38.0	42.1	45.5
Excluding Nigeria and South Africa	30.2	33.2	31.0	35.3	34.4	34.0	31.1	34.8	35.4
Central and Eastern Europe	38.8	34.6	34.8	41.1	39.3	34.8	35.2	31.9	29.3

¹ International Monetary Fund, “IMF Financial Activities—Update January 18, 2007.”

² Oxford Analytica Daily Brief, “IMF could cut spending to cover losses,” November 30, 2006.

³ Quotas are, in effect, a line of credit. When the IMF makes a loan, it borrows from its member countries and it relends that money to its own borrower countries. Repayments from IMF borrowers are used to repay countries for quota resources used. Countries pay the IMF interest for their loans and the IMF pays interest to the countries whose quotas are used. The difference in these interest rates produces the income the IMF currently uses to fund its operations.

⁴ See, for example, testimony by Dr. Adam Lerrick before the Senate Banking Committee’s Subcommittee on Security and International Trade and Finance, August 2, 2007.

	1999	2000	2001	2002	2003	2004	2005	2006	2007
Commonwealth of Independent States	17.6	30.5	34.4	41.0	52.1	64.3	75.7	96.0	109.1
Russia	17.2	40.6	44.6	52.9	71.5	92.7	107.2	135.2	152.7
Developing Asia	58.6	49.2	58.4	68.1	74.6	79.6	81.9	87.9	93.9
China	83.3	67.4	79.7	89.0	91.1	101.5	115.5	124.3	132.2
India	52.9	52.6	65.0	90.0	107.1	97.0	72.5	70.4	68.6
Middle East	64.0	75.5	78.7	74.3	78.5	77.9	90.5	98.3	97.9
Western Hemisphere	38.0	35.9	37.3	40.5	47.6	44.8	43.8	44.0	46.2
Brazil	37.6	43.5	49.2	61.1	77.2	65.9	54.8	71.3	86.2
Mexico	20.4	18.6	24.2	27.3	31.4	29.8	30.5	26.2	25.9

Source: Barry Eichengreen, "A Blueprint for IMF Reform: More than just a Lender," *International Finance*, Fall 2007.

IMF Reform

To stimulate discussion on possible reform options, former IMF Managing Director Rodrigo Rato convened a committee of eminent persons to examine the IMF's income model. Headed by Andrew Crockett, former head of the Bank for International Settlements, the committee also included former Federal Reserve Chairman Alan Greenspan and former European Central Bank President, Jean Claude Trichet. Current IMF Managing Director Dominique Strauss Kahn is expected to introduce reform proposals during 2008.

As the Crockett Report illustrates, the IMF's income derives largely from a single source—the difference between the rate the IMF charges when it lends and the rate the IMF pays countries for use of their quota resources. This creates a perverse situation, where, according to Mr. Crockett: "when the world economy is not doing well and the Fund has to lend in crisis situations, it is well furnished with resources. When the Fund is successful in stabilizing the global economy, then it is short of resources."⁵

The Crockett Report Recommendations

The Committee released its report on January 31, 2007.⁶ The report made several recommendations to provide sufficient financing for the IMF's three major functions: (1) providing a source of short-term finance for countries suffering from balance of payments crises; (2) providing a public good of surveillance of the international economy; and (3) providing bilateral technical assistance to countries as they pursue market-oriented economic reform.

To meet these goals, the Committee recommends (1) revising the IMF's investment operations; (2) creating an endowment fund; (3) charging separately for IMF services; and (4) eliminating the IMF's waiver on reimbursement of the administrative charges for the IMF's concessional lending

⁵ Transcript of a Press Briefing on the Final Report by the Committee to Study Sustainable Long-term Financing of the IMF (Crockett Report), January 31, 2007. Available at <http://www.imf.org/external/np/tr/2007/tr070131.htm>.

⁶ Committee to Study Sustainable Long-term financing of the IMF, *The International Monetary Fund*, January 2007. Document is available at <http://imf.org/external/np/oth/2007/013107.pdf>.

facilitates. The Committee rejected the option of financing the IMF's oversight and research functions through a periodic levy on member nations due to fear that this would overly politicize the IMF's activities. According to the Committee: "subjecting the Fund's administrative expenditure to national budgetary procedures might indirectly threaten the independence of the Fund's policy advice."⁷

The Committee made two recommendations regarding the IMF's existing investment options: (1) broaden the IMF's investment mandate for existing reserves by extending portfolio duration beyond the current 1-3 year benchmark index and expand the types of financial instruments that the IMF is allowed to invest, and (2) use quota resources subscribed by member countries to invest in marketable securities. The Committee also recommended that the IMF create an endowment fund through the sale of 12.9 million ounces of gold held in its reserves. Gold sales have been used in the past to generate income. In 1957, for example, gold was sold to create a Special Reserve to cover Fund losses incurred early in its existence. Between 1976 and 1980, 50 million ounces were sold by public auction to fund special loans to low-income countries.

IMF Gold

The IMF holds 103.4 million ounces of gold in reserves, valued at around \$95.01 billion at current market prices.⁸ The IMF acquired virtually all of this gold through four types of transactions. First, before they were revised in 1978, the IMF Articles of Agreement required that 25 percent of a country's quota subscriptions was to be paid in gold. This was the largest source of IMF gold. Second, all payments of charges (i.e. interest on members' use of IMF credit) were originally made in gold. Third, a member wanting to obtain the currency of another member could do so by selling gold to the IMF. (South African gold sales between 1970 and 1971, for example, were the main such source of gold.) Fourth, members could use gold to repay the IMF for previously extended IMF credit.

In 1978, IMF members adopted an amendment to the Articles of Agreement allowing each country to determine its own exchange rate system. The amendment officially severed the link between currency and gold. IMF member countries were prohibited from defining the value of their currency in terms of gold and the IMF was prohibited from lending gold or defining its assets in terms of gold. Countries could use any exchange rate system (other than using gold as a base) for defining the value of their currencies. Prior IMF approval of exchange rate changes would no longer be required. Since the 1978 amendment, the use of gold in the IMF's operations has been severely limited. If an 85 percent majority approves, the IMF may sell gold outright on the basis of prevailing market prices. It may also accept gold in the discharge of a member's obligations, using the market price at the time of acceptance. All other transactions, such as gold purchases, loans, leases, swaps, or use of gold as collateral, are prohibited.

In 1995, the IMF Executive Board undertook a review of the role of gold in the IMF in a post-gold standard international economy. Following this review, there was broad agreement from members of the IMF Executive Board that the IMF's policy on gold should be governed by several principles including:

⁷ Ibid, p. 8.

⁸ The price of gold on January 28, 2008 was \$918.88 per ounce. See <http://goldprice.org/>.

- As an undervalued asset held by the IMF, gold provides fundamental strength to its balance sheet. Any mobilization of IMF gold should avoid weakening its overall financial position; and
- The IMF should continue to hold a relatively large amount of gold among its assets, not only for prudential reasons, but also to meet unforeseen⁹ contingencies.

Issues for Congress

In the past, proposals to sell IMF gold reserves have been unpopular among some Members of Congress. Some have argued that there is a potential lack of IMF transparency. Some claim that the gold held by the IMF belongs to the member nations and it is not the IMF's place to propose gold sales to fund current operating expenses. Some also claim that gold sales have the potential to weaken the global price of gold and the effect on the IMF balance sheet is unclear.

In the late 1990s, limited gold-sales were proposed to finance the IMF's initial contribution to the Heavily Indebted Poor Countries (HIPC) initiative. Due to the concerns raised above, the Clinton Administration and several members of Congress strongly objected to these plans, and a compromise was reached at the September 1999 IMF annual meetings, which authorized off-market transactions in gold of up to 14 million ounces to help finance IMF participation in the HIPC program. Between December 1999 and April 2000, transactions involving a total of 12.9 million ounces of gold were carried out between the IMF and two members, Brazil and Mexico, that had financial obligations to the IMF. Gold was sold at the market price and profits were placed in a special IMF HIPC account. At the same time, the IMF accepted back the gold sold to Brazil and Mexico in settlement of their financial obligations to the Bank. The result was that the balance of the IMF's holdings of physical gold remained unchanged, although its usable resources shrank.¹⁰

Under Article V, Sec. 12 of the IMF's Articles of Agreement, approval of gold sales by the IMF requires an 85 percent IMF voting majority. The United States has almost a 17 percent vote and could thus block any sale of IMF gold. Understanding this "virtual" veto, Congress, in 1999, enacted legislation in the *FY 2000 Consolidated Appropriations Act* that authorized the United States to vote at the IMF in favor of a limited sale of IMF gold to fund the IMF's participation in HIPC debt cancellation. However, the act requires the explicit consent of Congress before the Executive Branch can support any future gold sales.¹¹

Prior to the adoption of this law, the requirement for congressional agreement was less clear. In 1976, Congress approved legislation, section 3 of P.L. 94-564, which prohibited the Administration from supporting any sale of IMF gold that would be used to create a trust fund "for the special benefit of a single member, or of a particular segment of the membership, of the Fund."¹² Subsequently, Congress approved section 4(a)(1) of P.L. 95-147 which stated, in part,

⁹ See "Gold in the IMF: a Factsheet," International Monetary Fund, <http://www.imf.org/external/np/exr/facts/gold.htm>.

¹⁰ The IMF may hold gold as an asset, but it cannot lend gold nor can it use gold as security for borrowing funds. The transactions in 1999 shifted money out of the IMF's general resources account into a special fund for HIPC debt cancellation. To offset this deduction, the IMF revalued some of its gold by an equal amount. See Jonathan E. Sanford, "IMF Gold and the World Bank's Unfunded HIPC Mandate," *Development Policy Review*, January 2004.

¹¹ P.L. 106-113, *Consolidated Appropriations Act, 2000*, Sec. 504(d).

¹² P.L. 94-564, *A Bill to Provide for Amendment of the Bretton Woods Agreement*.

that the United States could not support the sale of IMF gold for “the establishment of any additional trust fund whereby resources of the International Monetary Fund would be used for the special benefit of a single member, or of a particular segment of the membership, of the Fund.”¹³ Were these provisions of law still in effect, the Secretary of the Treasury might arguably be able to support a sale of IMF gold for the purpose of establishing a trust fund if the proceeds would benefit the whole membership of the Fund, as might be the case with the present proposal for a sale that would help offset IMF operating expenses. With the passage of the 1999 law, however, that option is not possible and an act of Congress is required before the Administration can support any sale of IMF gold.

The Crockett panel also proposed, in addition to gold sales, that the IMF should augment its income through a more aggressive investment program. The IMF would borrow money from its member countries by drawing on their quota resources to fund these investments. The sale of gold and the use of quota resources were not posed as alternatives. Nevertheless, it could be argued that if gold is not sold to fund the proposed endowment plan, more quota resources will be needed to fund the investment program.

Questions might be raised about this use of quota resources. First, the IMF’s quota resources were originally intended to finance the IMF’s loan operations, not to subsidize its administrative costs. Their use for the latter purpose deserves careful consideration. Second, only the countries with strong currencies are likely to be asked to provide permanent low-cost loans to the IMF for this purpose.

As the IMF deliberates on the Crockett Report recommendations, Congress may wish to consider the following questions in anticipation of a potential request to authorize the sale of a portion of IMF gold reserves: (1) Are gold sales desirable compared to the other alternatives for raising revenue? (2) If gold sales are not authorized, should the IMF fund its new investment plan by borrowing quota resources from the United States and other countries with strong currencies without also asking other countries to bear some of the costs? (3) How should the United States raise the money—be it on-budget or off-budget—to finance its share of the investment plan? (4) Will the IMF be more effective if it is autonomously financed rather than being dependent solely on income from its loan operations to fund in its administrative budget? In particular, will the IMF be more effective in the exercise of its surveillance and its other economic oversight functions if these activities are funded autonomously through an endowment or investment plan?

Alternatively, some in Congress might wish to reconsider the *raison d’être* of the IMF in an international economy marked by rapidly growing emerging market reserves and capital flows from the emerging to the developed countries. The Fund’s three current functions—crisis lending, technical assistance and surveillance of the international monetary system—might be reoriented within the IMF or allocated to other institutions to better reflect the new reality. For example, the IMF’s function as lender of last resort could be performed by regional reserve-pooling arrangements such as that developed in Asia under the Chiang Mai Initiative, or through enhanced functions of the Bank for International Settlement. The Fund’s technical assistance functions could be provided by the multilateral development banks. A renewed IMF could focus on its member countries’ economic policies and on surveillance of the international exchange rate and monetary systems. Such reforms will likely be on the IMF’s agenda over the next several years.

¹³ P.L. 95-147, *A Bill to Authorize the Secretary of the Treasury to Invest Public Moneys*.

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