Paying for 100% Multilateral Debt Cancellation

Current proposals explained

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January 2005

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Foreword

It is highly likely that significant further progress on low-income country debt can be made during 2005. Many officials and politicians have now recognised that the Heavily Indebted Poor Country (HIPC) Initiative has not solved the debt crisis and that more therefore needs to be done.

This recognition is due to continued pressure from campaigners and the evidence from low-income countries. The poorest countries in the world are in a debt trap which they need to escape urgently in order to stand a chance of achieving the Millennium Development Goals (MDGs) by 2015.

Proposals for multilateral debt cancellation have been put on the table by two of the G7 countries – the UK and US in recent months. The political negotiations are expected to begin in earnest in the first week of February at the G7 finance ministers meeting.

Even though the principle of further debt cancellation is becoming increasingly accepted, progress could be blocked by disputes over how to pay for it. Some key governments frequently argue that they cannot provide extra resources for debt relief even though the amounts concerned are very small in proportion to their budgets as a whole. Civil society groups are therefore proposing other sources of funds that could raise around US$50 billion.

This briefing aims to enable more civil society organisations and journalists to understand the details of the current proposals and engage in political discussions in the coming weeks and months. It also acts as a resource for policymakers to get a better understanding of civil society concerns and suggestions. It describes the proposals from the British Government and others and assesses their coverage, financial cost and where resources can be obtained. These are set out in the form of frequently asked questions and answers. The briefing demonstrates that the international financial institutions – the International Monetary Fund (IMF) and World Bank – have significant resources to contribute to debt relief. These – IMF gold reserves and World Bank financial reserves – are genuinely additional to the money already set aside for aid transfers and debt relief and would therefore ensure more budget resources are available for low-income country governments to invest in their people. Coupled with additional bilateral contributions from creditor governments, these have the capacity to provide genuine 100% multilateral debt cancellation to a large set of countries beyond the 20 countries currently envisaged under UK Government proposals. Top priority should be the sale of IMF gold reserves.

This briefing outlines ways to get the most desirable outcome from the current momentum for a debt relief deal. There exists a unique window of opportunity for civil society, parliamentarians and the media to influence the outcome of this year’s official discussions so as to achieve a genuine exit from the debt trap in which so many countries have been caught. Eurodad will play an active role in galvanising action and debate on this issue and we would welcome your feedback on this briefing and on actions being taken in your country.

Alex Wilks and Gail Hurley, Eurodad
20 January 2005

Note: This document is a briefing paper only. The analysis and proposals it contains do not necessarily reflect the views of all Eurodad member organisations.
Summary

Debt owed to the International Monetary Fund, World Bank and other multilateral development banks has grown rapidly in recent years so that they are now the major creditors of low income countries. Largely because there are serious consequences for governments which default on payments to these bodies, multilateral debt can be very onerous.

Campaigners pressed throughout the 1990s for cancellation of debt owed to multilateral institutions. Largely in response to this, the World Bank and the IMF launched the Heavily Indebted Poor Country Initiative in 1996 and the Enhanced HIPC Initiative in 1999. This initiative included a list of 42 countries and aimed to enable countries achieve “a robust exit from the burden of unsustainable debts”. While it resulted in some debt being written-off, it was a far cry from the cancellation of unpayable debt called for by many debt campaigners and low-income country representatives who had called for a fresh start for debt-burdened countries.

There is an acute humanitarian crisis in the poorest countries where thousands of lives are lost every day due to insufficient resources to tackle the problems of hunger, disease and poverty. Every day that action is not taken to deliver more resources to these countries costs thousands of human lives that could otherwise be saved.

About the author:

This briefing was written by Sony Kapoor. Gail Hurley and Alex Wilks also contributed to and edited the paper. Sony Kapoor is a consultant and senior adviser to both Jubilee Research and Jubilee USA. He is also a senior policy and advocacy adviser to the Tobin Tax Network and the International Tax Justice Network. His other writings on debt cancellation include:

- ‘Can the World Bank and IMF Cancel 100% HIPC Debt’, Debt and Development Coalition Ireland (DDC), 2003
- ‘Resource Rich BWIs, Multilateral Debt Cancellation and the MDGs’, IOB (Dutch Foreign Ministry), 2004
- ‘The IMF, Gold Sales and Multilateral Debt Cancellation’, DDC 2004
- ‘The World Bank (IBRD) Resources and Debt Cancellation’ Jubilee USA Network, 2005
- ‘Mobilizing IMF Gold for Multilateral Debt Cancellation’, Development March 2005

About Eurodad:

The European Network on Debt and Development (Eurodad) is a network of 48 non-governmental organisations (NGOs) from 15 countries across Europe working on issues related to debt and finance and poverty reduction. Eurodad’s overarching aim is to work for national economic and international financing policies that achieve poverty eradication and the empowerment of the poor.

The Brussels secretariat acts as an information hub, monitoring and analysing changes at the international level, gathering and disseminating knowledge and experiences from the national level, and developing new policy positions to feed into advocacy, campaigning and education work by our members and other contacts around the world. Eurodad staff also engage in advocacy towards institutions such as the World Bank, IMF and European Commission.

Eurodad is funded by its members, the Dutch Ministry of Foreign Affairs and the Swedish International Development Agency.

Contact us for more information and to subscribe to our two regular e-bulletins, Debt-Watch and PRS-Watch.

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Section 1: The importance of multilateral debt cancellation

1) How much multilateral debt do poor countries owe?

The multilateral debt burden of the poorest countries has grown significantly over the past few years, both in terms of amounts outstanding and as a share of total global external debt. Multilateral creditors such as the World Bank, International Monetary Fund, African Development Bank are now the largest creditors for most poor countries, especially those classified as Heavily Indebted Poor Countries (HIPCs).

For the whole group of countries classified as low income,¹ outstanding external debt has risen 430% since 1980 and now amounts to US$523 billion. Debt owed to multilateral institutions has increased faster - 793% to US$154 billion. This represents 30% of the total current debt stock of these countries.

For the Heavily Indebted Poor Countries, external debt has risen 320% since 1980 to US$189 billion. Debt owed to multilateral institutions has increased 800% to US$70 billion. It now constitutes 37% of total external debt, up from 14% in 1980. Of the countries 15 that have to-date passed through the HIPC Initiative, the share of debt owed to the multilaterals still amounts to a staggering 61%.

2) How does multilateral debt differ from other forms of debt?

Multilateral debt is almost always serviced because the international financial institutions enjoy “preferred creditor” status. This is because a default on a multilateral debt obligation is likely to result in a country being cut off completely from international credit from any official or private source. This is different from the debt owed to bilateral and private sector creditors, significant proportions of which are in arrears, i.e. not serviced regularly. Cancellation of bilateral and private sector debt may therefore represent simply a paper transaction involving the cancellation of debt that was not being repaid in the first place. Such a transaction, while effective in reducing the overall debt overhang, may not actually free up any resources for investments in poverty reduction and infrastructure in a country.

The chart overleaf clearly shows that most HIPC debt stock reduction to date has come in the form of writing off debt already in arrears. In fact, over 80% of debt stock reduction has been eroded by a reduction in arrears.

The cancellation of multilateral debt on the other hand, almost always means that money that would otherwise have gone into servicing debt becomes available to spend instead on development. It also reduces debt overhang at the same time. Research has shown that it is also the most efficient form of resource delivery to countries in need.

¹ 61 countries with a Gross National Income (GNI) per capita less than $765. For a full list, see: http://www.worldbank.org/data/countryclass/classgroups.htm#Low_income
3) What are the other advantages of cancelling multilateral debt?

a) Policy conditionalities

The World Bank and the IMF, while lending to developing countries require certain conditions to be met by debtor governments. These policy conditions, also called conditionalities have expanded over time to cover government’s policies in a wide range of areas, from economic and fiscal policy to governance, human rights and the social sectors.

Such conditionalities have been instrumental in advancing a standardised model of development on poor and middle-income countries. This model, which has promoted privatisation, trade and capital account liberalisation, reduced spending in the social sectors and on the institutions of the state has failed to promote growth or reduce poverty in most poor countries. These conditionalities also leave limited policy space open to governments and their citizens to pursue the development priorities they themselves have defined.

Cancelling multilateral debt will reduce the level of policy leverage the international financial institutions currently have over the poorest countries.

b) Equal burden sharing

The doctrine of equal burden sharing for creditors – that all creditors should contribute resources for debt cancellation in proportion to the debts owed to them - is one of the central tenets of the HIPC Initiative. In reality however, bilateral creditors have contributed far more than the multilateral institutions.

In fact, most multilateral debt cancellation to date has actually been financed by additional bilateral contributions. This effectively turns grants into loans – as the money contributed by donor countries is then recycled as additional loans by the institutions. Multilateral debt cancellation using the multilaterals’ own resources is one way to redress this imbalance.
c) Moral hazard

The International Financial Institutions (IFIs) are treated as preferred creditors. Historically, even when countries have defaulted on both private and official bilateral repayment obligations, they have continued to repay multilateral debt for fear of being cut off by all funding sources.

Furthermore, it is practically impossible for a country to receive debt cancellation from others if it is in default of its multilateral obligations. The Paris Club of creditor countries will not even consider a country for debt reduction until it has signed up to an IMF-sponsored adjustment programme.

This means that the IFIs have always been confident that loans owed to them would be repaid. Knowing this at the time of lending has led to some irresponsible lending decisions and the practice of defensive lending (where new loans provided to a country simply paid-off old loans and did not serve any real development purpose). This is called moral hazard.

Forcing the IFIs pay for multilateral debt cancellation using their own resources would mean that they face the consequences of bad or irresponsible lending. It will also encourage the IFIs to lend more carefully in future thereby reducing moral hazard. Citizen and parliamentary scrutiny – as proposed by Afrodad, Christian Aid and others2 – will also be required.

Section 2: The modalities of multilateral debt cancellation

4) What proposals for multilateral debt cancellation are currently under discussion?

Three distinct proposals have so far been tabled for discussion. The proposals all talk about multilateral debt cancellation for the poorest countries, but differ on the sources of funds, lists of countries, cut off dates and operational details.

The first proposal, put forward by the UK Government in September 2004 includes a total of 20 countries to begin with, though it could potentially expand to include a further 45 countries. It seeks to use funds raised through selling or revaluing IMF gold reserves to cancel debt owed by eligible countries to the IMF. For the World Bank and the African Development Bank, the plan proposes the use of additional bilateral contributions from donor countries to fund a cancellation of debt service obligations between 2005 and 2015. The UK Government has pledged to fund 10% of debt service due until 2015. There is a possibility that this could be extended beyond 2015 as well as extended to other multilateral development banks.

The second proposal, put forward informally by the US Government last year extends to all 42 HIPCs and involves the use of the multilaterals’ own resources to fund the cancellation of multilateral debt. For the World Bank, all outstanding debt would be converted retrospectively into grants. The consequences of this would be a decrease in future reflows (loan repayments) to the International Development Association (IDA). In order to fund the IMF’s share of the cancellation, the plan suggests using the principal from the gold revaluation in 1999 as well as the IMF’s Poverty Reduction and Growth Facility (PRGF). Significantly, the US proposal is not backed up by any pledges of new resources and hence does not result in any additional resources being transferred to recipient countries.

A third proposal, put forward by several civil society organisations extends to all low income countries that have a shortfall of resources needed to meet the internationally agreed MDGs.

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It seeks to provide a genuine 100% multilateral debt stock cancellation and looks at the funds available in tiered way with each tier being exhausted before the next one is used. It prioritises the sale of IMF gold, which could mobilise as much as US$35 billion. This money should be used for the cancellation of multilateral debt owed not just to the IMF but also to other multilateral institutions such as the World Bank.

Further resources would also be needed. This plan therefore turns to additional bilateral contributions of the kind pledged by the UK Government as the second port of call. While the proposal states the desirability of maximising this source of funding, it recognises that in reality a number of donor countries may not contribute and hence this source of funds can only provide partial additional funding at best.

Therefore should additional funds still be needed, the plan proposes the use of up to US$17.5 billion of transfers from the resources of the International Bank for Reconstruction and Development (IBRD) – the non concessional lending arm of the World Bank. The IBRD has amassed significant reserves (loan loss and capital) over recent years and money could come from a combination of these reserves and a partial transfer of income over a number of years.

5) What are the advantages and disadvantages of each proposal?

Each proposal for multilateral debt cancellation must be evaluated in the wider context of:

1. Its contribution to mobilising additional resources to help countries achieve the Millennium Development Goals;
2. How many countries it applies to;
3. Its impact on governance;
4. Its political and technical feasibility.

<table>
<thead>
<tr>
<th>UK Government Plan</th>
<th>US Government Plan</th>
<th>NGO Proposals</th>
</tr>
</thead>
<tbody>
<tr>
<td>Country List</td>
<td>20 to start with, potentially up to 65.</td>
<td>42</td>
</tr>
<tr>
<td>100% cancellation of debt stock?</td>
<td>No, debt service cancellation between 2005 and 2015</td>
<td>Yes</td>
</tr>
<tr>
<td>Mobilises additional resources for the MDGs?</td>
<td>Some money is new</td>
<td>No new money: an equivalent reduction in future aid flows</td>
</tr>
<tr>
<td>Represents moral hazard for multilateral creditors?</td>
<td>Yes</td>
<td>No</td>
</tr>
<tr>
<td>Changes unequal creditor/debtor power relations?</td>
<td>No</td>
<td>No</td>
</tr>
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The UK Proposal

The UK proposal is limited to just 20 countries.

1. All post completion point HIPC’s (15 countries to date, January 2005);
2. All IDA-only countries with “suitably robust public expenditure management systems to ensure savings are directed towards poverty reduction”. A suitable proxy for the latter is those countries that have benefited from a Poverty Reduction Support Credit (PRSC).
Mali  Mali
Madagascar  Madagascar
Mauritania  Mauritania
Mozambique  Mozambique
Nepal*  Nepal*
Sri Lanka*  Sri Lanka*
Vietnam*  Vietnam*
Nicaragua  Nicaragua

* IDA-only countries

The UK Government claims that debt relief will be automatic for these countries and that it will suspend debt relief only when there are “serious fiduciary concerns such as corruption or diversion of resources for illegal purposes or military conflict”. At the same time however, the UK initiative is limited to post-completion point countries and IDA-only countries receiving World Bank Poverty Reduction Support Credit loans. By definition, post-completion point countries will have already implemented whole packages of economic adjustment reforms such as privatisation and liberalisation in order to reach this point. In a recent paper the UK Government has itself recognised the problems with conditionality approaches. See: Partnerships for Poverty Reduction: Changing Aid Conditionality http://www.eurodad.org/articles/default.aspx?id=565

Moreover, since the proposal pledges to provide only debt service cancellation between 2005 and 2015, it is actually more akin to a 25-30% debt cancellation rather than a 100% debt cancellation. This is because most loans taken on by low-income countries from the multilateral institutions have grace periods of up to 10 years and repayment periods of an average 30-35 years. The proposal is also ambiguous on how IMF gold should be mobilised. Any revaluation of IMF gold (not outright sale) will increase the borrowing costs of IMF members and also impose additional costs on creditor countries. This would not occur with a phased sale of gold.

The proposal does however promise to mobilise some additional resources towards meeting the MDGs. This is especially true if countries, while pledging to contribute toward the cost of multilateral debt cancellation, commit resources that they would not have otherwise used for overseas development. However, there remains the danger that at least for some countries, resources committed for multilateral debt cancellation could come at the cost of other forms of development aid flows. Even when the resources pledged are new, there is always a possibility that they come at the expense of future aid commitments.

Another problem with the UK proposal is that it has the potential to further encourage moral hazard on the part of the IFIs as they see their unpayable loans repaid through additional bilateral contributions. In fact, a recent study for the Dutch Government concludes that bilateral financing of multilateral debt repayments has the effect of turning grants into loans – as the money contributed by the donor countries is then recycled as additional loans by the institutions. The UK proposal therefore, instead of rectifying the problem of unequal burden sharing between the multilateral and bilateral creditors, ends up exacerbating it.

Finally, because additional bilateral contributions are voluntary, many countries may not sign-up. The UK has pledged to contribute 10% of the cost (roughly equal to its share) but only four other countries have expressed support. These are: Italy, Canada, Norway and Ireland. In total, this would amount to between 20 and 25%. Other donor countries however have already publicly stated their inability or unwillingness to follow suit: Germany because of fiscal constraints and the Netherlands because it argues it has already contributed much more than its fair share of debt cancellation.

In summary, while the UK proposal is a positive development, it suffers from serious limitations and even under an optimistic scenario it may only be able to raise a fraction of the resources needed for 100% multilateral debt cancellation.

3 Results of International Debt Relief, Policy and Operations Evaluation Department, Netherlands Ministry of Foreign Affairs, 2003. Available at: www.euforic.org/lob/detail_page.phtml?&username=quest@euforic.org&password=9999&groups=IOB&lang=en&page=publ.nlSV
The US Proposal

The US proposal extends to the 42 countries that are part of the HIPC Initiative. Furthermore, because the multilaterals' own resources would be used to fund debt cancellation, this would reduce moral hazard and restore a more equitable burden sharing arrangement between bilateral and multilateral creditors.

However, the US proposal does not mobilise any additional resources to help countries meet the MDGs. Many senior figures in the US Government are proposing turning the World Bank into a grant-making rather than a lending agency. Multilateral debt cancellation is seen from this perspective as a retrospective conversion of IDA loans into grants. The idea of grants, not loans is appealing in principle to prevent low-income countries falling back into debt traps. At the same time however, it would reduce the amount of money available to the international financial institutions to channel to low-income countries in future and would make the IFIs more dependent on regular financial contributions from rich countries. This makes it politically unpalatable for many European and Southern Governments because unless rich creditor nations contribute more resources to the World Bank (which the US Government is not pledging to do), low-income countries will in effect pay for their own debt cancellation in the form of reduced grants in the future.

There appears to be more support for the use of IMF Poverty Reduction and Growth Facility (PRGF) funds coupled with the principal from the gold revaluation exercise in 1999 to fund the cancellation of IMF debt. Based on recent intelligence, it seems that the US proposal has turned out to be a political non starter and has quite possibly fallen off the agenda.

NGO Proposals

Many civil society organisations have called for 100% cancellation of multilateral debt for all those countries where debt repayments are seriously hindering a country's efforts towards attaining the MDGs. In practice, this means that most low-income countries require 100% debt cancellation plus significant additional resources if they are to have any hope of reaching the MDGs by 2015. This is especially the case for the countries of Sub-Saharan Africa. Civil society proposals therefore have the advantage of being both more inclusive and equitable across countries.

NGO proposals also have the advantage of combining the various pots of money potentially available and thus have the capacity to raise more funds to finance 100% debt cancellation for a larger number of poor countries. By drawing mostly on the multilaterals' own resources, these plans help reduce moral hazard and restore equal burden sharing between creditors. The biggest advantage of the proposals however are that a large part of the resources they propose are new and would not otherwise be available for development purposes – so the money is unambiguously additional.

These proposals are supported by a significant number of civil society organisations around the world and there are signs that they are also gaining significant political support within the debtor community, for example HIPC Finance Ministers. They recently declared their support for IMF gold sales in a press statement at the 2004 World Bank/IMF Annual Meetings in Washington DC.

6) How much money is needed to cancel 100% of multilateral debt?

The amount of resources needed to cancel 100% multilateral debt depends on which group of countries one looks at.

For the 42 countries classified as HIPCs, about US$35 billion upfront will provide for the cancellation of 100% of multilateral debt in net present value terms.
For a larger group of 60 low income countries (all low-income countries as defined by the World Bank minus India which is on course to meet the MDGs without a need for further debt cancellation), the amount needed could be as high as US$80 billion in net present value terms.

Section 3: IMF Gold Sales and Debt Cancellation

7) How much money could gold sales raise for debt cancellation?

The IMF owns 103.4 million ounces of gold which is valued in its books at about US$8.5 billion. This is because most of the gold is still held at the historical price of US$51.5 / ounce. The current market price of gold however is much higher and in mid-January 2005 stands at US$424 / ounce.

If the IMF sells this gold at the current market price, it can generate US$424 x 103.4 million = US$43.8 billion.

This means that by selling gold at the current market price, the IMF could mobilise US$43.8 billion - US$8.5 billion = US$35.3 billion.

This could then be used for the cancellation of multilateral debt owed to the IMF and other multilateral creditors.

If we use a more conservative price for gold – the 24 year average since 1980 of US$370/ounce – the sale of all IMF gold would still generate US$30 billion for multilateral debt cancellation. This would cover almost 50% of the cost of providing 100% debt multilateral debt cancellation to all low income countries that face resource constraints to meet the MDGs. The remainder would need to be found from other sources such as voluntary bilateral contributions and/or the World Bank’s own resources.

8) Can the IMF gold be sold in such a way so as to minimise the impact on the market price?

The impact on the market price of gold can be minimised if it is sold in a phased and transparent manner over the next 10 – 20 years.

In order to completely eliminate any impact on world gold prices, IMF gold could be sold under the existing Central Bank Gold Agreement, under which (mostly) European Central Banks\(^4\) plan to sell 80 million ounces of gold over the next 5 years. These banks could be persuaded to take a quota cut to accommodate IMF sales so that the total amount of gold sold does not exceed the 80 million ounces already announced. Since the market widely expects the Agreement to be renewed in 2009, the mechanism could be repeated until all IMF gold has been sold.

Just as some Central Banks are selling gold, others are buying it. Developing country Central Bank foreign exchange reserves have grown by 200% since 1997 to US$1.5 trillion in 2004. Until recently, most of this increase has been in the form of currencies. It appears however that many are now seeking a more balanced portfolio by buying up large quantities of gold. The IMF could therefore sell gold directly to these Central Banks at a price indexed to the market price. Since the gold would not be sold outright and would not enter the open market, its impact on the world market price would be minimal.

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\(^4\) In most European countries, Central Banks are under direct government control or under indirect control because they are owned by the respective Finance Ministries. Therefore the decision to sell or not to sell gold can be influenced by the government. This means that if there is any political agreement on debt cancellation, it can be translated into quota cuts by Central Banks.
A combination of the above two mechanisms would perhaps be the most appropriate and efficient way of selling IMF gold without any significant impact on the market price.

9) Will the sale of IMF gold impact negatively the IMF’s ability to lend?

The IMF’s ability to lend is determined by the capital it holds. There is an ongoing debate about whether the IMF has too much capital or too little. However, it is critical to note that the sale of IMF gold does not imply taking sides in this debate. Selling IMF gold is not an implicit recognition that the IMF is overcapitalised. In fact, the sale of gold will have no affect on the amount of capital that the IMF holds and is able to lend.

Gold, as it is currently held by the IMF, constitutes about 2% of the institutions’ resources. In fact, the IMF’s articles forbid it from lending gold to member countries. It therefore cannot use it for normal lending operations which means that gold is in fact of no practical use to the IMF for its lending operations.

In fact, the sale of gold would actually increase, not decrease the IMF’s capacity to lend. Even after allocation of US$30 billion dollars to debt cancellation, the IMF would have an extra US$5.3 billion in cash which it can then use for lending. This happens because US$51.5 gets credited to the IMF for every ounce of gold sold. So, for the IMF the sale of 103.4 million ounces of gold translates into US$5.3 billion of additional cash. The Fund loses the gold, which was lying idle since it cannot be used for lending, and gains US$5.3 billion in cash which can be used for lending.

10) Does holding undervalued gold lend fundamental strength to the balance sheet of the IMF?

This premise is based on the notion that one day, if needed the IMF will be able to unlock the US$30 billion or more that lies locked up in latent value in the undervalued gold held by the Fund. This can only be done of course through an outright sale of gold.

In fact, members of staff at the IMF first proposed selling gold in 1980, but were thwarted by a lack of political will. Calls for the sale of gold were later revived in 1999 when it was proposed that resources mobilised via a sale of gold reserves be used to cancel some of the debt owed to the institution by the group of countries classified as highly indebted poor countries. However, even then, a lack of political will thwarted the outright sale of gold and instead a compromise solution involving the off market revaluation of gold – a mere accounting trick – was reached.

There is potential opposition to the sale of gold. This could come from:

a) Gold producing nations concerned at the potential negative impact on world gold prices;
b) Central bankers or analysts who continue to hold the belief that gold is a special asset with a role in the monetary system even though such a role was abolished by the IMF itself.

South Africa, an important gold producer, has however over recent weeks publicly announced that it favours the revaluation of IMF gold to support multilateral debt cancellation. Since the UK also favours a better use of this resource to fund deeper and broader cancellation, we are hopeful that enough political will can be mobilised to sell IMF gold. However detailed negotiations for the sale of gold may well be carried out behind closed doors with a public announcement only when a final deal is struck.

In sum, the option that would be acceptable to the widest possible community of stakeholders including borrowers, creditors and civil society is that which prioritises freeing up unused IFI resources.
Finally, it is also true that holding gold has a significant opportunity cost for the IMF. It has been estimated that if the Fund had started phased sales of gold in 1980 and invested the proceeds in income generating assets, it would now have a balance sheet that would be stronger by US$70 billion. Of this, over US$30 billion is the lost income and the rest is the cash value generated by gold sales.

11) Does the sale of gold represent “additionality” and how?

The proceeds from the sale of gold are additional in the sense that this is new money raised by unlocking the latent value in the form of vast reserves of undervalued gold held by the IMF. This money also does not represent the diversion of funds from one pot of development money to another. Furthermore, it does not involve the transfer of money from one developing country to another.

12) Can the fund not draw on this undervalued gold if faced with an emergency need for funds?

The IMF has a huge pool of resources – about US$370 billion (of which US$290 billion is in usable currencies). The IMF also continues to maintain its preferred creditor status. It is therefore unlikely that it would face a sudden and acute shortage of resources unless there is a major financial crisis and a number of its large borrowers are unable to repay (at the same time) IMF loans.

Such a situation will be no doubt be accompanied by stressed financial markets and most financial practitioners would agree that selling huge quantities of gold – an illiquid asset - into stressed financial markets would only serve to exacerbate the crisis. So it is clear that especially in the event of an emergency, the IMF would not be able to draw on its reserves of gold.

Holding undervalued gold does not therefore help the IMF to tackle an emergency in any way whatsoever. Rather, selling gold would generate an additional US$5 billion in liquid resources for the institution which could be drawn on for a number of development and/or emergency purposes.

13) What is the difference between gold sales and revaluation? Why is sale better than revaluation?

In 1999, a portion of IMF gold was revalued to finance debt cancellation for HIPCs in the framework of the HIPC Initiative. It was nothing but a paper accounting trick that had little, if anything to do with gold. In 1999, the IMF “sold” some of the agency’s gold to Brazil and Mexico in a series of transfers. These countries in turn had payments falling due to the institution. The IMF then agreed to “buy” the gold from these countries at the prevailing market price in lieu of cash settlement of debt repayments. The countries covered their debts to the IMF while at the same time, the institution was able to revalue the gold which otherwise would have continued to sit on its books at values of 50 years ago.

However this sort of transaction does not generate any new and additional inflow of funds because no gold actually left the IMF’s coffers. The money came not from the use of gold, but from an internal transfer of resources from IMF borrower and creditor nations. Funds were diverted from borrowers – in the form of a higher interest burden, and creditors – in the form of lower compensation for their contribution to the Fund, and used to pay off HIPC debt. This transaction costs IMF borrowers and creditors an additional US$140 million every year.

Revaluing all IMF gold, in a manner akin to that used in 1999 would in fact impose an additional annual cost on IMF members more than US$2 billion – an amount that will surely not allow the IMF to perform its job as the lender of last resort. Gold sales, on the other hand,
would actually generate new resources for debt cancellation: the IMF loses its gold and in
return raises money for multilateral debt cancellation.

14) Is it possible for the IMF to finance the World Bank’s share of debt cancellation? Isn’t there a problem with using funds from one institution to cover another’s debts?

Yes, it is entirely possible for the IMF to finance at least a large portion of World Bank debt cancellation. The IBRD has already transferred more than US$7 billion of resources to the IDA even though the two institutions are legally distinct entities within the World Bank Group.

In practice, the sale of gold by the IMF requires an 85% majority decision in the Board which is the same majority required to amend the IMF’s articles. So, if there is a political agreement to use IMF gold for World Bank debt cancellation, the articles of the IMF can be suitably amended at the same time to enable a transfer of funds from the Fund to the Bank. Most countries would only need executive approval to vote in favour but in some, such as the United States, a parliamentary vote is required. In Germany, the Central Bank would need to be consulted but the final decision would be taken by the executive.

Even if a direct transfer of resources from the IMF to the World Bank may prove politically or technically contentious, there is an easy alternative mechanism that allows for an indirect transfer of money. The proceeds of IMF gold sales should be restituted to member countries on the understanding that these countries would then immediately transfer this money to the World Bank for the purposes of multilateral debt cancellation.

15) Which stakeholders might block the proposals?

Most IMF gold comes from Organisation for Economic Cooperation and Development (OECD) countries. In a bid to get other countries on board (and in the interest of fairness), any IMF gold contributed by emerging and developing economies should not be used for multilateral debt cancellation and should be returned to them.

Both in the interest of equity and in order to minimise opposition to cancellation plans from other developing countries, non HIPC low income countries should also be included as beneficiaries of multilateral debt cancellation.

Central Banks are also not expected to block proposals and in most cases cannot practically do so. Most have limited control over any decision on the sale of gold even where they are independent of the government. Others who may have the power to block decisions would have little interest in doing so since it has little impact on the money supply or the inflation targets in the country concerned.

16) If IMF gold sales are feasible, why would the World Bank and IMF oppose the sale?

The World Bank does not actually oppose the sale of gold. In fact, World Bank President, James Wolfensohn has, at least in private conversations, endorsed the idea of gold sales to finance the cancellation of IDA debt. Several Executive Directors to the World Bank also support the idea. It is clear however, that for many World Bank staff, they feel it would not be politically expedient to publicly support these proposals as it would run the risk of aggravating colleagues at the IMF across the street.

The IMF, on the other hand, opposes the sale of gold to finance multilateral debt cancellation and in particular to finance the component not owed to the IMF. Their opposition is understandable given the natural tendency of any institution to expand its power. Selling off gold means that the Fund will lose resources that it (rightly or wrongly) feels it owns. What’s
more, such a proposal will see these resources go to another institution such as the World Bank with which the Fund does not always see eye to eye.

That said, many staff at the Fund do in fact recognise that in its current form, gold is of no real use to it and do not therefore oppose the sale. Nevertheless, many say they would prefer to see resources mobilised from the sale of gold to stay within the institution rather than be used to fund debt cancellation.

17) Is this not just an exercise in crisis management? How does this tackle unequal power relations between creditors and debtors?

Debt repayments are a huge drain on a country’s limited resources. Countries such as Senegal and Ghana spend over 20% of government revenue on debt service payments. This money could be better spent on poverty reduction expenditures, tackling HIV/AIDs and infrastructure. This situation is therefore clearly unacceptable. For these reasons, multilateral debt cancellation needs to be tackled immediately and without further delay.

It is true however that a “simple” debt cancellation does nothing to alter fundamentally unequal creditor/debtor relations which currently dominate the international debt architecture. At present, it is the creditors only who decide whether and on what terms they will grant a restructuring of outstanding debt or eventually any debt reduction. This approach has failed to guarantee debt sustainability in low-income countries and does not take into account the urgent human development needs of these countries. It has also failed to recognise that much of this debt is in fact odious debt, contracted by dictatorial regimes and not used for development purposes.

A number of civil society organisations across the world have therefore put forward their own plans for a more long term solution to the debt crisis. These include proposals for a Fair and Transparent Arbitration Process, an International Arbitration Court for Debt or a Tribunal Internacional de Deuda Soberana. According to these proposals, which all merit serious consideration, a neutral arbitration body negotiates and decides on the conditions for a sustainable exit from the burden of over-indebtedness.

100% debt cancellation for low-income countries will have a massive impact on millions of lives now. It is urgently needed and the IFIs and rich donor countries together have the resources needed to make it happen. It will also wipe the slate clean – which in itself is an important first step in shifting the balance of power away from creditors. Longer-term however, the international community must work towards a comprehensive fair and transparent mechanism which would be open to all countries and would address private, bilateral and multilateral debt.

Section 4: World Bank (IBRD) Resources and Debt Cancellation

18) What are some other sources of funds in the institutions that could be used to finance multilateral debt cancellation besides gold?

IBRD loan loss reserves and IBRD income allocation are other pots of multilateral funds that could be mobilised to finance multilateral debt cancellation. We believe that the IBRD could mobilise up to US$10 billion for multilateral debt cancellation from its general reserves, which currently stand at US$21.5 billion (total equity US$37 billion). Such a transfer would merely reduce the IBRD’s reserves to the level they were at in 1997, at which point the Bank was just as active and successful as it is now (and rated AAA by major credit rating agencies). Such a transfer would be worth US$10 billion in net present value terms.

Additionally, the IBRD could appropriate up to US$600 million annually from its net income for multilateral debt cancellation over the next few years. The IBRD’s net income (profit) has
been more than US$1 billion annually for more than 15 years and has averaged US$1.6 billion over the past 10 years. Such an annual transfer of US$600 million up to the year 2020 can generate US$7.5 billion in NPV terms. It would be most prudent for the IBRD to use a combination of transfers from the reserves and income allocations.

The IBRD could therefore mobilise up to US$17.5 billion in NPV terms which should be used to part fund the cancellation of poor country debt owed to IDA. In the past, the IBRD has already transferred more than US$7.5 billion to IDA from its annual earnings.

19) Would this transfer of funds from the IBRD affect the AAA credit rating that is so critical for its operations?

IBRD is accorded the highest credit rating AAA by all three of the world’s most internationally recognised credit rating agencies: Fitch, Standard & Poors and Moodys. The rating agencies seldom differ much on the ratings they assign to organisations.

Fitch finds that in fact, as of 2003, the IBRD had 490% times as much capital available as it required to maintain its AAA rating. It is clear then that the IBRD is not an organization teetering on the edge and indeed exceeds the requirements of a AAA rating by a wide margin of 390%. An allocation of US$10 billion of its reserves to IDA for multilateral debt cancellation would in no way threaten the IBRD’s AAA rating. In fact, according to analysis conducted by Fitch, the IBRD would still have 465% of the capital that it requires to hold on to a AAA rating.

20) Would the use of IBRD funds raise the cost of borrowing for IBRD borrowers?

The cost of borrowing for IBRD borrowers might increase very slightly, but are unlikely to go up for Brazil and India. The costs of using a part of the IBRD’s resources for IDA debt cancellation could be funded in either of two ways: a) through a small increase in the interest costs to borrowing countries while keeping the income the same, or b) through a small decrease in income while keeping the interest rates the same.

The tables below show what the effect of an appropriation of US$10 billion of reserves for debt cancellation would have been in each of the past 3 years using either of these options.

The first table shows what effect the proposal would have had on IBRD income if it chose to keep the lending rate constant. We see that the IBRD would have seen a significant but small decrease in its net income in each of the years. This would not have any significant impact on its operations especially given that the IBRD has been earning record amounts of net income over the past five years.

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<tr>
<td>Original Income</td>
<td>1,924</td>
<td>3,021</td>
<td>1,696</td>
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<tr>
<td>Revised Income</td>
<td>1,479</td>
<td>2,690</td>
<td>1,438</td>
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<tr>
<td>Percentage Decrease</td>
<td>23%</td>
<td>11%</td>
<td>15%</td>
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This next table shows what effect our proposal would have had if the IBRD chose to keep its net income constant and instead increased the interest rates on lending. This shows that the lending rate would need to go up but only fractionally – about 6% of what the original lending rate would have been.

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5 Using a discount rate of 3%
6 Risk Analysis of Multilateral Development Banks and other Supranationals, Fitch, March 1999 and IBRD credit update, Fitch, 14th June 2003
The IBRD is not restricted to using either one or the other of the options discussed above and could use a combination of both to compensate for the loss of reserves.

However, the best option would probably be to reduce income without affecting lending rates especially given that many commentators have questioned the need for the IBRD to have the high levels of income seen in recent years.

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<tr>
<td>Original Effective Lending Rate</td>
<td>5.60%</td>
<td>4.90%</td>
<td>4.02%</td>
</tr>
<tr>
<td>Revised Lending Rate</td>
<td>5.97%</td>
<td>5.18%</td>
<td>4.26%</td>
</tr>
<tr>
<td>Percentage Increase</td>
<td>6.49%</td>
<td>5.77%</td>
<td>5.86%</td>
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Recommended further reading

Civil society
‘The World Bank (IBRD) Resources and Debt Cancellation’ by Sony Kapoor for the Jubilee USA Network, January 2005
UK Government Proposals for up to 100% Multilateral Debt Cancellation, Eurodad briefing, December 2004
Fool’s Gold: The Case for 100% Multilateral Debt Cancellation for the Poorest Countries, ActionAid, Cafod and Oxfam International, October 2004
http://www.cafod.org.uk/policy_and_analysis/policy_papers/debt/fools_gold
‘The IMF, Gold Sales and Multilateral Debt Cancellation’ by Sony Kapoor for Debt and Development Coalition Ireland, September 2004
Resource Rich BWIs, Multilateral Debt Cancellation and the MDGs, Sony Kapoor for the IOB (Dutch Foreign Ministry), 2003
Did the G8 Drop the Debt? Five years after the Birmingham Human Chain, what has been achieved, and what more needs to be done? New report from Jubilee Research, Jubilee Debt Campaign and CAFOD, May 2003. Available at: http://www.jubilee2000uk.org/analysis/reports/G8final.pdf

Official
Results of International Debt Relief 1990-1999, IOB Evaluations, May 2003 http://www.euforic.org/ob/detail_page.phtml?&username=guest@euforic.org&password=9999&groups=IOB&languages=en&page=publ_nlSV
IMF Debt Relief Website: http://www.imf.org/external/np/exr/facts/hipc.htm