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April 21, 1995

To: Members of the Executive Board

From: The Secretary

Subject: Gold in the Fund

Attached for consideration by the Executive Directors is a paper on gold in the Fund, which will be brought to the agenda for discussion on a date to be announced. A summary and conclusions appear on pages 22-24.

Mr. David Williams (ext. 38305), Mr. Wittich (ext. 38307), or Mr. Roncesvalles (ext. 37800) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

Gold in the Fund

Prepared by the Treasurer's Department

(In consultation with other departments)

Approved by David Williams

April 21, 1995

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I. Introduction

Questions regarding the role and use of gold in the Fund have arisen on a number of occasions in recent Executive Board discussions. In the context of the review of the financing of the Fund's operations, a number of Executive Directors expressed interest in the possible use of gold to produce income for the Fund, taking into account the limited scope for Fund transactions in gold under the Articles (which restricts the Fund to selling gold or accepting it in the discharge of obligations, but precludes the trading of gold by the Fund). Questions have also arisen regarding the role of gold in the Fund's prudential provisions. Lastly, the possible use of gold to support the adjustment process of low income and debt-distressed member countries has been raised. This paper reviews the present position of gold in the Fund. Section II briefly summarizes the role of gold in the Fund prior to the Second Amendment of the Articles of Agreement and outlines the operational framework of gold in the Fund resulting from the Second Amendment, which entered into effect on April 1, 1978. Section III reviews the Fund's policies as regards the sale of its gold at the time of the Second Amendment and since then. Section IV discusses systemic and financial considerations relating to the Fund's continued holding of gold. A summary and conclusions are provided in Section V.

II. Operational Framework

Before the breakdown of the par value system and the subsequent amendment of the Articles, the role of gold in the international monetary system was both central and pervasive. In order to put in perspective the far-reaching nature of the changes brought about by the Second Amendment of the Articles of Agreement, it may be useful to recall the position of gold in the Fund under its pre-1978 Articles.

1. Gold prior to the Second Amendment

Under the exchange arrangements agreed upon at Bretton Woods, and reflected in Article IV of the Fund's original Articles, the par value of each currency was to be expressed in terms of gold and members were obliged to keep the exchange rates for their currencies within one percent of parity. In practice, most countries fulfilled these obligations by buying or selling their currencies for U.S. dollars, while the United States undertook to buy and sell gold freely for U.S. dollars at $35 per fine ounce, the par value of the U.S. dollar, which was equivalent to US$1 per 0.888671 gram of fine gold. This was also the "official price" of gold, at which all the Fund's transactions and operations in gold were conducted.

Gold played an important role in transactions between the Fund and its members. Twenty-five percent of a country's quota was normally payable in gold, and the same proportion was required for the payment of quota increases. 1/ Members could purchase any other member's currency by selling gold to the Fund, some repurchases were required to be made in gold and others could be so made, and charges on the use of the Fund's resources were payable in gold. In addition, the Fund could sell gold to members in order to replenish its holdings of currency. The value of the Fund's currencies were also maintained in terms of gold. 2/ Annex I provides summary information on the amounts of gold received and paid out by the Fund under these transactions.

The Articles also contained provisions aimed at preventing transactions in gold by member countries that might be destabilizing to the maintenance of par values and to the international monetary system. Article IV, Section 2 effectively specified a small allowable margin around par values, precluding purchases of gold by members at a price above the allowable upper limit or sales of gold by members at a price below the lower limit. These provisions did not prohibit sales of gold by members to nonmembers at prices above the upper limit--so-called premium sales--nor did they proscribe gold transactions between nonmembers. 3/ Private market prices for gold at

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1/ For many members with low holdings of international reserves, the initial gold subscription was set at less than 25 percent of quota but members incurred a repurchase obligation equivalent to the difference between the amount paid in gold and 25 percent of quota. Since the Second Amendment of the Articles, a part of the initial subscription reflecting the reserve asset payment of countries already member of the Fund is payable in SDRs.

2/ The maintenance-of-value requirement therefore applied to currencies whose par values were changed. Following the First Amendment of the Articles (in 1969), it became possible to waive the maintenance of the gold value of the Fund's currency in the event of a uniform proportionate change in par values, if this was agreed by an 85 percent majority of the total voting power of the Board of Governors. There never has been a uniform change in par values.

3/ Shortly after the establishment of the Fund, it became apparent that premium sales by gold-producing countries threatened to divert excessive amounts of gold from official holdings into private holdings. Accordingly, based on Article IV, Section 4a, which required members to collaborate with the Fund for exchange stability, the Fund made a statement in June 1947 recommending that members take action to prevent such sales.

times diverged from the official parity price, particularly in the later part of the Bretton Woods period. 1/

The First Amendment of the Articles, which provided for the introduction of the SDR into the international monetary system, did not fundamentally change the role of gold in the Fund. 2/ The SDR was valued in terms of gold (at the equivalent of the par value of the U.S. dollar of 0.888671 grams of fine gold). Almost all of the other gold provisions were maintained unchanged under the First Amendment. However, SDRs became usable for conducting operations and transactions with members in addition to gold and currencies. For example, the Fund could sell SDRs in purchases, accept SDRs in repurchases, and charges could be paid in SDRs; the Fund could also sell SDRs to replenish its holdings of currencies. (SDRs were not, however, directly convertible into gold in official transactions.)

2. The Second Amendment - gold provisions

The end of the Bretton Woods system was foreshadowed with the announcement by the United States in August 1971 that it would no longer freely buy and sell gold at the official price. This was followed shortly by the effective breakdown of the par value system soon after the formal devaluation of the U.S. dollar in December 1971, and by the generalized floating of exchange rates in March 1973.

A series of discussions on the structure of the international monetary system, including the roles of gold, SDRs, reserve currencies, and the convertibility of currencies into reserve assets in a reformed system, formally began in July 1972 with the establishment of the Committee of Twenty (C-20) 3/ which was directed by the Board of Governors to report to it and advise on all aspects of international monetary reform. The C-20 issued its final report in June 1974, but was unable to reach agreement on

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1/ In 1961, the "Gold Pool" was established, by which the central banks of seven large European countries agreed to cooperate with the U.S. Federal Reserve to operate in the London gold market to stabilize prices around the official price. Following heavy losses of gold by the central banks of the gold pool in late 1967, the pool was abolished, and on March 17, 1968, the central banks announced that they would no longer intervene in the private gold market. This resulted in the segmentation of the market for gold into the official market where transactions continued at the official price, and the private market where prices were freely determined by market conditions.

2/ The First Amendment became effective on July 28, 1969, following an affirmative vote by the necessary majority of the Board of Governors on Resolution No. 23-5, adopted May 31, 1968.

3/ The formal name was Committee on Reform of the International Monetary System and Related Issues.

appropriate arrangements for gold. 1/ The differences of view which remained among Fund members on the future role of gold were related in part to the fact that gold continued to represent an important part of the reserves of a number of countries (mostly industrial countries) and had increased in value as its price in the market rose, but under the pre-reform Articles of Agreement had become largely illiquid as it could not be used at market prices above the official price. At the same time, the reserves of other countries consisted primarily of holdings of reserve currencies. Questions at issue revolved mainly around the use members would be able to make of gold held in their reserves, and the implications such use--and limitations of use--would have for international liquidity in general, and for members that held little or no gold. While these issues related primarily to the role gold would play in the future as an asset in members reserves, it also strongly influenced the views of members regarding the treatment and use of the gold held by the Fund at the time. In the event, and despite some remaining differences, subsequent discussions on the reform of the system and the revision of the Articles culminated in an agreement on the Second Amendment of the Articles in 1976, which came into effect in April 1978.

The Second Amendment contained a comprehensive set of new provisions that in combination were intended to achieve the objectives of a gradual reduction in the role of gold in the international monetary system and in the Fund, and of making the SDR the principal reserve asset in the system. The financial operations and transactions of the Fund were adapted in part to reflect these two objectives. The most important changes in the provisions on gold introduced by the Second Amendment are listed in the *Commentary on the Second Amendment*, 2/ as follows:

> "(a) the elimination of the function of gold as the common denominator of the par value system and as the unit of value of the special drawing right;
>
> (b) the abolition of the official price of gold;

1/ That Report concluded that the main features of the international monetary reform would include, *inter alia*, "better international management of global liquidity, with the SDR becoming the principal reserve asset and the role of gold and of reserve currencies being reduced," and proposed "further international study in the Fund of arrangements for gold in the light of the objectives of reform." See *Final Report and Outline of Reform of the Committee of Twenty*, reprinted in Margaret G. de Vries, *The International Monetary Fund 1972-78: Cooperation on Trial*, Volume III: Documents, pp. 165-196.

2/ See *Proposed Second Amendment to the Articles of Agreement, A Report by the Executive Directors to the Board of Governors*, Washington, D.C., March 1976, pp. 43-44.

(c) the abrogation of obligatory payments in gold by members to the Fund and by the Fund to members, and the necessity for decisions taken with a high majority of the total voting power to enable the Fund to accept gold in payments;

(d) the requirement that the Fund complete the disposition of fifty million ounces of gold;

(e) the authorization of the Fund to dispose of the remainder of its gold holdings and to place the "profits" in a special account;

(f) the requirement that the Fund, in its dealings in gold, avoid the management of the price, or the establishment of a fixed price, in the gold market; and

(g) the undertaking of members to collaborate with the Fund and with other members with respect to reserve assets so that better international surveillance of international liquidity and the role of the special drawing right as the principal reserve asset in the international monetary system will be promoted."

Many of these changes in the Articles had operational effects on the functioning of the Fund. First, in all its operations in gold, the Fund must be guided by the objectives laid down in Article V, Section 12(a) of (i) promoting better international surveillance of international liquidity; (ii) making the SDR the principal reserve asset in the international monetary system; and (iii) avoiding the management of the price, or the establishment of a fixed price, in the gold market. 1/

Second, with the abolition of the official price of gold and the generalized floating of exchange rates, the value of the Fund's assets was to be maintained in terms of SDRs and not gold. However, the valuation of gold raised a number of issues, and because the "valuation of gold was not a simple or unitary concept," it was agreed that different principles of valuation could apply in different contexts. Gold held by the Fund at the time of the Second Amendment is valued by the Fund on the basis of SDR 1

1/ For their part, members are to collaborate with the Fund and other members in order to ensure that their policies with respect to reserves (including gold, SDRs, and foreign exchange) will be consistent with objectives (a) and (b) set out in the text above.

per 0.888671 gram of fine gold, the former official price for gold, whereas the valuation of newly acquired gold is to be decided by the Executive Board. 1/

Third, the Second Amendment developed a detailed operational framework regarding the disposition of some or all of the Fund's gold and also the use of the proceeds from any sale by the Fund. In this respect, it is important to note that, in accordance with Article V, Section 12(b) and 12(f), all decisions to sell gold for a specified purpose, whether they call for immediate or future action, require a majority of 85 percent of the total voting power. 2/

Fourth, the Fund was required to complete the sale of 50 million ounces of gold that had been agreed prior to the Second Amendment of the Articles coming into effect. 3/ Furthermore, the Fund may sell gold held on the date of the Second Amendment to members that were members on August 31, 1975 (and Papua New Guinea) 4/ and that agree to buy it, in proportion to their quotas and at the price of SDR 1 per 0.888671 gram of fine gold (Article V, Section 12(e)). This would effectively represent a "restitution" of gold to such Fund members in return for an amount of the member's currency corresponding to the "capital value" of the gold, i.e., the equivalent of SDR 35 per troy ounce or SDR 1 per 0.888671 gram of fine gold. No "profits" accrue to the Fund as a result of such operations. (In contrast, the amended Articles do not prescribe the price at which members may transact in gold.)

The Fund is also authorized to sell any part of its gold for the currency of a member, or accept it in the discharge of a member's obligations, in voluntary transactions at a price agreed for each operation or transaction on the basis of prices in the market (Article V, Section 12(c)), whether the gold was acquired before or after the date of the Second Amendment. If the gold that was sold had been acquired prior to the effective date of the Second Amendment, then the "capital value" of the

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1/ Issues raised by the Second Amendment as regards the valuation of gold in the Fund were discussed in *Treatment and Valuation of Gold for Fund Purposes*, SM/79/40 (2/7/79). The valuation of the Fund's gold is discussed further in Annex II.

2/ In addition, it may also be noted that under U.S. law a sale of the Fund's gold "for the special benefit of a single member, or of a particular segment of the [Fund's] membership" must be approved by the U.S. Congress before the U.S. Executive Director in the Fund may vote in favor of it (U.S. Code, paragraph 286c).

3/ The Fund's gold sales program of 1976-80 is discussed further in Annex III.

4/ Papua New Guinea is included in this context because members on August 31, 1975 were deemed to include a member that accepted membership after that date but whose membership resolution had been adopted by the Board of Governors on or before that date.

gold sold must be placed in the General Resources Account (GRA). The "profits," i.e., the amount in excess of the capital value of SDR 35 a fine ounce, may be placed in the Special Disbursement Account (SDA) unless the Fund decides to place them in the Investment Account for immediate investment (Article XII, Section (6(f)). Decision by the Fund to accept gold in satisfaction of obligations or to sell gold require a majority of 85 percent of the total voting power; decisions on the transfer of the capital gain from the sales of gold to the GRA for immediate use in operations and transactions require a 70 percent majority; and all other decisions on use and transfer to the Investment Account require an 85 percent majority. 1/

Finally, the Fund does not have the authority to buy gold. Indeed, as noted above, the Fund is enjoined not to re-establish an official price of gold, nor take any action that could be regarded as management of the price of gold, nor establish a fixed price in the gold market. 2/

3. Investment Account

The Fund is authorized to establish an Investment Account in the General Department with a majority of the votes cast (Article XII, Section 6(f)(i)). To date, no decision has been taken to this effect. The assets in the Investment Account are to be held separately from the GRA, are not usable in any transactions or operations of the Fund except those provided for under Article XII, Section 6(f), and are not subject to maintenance-of-value. The total amount transferred to the Investment Account may not exceed the amount of resources held in the Fund's General and Special Reserves, which amount to SDR 1,701.5 million at present. Assets placed in the Investment Account can flow from the following sources:

a. a part of the profits of a sale of the Fund's gold that the Fund decides, by an 85 percent majority of the total voting power, to transfer to the Investment Account;

1/ The special voting majorities for the various uses of the Fund's gold and related aspects are summarized in Annex IV.

2/ The *Commentary* noted that "when entering into operations or transactions in gold, the Fund must seek to follow and not to set a direction for prices in the gold market." In this connection, it may be recalled that on December 14, 1992, the Fund accepted 21,296 ounces of gold from Cambodia, in partial settlement of that member's arrears. The gold was valued at the morning fixing price in London on the day of acceptance ($335.30), yielding SDR 5.1 million. This acceptance followed immediately upon the restitution to Cambodia of gold which had been held by the Fund on Cambodia's behalf while Cambodia had overdue financial obligations to the Fund. See Executive Board Decision No. 5312-(77/3), adopted January 5, 1977, and Executive Board Decision No. 10233-(92/149), adopted December 11, 1992.

b. currencies held in the GRA that the Fund may decide, by a 70 percent majority of the total voting power, to transfer to the Account;

c. the income from investments of the Account; and

d. the proceeds of matured or liquidated investments of the Account.

The income from investments is not taken into account in applying the limit to the total resources that can be held in the Investment Account. Investments may be made only in income-producing and marketable obligations of international financial organizations or of the member whose currency is used for the investment. The income from investments may be invested, held in the Investment Account, or used to meet the expenses of conducting the business of the Fund, including both operational and administrative expenses.

4. The Special Disbursement Account

The SDA provides the financial framework for the disposition of the capital gain or profits realized upon the sale of gold acquired before 1978, except if the profits are transferred to the Investment Account. In other words, if the net proceeds of a sale of gold in excess of the capital value were not transferred for immediate investment in the Investment Account, the amount in excess of the capital value must be placed in the SDA, which is part of the General Department of the Fund. The assets in the SDA are kept separate from the other assets of the General Department and are not subject to the maintenance-of-value provisions of the GRA. The assets of the SDA may be invested in income-producing and marketable obligations of members or of international financial organizations. The obligations must be denominated in SDRs or in the currency used to make the investment. The concurrence of a member whose currency is used for such investments is required. The income from such investments is to be placed in the SDA pending use in accordance with the provisions regarding use of the other assets of the SDA.

The assets held in the SDA may be used at any time for any of the following purposes:

a. to make transfers of currency to the GRA for immediate use in operations and transactions authorized by provisions of the Articles other than Article V, Section 12. 1/ The transfer of currency may provide a

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1/ The term "immediate use" was intended to express that transfers take place in such a manner that they would not affect the position of members as calculated for various purposes under the Articles, i.e., that any such transfer would not affect the level of the transferred currency held in the GRA.

basis for capitalization at the time, or at a later date, by means of increases in the quotas of members on August 31, 1975 pursuant to Article III, Section 2(b) (such transfers require a 70 percent majority of the total voting power);

b. for operations and transactions that are not authorized by other provisions of the Articles, provided such use is consistent with the purposes of the Fund. Under this provision, the Fund may make balance of payments assistance available on special terms to developing members in difficult circumstances. (The latter could include, for example, the provision of subsidies on use of GRA resources.) When making available such assistance, the Fund will have to take into account the level of per capita income of developing members and may take into account other appropriate criteria but assistance must be on a uniform basis; 1/ and

c. to distribute directly to developing country members that were members on August 31, 1975 a part of the amounts that the Fund may decide to use to provide balance of payments assistance to developing countries. Such a direct distribution of profits to developing countries would be on the basis of the proportion that their quotas bore to the total quotas of all members on August 31, 1975. 2/

III. Policies Regarding Sale of the Fund's Gold

1. Discussion on the role of gold following reform of the system

While sale of 50 million ounces of the Fund's gold agreed in 1976 (the restitution of gold to member countries in proportion to quotas and the sales of gold for the benefit of developing countries) was still in progress, the Interim Committee requested the Fund to explore the possibility of a subsidy regarding the rate of charge on purchases under the

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1/ It may be recalled that resources of the Trust Fund stemmed from the proceeds of the sale of gold in excess of the capital value, and that subsequent repayments of such Trust Fund loans were used in part to subsidize the cost of using the Supplementary Financing Facility (SFF) and in part to finance the Structural Adjustment Facility (SAF) and also to help fund the ESAF Subsidy Account, as well as to help build up the ESAF Reserve Account. Repayments and payments of interest of Trust Fund and SAF loans would flow back to the SDA and could be used by the Fund in accordance with the provisions regulating the use of the Account.

2/ The Fund made such a direct distribution--from the Trust Fund--of the profits from the sale of gold in the period 1976-80 (see Annex III).

Supplementary Financing Facility (SFF) then being considered. 1/ Techniques considered for this purpose included voluntary contributions by members, the use of a transfer charge or commitment fee payable by the Fund, and the use of profits from the sale of gold by the Fund. 2/ With respect to the latter possibility, amendment of the decision on the existing gold sales program and the Trust Fund instrument was not favored, in part because it probably would result in a redistribution of the benefits of gold sales among the users of the Trust Fund and to other Fund members. Additional gold sales were considered preferable, and projections indicated that additional sales in the order of 1.4-2.8 million fine ounces (compared to 17 million fine ounces that remained to be sold under the then current sales program) would be needed to finance a SFF subsidy.

When the issue was taken up in the Executive Board, many Directors held that consideration of such a subsidy was premature in view of uncertainties about when the facility would become operational and how many low-income countries would in fact use it. 3/ Some Directors doubted the advisability of subsidies in principle; most of those who favored a subsidy considered voluntary contributions the most desirable financing method (which had been used for the Oil Facility Subsidy Account) and that further gold sales should not be contemplated before the end of the ongoing sales program. It was therefore concluded that consideration of the establishment of a subsidy account should be explored later.

When the question of reducing the cost of using SFF resources was taken up again two years later, the main technique considered was a reduction of the rate of charge on purchases outstanding under the SFF, the consequent shortfall of the Fund's income being financed by the income from investment of GRA resources through the Investment Account, or of profit on further

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1/ See *Press Communiqué of the Interim Committee, Eighth Meeting, Washington, April 29, 1977 (Annual Report 1977,* page 114), *Supplementary Financing Facility: Charges* (SM/77/216, 8/24/77), and *Possible Financing for Subsidies of Charges in Connection with the Use of the Supplementary Financing Facility* (SM/77/219, 8/26/77). (It may be recalled that charges on the use of that facility were to be set so as to meet the cost of the borrowing by the Fund to finance purchases under it; given the prevailing market rate of interest, these charges were then projected at about 7.25 percent per annum, compared to the rate of charge on the use of the Fund's ordinary resources of about 5.0 percent.)

2/ See *Possible Financing for Subsidies of Charges in Connection with the Use of the Supplementary Financing Facility* (SM/77/219, 8/26/77), and *Legal Aspects of Subsidies in Respect of Charges for Use of the Supplementary Financing Facility* (SM/77/218, 8/26/77).

3/ See EBM/77/140 (9/19/77). The first borrowing by the Fund for the Supplementary Financing Facility was made in May 1979.

gold sales through the Special Disbursement Account. 1/ In their discussion of these issues, many--though not all--Directors considered favorably the proposal for reducing the cost of using SFF resources, reflecting in part the fact that market interest rates had risen further since the earlier discussion, but thought further consideration was needed of techniques. 2/ In particular, the Fund's attitude towards the disposal or retention of its remaining gold holdings after completion of the four-year sales program needed consideration. Pending a general review of this issue--which had wider policy implications--these Directors considered it would be undesirable to take *ad hoc* decisions for particular uses which might be based on too narrow grounds.

2. Substitution Account and enhancing the Fund's income

In the spring of 1979, the Executive Board began to consider the establishment of an account, to be administered by the Fund, that would accept deposits of foreign exchange from members on a voluntary basis in exchange for an equivalent amount of SDR-denominated claims, as a further step toward making the SDR the principal reserve asset in the international monetary system (the Substitution Account). In the detailed consideration of such a Substitution Account, the question arose as to the means to ensure that assets of the Account would always be sufficient to meet the Account's liabilities, given that the deposits, as well as the interest earnings, would be in the form of currencies, primarily in U.S. dollars, while the claims on the Account and interest payable by it would be in terms of SDRs. One means of ensuring the viability of the Account that eventually was proposed was the deposit of (a substantial) part of the Fund's remaining gold holdings. 3/

In these circumstances, and taking also into account the completion within a few months of the Fund's program to sell 50 million ounces of its gold holdings, the Managing Director suggested to the Executive Board a review of how to deal with the questions of the Fund's gold in a comprehensive way. 4/ The Managing Director stated that any proposal concerning the Fund's gold should embody two principles: (i) the desirability of maintaining the Fund in a strong financial position, and (ii) the need to contribute to the achievement of the Fund's purposes. In

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1/ *Mechanisms to Reduce the Cost of Using the Supplementary Financing Facility* (EBS/79/547, 9/5/79).

2/ See EBM/79/157 (9/14/79). The (calculated) rate of charge on purchases under the SFF had risen from around 7 1/2 percent when the SFF was agreed to around 10 percent by mid-1979, compared to a rate of charge on the use of "ordinary" resources averaging around 5 percent.

3/ *Substitution Account--Use of Gold to Maintain Financial Balance* (SM/79/294, 12/21/79).

4/ *Statement of the Managing Director on the Fund's Gold Holdings* at EBM/80/5, January 11, 1980 (Buff 79/243, 12/21/79).

view of the likely future financial involvement of the Fund in support of balance of payments adjustment that was becoming discernible, the Managing Director considered that a further "restitution" could not be recommended as it would weaken the Fund's financial position. For this and other reasons, he also did not consider selling part of the Fund's gold for another Trust Fund compatible with these principles. To the contrary, if there were to be further sales of gold, the value would be best preserved for the Fund's finances if the profits from sales were kept intact as part of the Fund's assets, using only the income from the investment of those profits for agreed objectives.

To contribute to the achievement of the Fund's purposes, the Managing Director envisaged three possibilities for using the Fund's gold: (i) to encourage the adoption of stabilization programs supported by Fund credit, including through a reduction of the market-related rate of charge, then projected to reach 10 percent, on the use of the SFF, by engaging in gold sales of 1.2-3.5 million ounces (depending on the list of beneficiaries); (ii) to engage in a modest sales program to improve the Fund's income position while permitting an increase in the SDR interest rate and the rate of remuneration to bring them closer to market rates of interest, with a projected amount of gold sales of perhaps 6 million ounces; and (iii) to support the Substitution Account, for which 23 million or 32 million ounces could be set aside for later transfer to that Account.

In addition to a general discussion of the Managing Director's Statement, 1/ Executive Directors considered the issue of gold sales a number of times in connection with the ongoing consideration of the proposed Substitution Account and the use of profits from gold sales to support the Fund's income position. 2/ They broadly supported the general principles underlying the use of the Fund's gold as set out by the Managing Director. There was, however, less agreement on the methods proposed for putting these principles into practice.

On the use of gold in connection with a Substitution Account, views were divided. Some Directors maintained that the Account would benefit some groups of members more than others, and they related their support for the use of the Fund's gold for this purpose to the development of a package in favor of the developing countries. Others were in favor of the sale of gold for this purpose, and felt that the proposals for the Account should stand on their own merits. Views also differed on the amounts, modalities, and timing of the gold sales. On the question of the use of the Fund's gold to strengthen the income position of the Fund, several Directors supported that approach but others did not consider there was an urgent need to strengthen the Fund's financial position, which seemed satisfactory to them. If the

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1/ EBM/80/5 and 80/6 (1/11/80).
2/ EBM/80/40 and 80/41 (3/10/80), 80/46 (3/13/80), 80/55, 80/56, and 80/57 (3/27/80), 80/64 (4/7/80), and 80/68 (4/9/80).

need for a strengthening arose in the future, various other methods should also be considered, including a general review of charges on the use of Fund resources. Directors were also divided on the use of the Fund's gold for lowering the cost of using the SFF; most Directors favored using Trust Fund resources, including those resulting from repayments, rather than the proceeds of additional sales of gold, to finance such subsidies, which at any rate should be confined to developing countries.

The Managing Director eventually summarized the discussion of the Executive Board and reported to the Interim Committee at its meeting in April 1980 in Hamburg. 1/ There had been general agreement that the Fund should be cautious and prudent in its approach to using the remaining stock of gold of 103 million ounces. There should be no disposal of gold just to continue the sales program; and any further sales should be of limited amounts and be undertaken only to promote the purposes of the Fund in ways that commanded the broadest possible consensus among the Fund's membership; any proposal on the Fund's gold would therefore need to preserve a careful balance in order to ensure a wide agreement on the policies the Fund would thereby promote and the necessary support from the membership. Reflecting the emphasis on the preservation of the Fund's capital and maintaining the strength of its financial position, whenever feasible the profits from any such sales should be used to create an investment fund, and only income from it used to promote the agreed policies. Based on these general principles, the Managing Director expected that agreement could be reached to support the establishment of a Substitution Account that would be beneficial for all Fund members by setting aside some 25-30 million ounces of the Fund's remaining gold, and to promote the role of the SDR as the principal reserve asset by bringing the interest rate on the SDR close to the combined market rate while strengthening the Fund's income position and reducing the cost of using the SFF through use of income on the investment of the profits on the sale of some 5-6 million ounces of gold.

The Managing Director's proposals were considered at the Spring 1980 Meeting of the Interim Committee. However, some issues remained to be resolved, including arrangements for the maintenance of financial balance in the Substitution Account. While the Committee expressed its intent to continue its work on this subject, the question of the Substitution Account was in fact not taken up again in the Executive Board or the Interim Committee. Similarly, the Committee did not take any position on further sales of gold by the Fund, but expressed the hope that at an early date measures would be taken to reduce the cost of using the SFF and in this way ease access to that facility. 2/ In light of the Committee's lack of support for further gold sales, further discussion of an SFF subsidy concen-

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1/ *Policy on the Fund's Gold Holdings--Statement by the Managing Director* (ICMS/Doc/80/4, 4/14/80).

2/ *Communiqué of the Interim Committee, Thirteenth Meeting, Hamburg, April 24, 1980 (Annual Report 1980*, pp. 165-167).

trated on use of repayments to the Trust Fund and on voluntary contributions. 1/ Similarly, a thorough review was commenced on the Fund's income position and the method of determining the rate of charge, which led to the adoption of the current system of annual reviews and of linking the rate of charge more directly to the determinant of the major element of operational costs, i.e., the rate of interest on the SDR and underlying market interest rates. 2/ The issue of sales of gold for these purposes was dropped.

3. Enhanced Structural Adjustment Facility

In the mid-1980s, some observers of international monetary developments as well as some discussions in official circles considered the possibilities inherent in the Fund's large gold holdings to increase Fund resources or to deal with members' debt problems. 3/ In this regard, when the Managing Director proposed the establishment of a successor to the Structural Adjustment Facility (SAF), to provide support to some of the lowest income Fund members, some potential contributors suggested consideration of the use of the Fund's gold for this purpose, although no concrete proposals for sale of a specific amount were made at this time. 4/ When discussed in the Executive Board, this suggestion received both support and objections from Executive Directors, most of whom agreed with the position of Management and staff that in the then prevailing circumstances of great uncertainties as well as substantial demand on the Fund's resources, it would be undesirable to dispose of what was widely considered an important element of the Fund's financial strength. 5/ However, in further discussions of the proposed Enhanced Structural Adjustment Facility (ESAF) it became clear that in order to elicit financing for the ESAF, the Fund would need to provide certain assurances beyond those available through the ESAF Trust's Reserve Account that lenders would be repaid when their loans to the ESAF Trust matured.

1/ See *Interest Subsidies--Possible Means of Financing* (EBS/80/132, 6/10/80).

2/ See *Review of the Fund Charges* (SM/80/282, 12/24/80), and Supplements.

3/ See, for instance, the proposals for mobilization of the Fund's gold to finance regular Fund operations made in connection with the consideration of quota legislation in the U.S. Congress (Statement of the Honorable Beryl W. Sprinkel, Under Secretary of the Treasury, before the U.S. Senate Committee on Banking, Housing, and Urban Affairs, June 6, 1983) and the proposal by Congressman LaFalce to establish an International Debt Adjustment Facility backed, in part, by Fund gold (*Congressional Record*, March 5, 1987, p. H-1072).

4/ *The Chairman's Statement on the G-10 Meeting on Enhancement of the Structural Adjustment Facility* at Executive Board Informal Session 87/4, July 15, 1987 (Buff 87/136, 7/15/87).

5/ See *ibid.*, and *Further Consideration on the Mobilization of Resources in Association with the Structural Adjustment Facility* (EBS/87/190, 9/2/87), discussed at EBM/87/138 (9/15/87).

Accordingly, the Fund undertook, "if it appeared that any delay in payment by the Trust to lenders would be protracted, to consider fully and in good faith all such initiatives as might be necessary to assure full and expeditious payment to lenders," 1/ and the Managing Director confirmed in summing up the discussion leading up to the decision that the reference to "all such initiatives as might be necessary" had to be understood to include the possible use of the Fund's gold. 2/

4. Gold pledge for use of ESAF Trust resources under the rights approach

In view of the sharp increase of overdue financial obligations to the Fund during the second half of the 1980s, increasing attention was given to measures to resolve the problem of arrears to the Fund. Included among these was the use of profits on the sale of the Fund's gold to resolve the arrears problem, to strengthen the Fund's financial position, or to assist in the financing of concessional balance of payments support to the low-income developing countries. None of these proposals or suggestions received sufficiently widespread official support to lead to a conclusion at the time it was made. 3/

The possible use of gold was also considered in the context of the strengthened collaborative strategy to resolve the problem of protracted arrears, and specifically in the discussion of the "rights approach" adopted by the Fund in June 1990. Under that approach, it was understood that--for ESAF-eligible members--part or all of the encashment of rights following approval by the Fund of a successor arrangement to the member's rights accumulation program could be financed by purchases under ESAF. However, some lenders to the ESAF Trust considered that use of the resources made available to the ESAF by members that had such overdue obligations carried increased risks. They sought, therefore, more concrete assurances from the Fund regarding repayments due to lenders to ESAF. In response to these concerns, the Managing Director proposed a contingent but explicit undertaking on the mobilization of gold to provide additional assurances to ESAF creditors regarding loans reflecting the encashment of rights. 4/ Subsequently, the Fund decided--with the necessary 85 percent majority--to sell up to 3 million ounces of gold if it were determined that the resources

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1/ Executive Board Decision No. 8759-(87/176) ESAF, as amended.

2/ See *Chairman's Summing Up of the Discussion on the Enhancement of the Structural Adjustment Facility--Operational Arrangements*, EBM/87/171 (12/15/87).

3/ See, for instance, the Debt Adjustment Facility proposed by Congressman LaFalce noted above; the statement of Vice Minister Gyohten (Japan) at the time of the 1987 Annual Meeting; and U.K. Chancellor Lamont's statement at the 40th Meeting of the Interim Committee (April 1993).

4/ *Statement by the Managing Director on the Use of ESAF Resources in Connection with the Rights Approach* at Executive Board Meeting 90/66, April 27, 1990 (Buff 90/80, 4/19/90).

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4/ *Statement by the Managing Director on the Use of ESAF Resources in Connection with the Rights Approach* at Executive Board Meeting 90/66, April 27, 1990 (Buff 90/80, 4/19/90).

in the ESAF Trust Reserve Account (plus other available means of financing) were insufficient to meet payments to be made from that Account to ESAF lenders because of previous drawings on the Account attributable to overdue repayments of loans financed through the encashment of rights. 1/

IV. Considerations Relating to the Fund's Present Holdings of Gold

The Fund presently holds 103.4 million fine ounces of gold, equivalent, at SDR 35 per fine ounce, to SDR 3.6 billion. These holdings, which remain the second largest of official holders, are part of the Fund's general resources held in the General Resources Account. With the exception of some 21,300 ounces due to Cambodia in restitution which the Fund accepted in 1992 in discharge of Cambodia's overdue financial obligations, the Fund acquired all of the gold it holds before January 1, 1974 at the former official price, mainly through the payment in gold by members of original subscriptions (SDR 1,965 million) and subsequent quota increases (SDR 4,361 million). Members' sales of gold to the Fund, primarily by South Africa in 1970-71, amounted to the equivalent of SDR 777.4 million (see Annex I, Tables 1 and 2).

Apart from the gold sales program in effect between 1976 and 1980, the Fund prior to 1978 sold gold on occasion to replenish its currency holdings, for the payment of interest and transfer charges on borrowing under the General Agreements to Borrow, and for payment of remuneration. 2/ Total sales of gold by the Fund for these latter purposes amount to SDR 565 million. The Fund's gold holdings have thus remained essentially unchanged since May 1980, when the last of the gold auctions occurred.

1. Recent trends in official gold holdings

The Fund's gold holdings may reasonably be considered in the broader context of the stocks of gold held by others, particularly other official holders. The total stock of gold in the world has been estimated at some 3.5 billion ounces in 1994, of which approximately one third (1.1 billion ounces) is held by central banks (900 million ounces) and other official institutions (200 million ounces), mainly the Fund and the European Monetary

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1/ See *Modalities of a Gold Pledge for Use of ESAF Trust Resources Under the Rights Approach* (EBS/90/108, 6/12/1990); *Executive Board Meeting* 90/96 (6/18/90), and Executive Board Decision No. 10286-(93/23) ESAF, adopted February 22, 1993.

2/ See Annex I. The Fund also instituted a gold investment program, whereby gold swaps with the United States were undertaken during 1956-1960 for the purpose of raising income to offset the impairment of capital that had resulted from cumulative administrative deficits. The investment thereafter was continued in order to build up reserves against the risk of future administrative deficits. These investments were reversed in the early 1970s.

Cooperation Fund (EMCF). 1/ Of the remainder, it has been estimated that approximately one half is held as private investment or as speculative demand and the rest in the form of jewelry, ornaments, etc. 2/

Official holdings of gold have remained largely unchanged since 1968, though with a slight downward tilt. 3/ Some redistribution of holdings has occurred among official holders, in particular in the context of the sales of 25 million ounces of gold by the Fund in "restitution" between 1976 and 1980, with the developing countries increasing their gold holdings significantly during that period. Official holdings of gold have largely been concentrated in the G-10 countries (plus Switzerland), which together account for about 63 percent of official holdings.

Though total official gold holdings have been quite stable, some central banks have been net sellers of gold, after taking into account sales from gold production in a number of cases. The sales of gold by monetary authorities have been for diverse purposes, such as the minting of gold coins, to raise foreign exchange in the face of external payments deficits, domestic fiscal reasons, a desire to increase the rate of return on official reserves by acquiring interest-yielding foreign exchange, and to "harmonize" the structure of reserves with other members of the EMS. In terms of the total stock of gold held by official institutions, however, these outright sales of gold have been small, and no general trend seems to have emerged which would suggest that official holdings of gold are being sold. With the official or monetary role of gold having legally ended, gold has also become, for practical purposes, a relatively immobile asset of central banks.

As a component of total international liquidity, the relative importance of gold has declined sharply since the late 1960s, falling from over 50 percent of total reserves as of the end of 1968 to about 23 percent as of the end of 1994, valued at market prices. With the shift from the par value system and the growth of international capital markets, the use of gold in official settlements has effectively disappeared. Gold has been used occasionally as collateral for official borrowing--for example, by South Africa during the 1980s, Venezuela in 1989, India in 1991, and Russia in 1993.

Some central banks are reported to have begun in recent years to manage their gold holdings more actively, as they manage their foreign exchange holdings, by participating in the gold derivatives markets, especially

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1/ EMS member countries deposit 20 percent of their total gold holdings with the EMCF in exchange for ECUs under renewable swap arrangements.
2/ The private demand for and supply of gold is further discussed in Annex V.
3/ The current stock of official holdings of gold is approximately 5 percent lower than the level of holdings in 1968 (Annex V, Table 3).

through options, futures, and gold leasing. 1/ In a gold lease, a central bank places gold at the disposal of a private dealer, who contracts to return the same quantity at a fixed date in the future plus a payment (in gold) for use. 2/ The development of the gold leasing market has paralleled the growth of the gold futures market.

The use of the derivatives market by central banks helps to reduce the relatively high cost of holding physical gold and provides a rate of return on physical holdings. However, the rate of return on gold loans is very small given the very large stocks of central bank holdings, which far exceed any likely demand by borrowers of gold, and because of the limited range of dealers that are acceptable to central banks. Over the last few years, the interest rate on gold loans has varied between 1/2 - 2 1/2 percent per annum, and is currently reported to be of the order of 1/2 - 1.7 percent. Furthermore, there are considerable risks associated with lending gold, and indeed, some central banks reportedly experienced not insubstantial losses in the past. 3/ As explained to the Executive Board in the context of discussions in recent years on the costs of financing the Fund and on precautionary balances, the Fund does not have the legal power to engage in any gold transactions (such as those described above) other than a sale of gold. 4/

2. Reasons for holding gold

A number of considerations militate against substantial sales of gold by official institutions, and which *mutatis mutandis* also apply to the Fund.

The Fund's gold holdings represent an undervalued asset in terms of the market price. The potential unrealized gain on these holdings may be considered a significant element adding to the overall strength of the Fund as a financial institution. (At recent market prices, the potential gain from a sale of all the Fund's gold would amount to some SDR 23 billion, or slightly less than total Fund credit outstanding.) The Fund's gold holdings are perceived by many to represent the Fund's basic--or ultimate--reserve. A sale of significant amounts of gold by the Fund could be seen as an erosion of its reserves and a relative weakening of its financial position,

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1/ For a more extensive treatment of recent developments in gold markets, including transactions by official holders, see G. O'Callaghan, *The Structure and Operation of the World Gold Market*, IMF Occasional Paper No. 105, September 1993.

2/ New investment in mines is often financed in part by sales of borrowed gold, and the gold loan repaid from subsequent production.

3/ According to market reports, a number of central banks suffered losses in 1990 from the default of a major gold borrower (see O'Callaghan, *op. cit.*, p. 26).

4/ See Statement by the General Counsel at Seminar 92/1 (7/8/92), and also the discussion at EBM/94/19 (3/9/94).

unless the full proceeds from the sales--including the proceeds in excess of SDR 35 an ounce--would be retained in the Fund and used to strengthen the financial position of the GRA as the need arises. 1/ A perception of a weakening of the Fund's financial strength at a time of rapidly rising demand for Fund credit, and while a relatively large stock of overdue obligations remains outstanding, could be seen to diminish the Fund's credibility as the central institution in the international monetary system and, perhaps, cast doubt on its ability to carry out its mandate over the longer term.

Secondly, the Fund's gold holdings are also seen as being available in case of need to meet creditors' claims on the Fund in the event of liquidation, and to replenish the Fund's currency holdings if the Fund did not at some time have sufficient liquidity to encash member's reserve positions in the Fund, including claims arising from Fund borrowing. While all the Fund's assets are available to meet its liabilities, the ability to mobilize gold to acquire the necessary currencies (and SDRs) may be considered an added protection for the Fund in the event that the Fund's other assets could not for some reason be fully mobilized. As a corollary, it could also be maintained that the Fund's gold holdings strengthen the Fund's ability to borrow, both on its own account and as Trustee. 2/

Thirdly, it is held that the holding of gold enhances the Fund's ability to respond to unexpected developments of a systemic nature--i.e., gold should be held as a reserve against various future but unspecified

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1/ Such an erosion would be incurred if profits on the sale of the Fund's gold would be used for some purpose other than strengthening the General Resources Account. If these profits were set aside, to be used only to generate income which in turn could be transferred to the GRA for immediate use if the need arose, no such erosion would occur.

2/ As discussed above, the Fund has decided to sell up to 3 million ounces of gold if it appears there would be a potential shortfall in the resources of the ESAF Trust Reserve Account because of rights-related credits not being settled when due, and thereby provided added assurance to lenders to the ESAF Trust of the security of their claims. It may also be recalled that in connection with the Supplementary Borrowing Agreement with the Saudi Arabian Monetary Agency (EBS/84/78, 4/4/84), it was understood that in the event the Fund were seriously to consider a material reduction in its gold holdings without having taken such steps as would be necessary to ensure its continued ability to meet its obligations to its creditors, SAMA reserved the option to request the Fund formally to make early repayment of outstanding debt to SAMA, and it was understood that the Executive Board would consider such a request fully and in good faith (see EBM/84/64, 4/24/84).

contingencies. 1/ In other words, the Fund's gold holdings provide greater leverage in the future, in the sense that its gold holdings could make possible more reliable ways of supporting the Fund's financial activities than would a conversion of gold into currency assets at present.

A sale by the Fund of some of its gold holdings--or the announcement of an intent to sell--would, *ceteris paribus* and at least in the short run, be likely to cause a fall in the market price of gold, depending on the size of the expected addition to market supplies (including both the indicated mobilization and the perceived likelihood of future sales), on expectations as regards the policies of other monetary authorities with respect to their holdings of gold and on the supply response. 2/ In this connection, some official holders of gold which value their holdings at or in relation to the market price, may view with concern a sharp decline in the value of their reported gold holdings because of an announced program of gold sales by the Fund. A major decline of the market price of gold upon announcement of gold sales by the Fund would, if prolonged, also affect adversely the potential size of the profits from gold sales by the Fund. In sum, any sale of gold from official stocks is likely, at least in the short run, to depress prices in what is a relatively narrow and volatile market. The issue is not, however, whether sales of gold should or should not take place, but whether, after taking into account the likely fall in price, it is justifiable, over the long run, to sell gold in the face of relatively weak prices. In practice, the issue boils down to the expected rate of return on the proceeds of gold sales over the short run.

In sum, four main reasons have been put forward to justify the Fund, and other official institutions, holding gold as a major component of its assets: (i) they are an important element in backing the Fund's overall financial position and gold is in some sense the Fund's ultimate reserve; (ii) the Fund's gold holdings as general resources support the Fund's liquidity position, in particular to back the Fund's liquid liabilities; (iii) its gold holdings strengthen the Fund's ability to borrow; (iv) they are a significant asset that could be mobilized to meet various contingencies; and (v) the private market for gold is relatively narrow and

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1/ The view that the holding of gold is an insurance against unforeseen contingencies was taken by the 1982 U.S. Gold Commission, which concluded that "if gold is regarded as a valuable asset to be held against emergencies by the United States, the same considerations should apply to the international gold reserve." See *Report to Congress of the Commission on the Role of Gold in the Domestic and International Monetary Systems*, Vol.I, pp. 13 and 147.

2/ The extent of price reduction would reflect the degree to which the demand for gold is inelastic with respect to price. Most econometric estimates of the price elasticity of demand for gold, as well as the Fund's experience in announcing gold sales in 1975, suggest that the risk may be significant for sales in a range exceeding 6-8 million ounces per year.

volatile, and relatively heavy and continuing sales of gold could depress the price significantly, thereby impacting the value of central bank assets.

3. Cost of holding gold

In contrast to the prudential considerations discussed above, a strict financial analysis of the costs and benefits to the Fund and other financial institutions of the world continuing to hold gold is unlikely to conclude that holding gold--or at least holding a relatively large stock of gold--is advantageous on financial grounds. The holding of gold by the Fund involves considerable direct and indirect carrying costs in terms of remuneration expense and of interest income foregone. As noted earlier, the Fund holds its gold in the General Resources Account (GRA). The alternatives to holding gold are (i) larger holdings of currencies usable in Fund transactions or (ii) larger SDR holdings. The carrying cost to the GRA of the Fund's gold holdings, in terms of remuneration expense the Fund would not incur if it held currencies rather than gold or income from its SDR holdings, is estimated at approximately SDR 180 million a year on the basis of the current SDR interest rate of around 5 percent. 1/ These "carrying" costs are related to the valuation of gold in the GRA at SDR 35 an ounce and do not include the opportunity cost reflected in the income foregone on the unrealized value of the Fund's gold holdings in excess of its value in the financial statements. 2/

Considering only the rate of return on gold and the rate of return on alternative instruments, it could be argued that, from a strictly financial point of view, the holding of gold by the Fund could be justified if the annual increase in its price, expressed in terms of SDRs, is expected to exceed the SDR interest rate (i.e., the cost to the Fund of holding gold which is equal to the (basic) rate of remuneration). In this regard, it may be noted that the annual increase in the price of gold has, on average, been negative from the early 1980s to 1995--i.e., after the completion of the Fund's four-year gold sales program--while the average SDR interest rate has been above 5 percent per annum during most of these years. 3/

1/ See also *Cost of Fund Credit - Principles of Burden Sharing - Concessionality in Fund Operations and Related Matters* (EBS/92/108, Sup. 1, 6/15/92).

2/ At the present SDR interest rate and rate of remuneration, each million ounces of gold held by the Fund represents remuneration expense of SDR 1.8 million per year, while the foregone interest income on the unrealized gain, which reflects the difference between the market price and SDR 35 per fine ounce, is of the order of SDR 10.5 million, based on the current market price of gold of about US$380 and the value of U.S. dollar in terms of SDRs.

3/ A simulation of income foregone by holding gold is summarized in Annex VI.

Gold price developments in past periods do not, of course, give any indication of future price movements, or of the prices at which the Fund could sell gold. In general, however, and on the basis of strictly financial considerations, a sale of gold by the Fund could be expected to improve its overall financial position only as long as the expected future interest rate of the SDR exceeds the expected price increase of gold, and in particular if the profits from such sales were invested and retained by the Fund.

However, it could not be inferred from such calculations that the Fund would gain in the longer term from the sale of all or most of its gold. Indeed, the considerations presented above do not indicate an optimal or "right" level at which the Fund should maintain its gold holdings. Any sale of the Fund's gold must weigh the advantages of alternative uses of the proceeds of any given potential profit. In retrospect, the sale of part (25 million ounces sold by auction) of the Fund's gold holdings between 1976 and 1980 was highly "profitable", not only because the Fund happened to sell gold in a sharply rising market with very large profits accruing to it, but because the large amount of profits enabled the Fund to finance, successively, a number of highly desirable initiatives, including the ESAF. In general, the Fund must have discretion as to the amount of gold it believes appropriate to meet its long-term needs in relation to short-term objectives as to the use of the proceeds of a sale of gold. Fundamentally, the guiding principle of the Fund's policy on gold should be expressed in terms of the basic objectives or purposes of the Fund which can be better achieved or furthered through a strengthening of its overall financial position both in the short and long run, having very much in mind the policy adopted in this respect by its key shareholders who happen to be also the main holders of gold in the world. De facto only very powerful reasons of a lasting nature can justify a departure by the Fund from the practices of other official gold holders. The issue is indeed one of judgment, and when dealing with an essential component of what may be thought of as an ultimate reserve--an international financial safety net--the Fund must err on the side of prudence.

V. Summary and Conclusions

The Fund presently holds 103.4 million fine ounces of gold, equivalent at SDR 35 per fine ounce, to SDR 3.6 billion, at which value the holdings of gold are carried in the Fund's financial statements. These holdings have been virtually unchanged since the completion of the disposal of 50 million ounces of gold in 1980, which was agreed in the context of the discussions leading to the Second Amendment.

The Second Amendment introduced far-reaching changes with respect to gold in the international monetary system and in the Fund, consistent with the objective of reducing the role of gold and making the SDR the principal reserve asset in the system. Under the amended Articles, there is no longer an "official" price for gold, members are not obliged to make payments to the Fund in gold (or the Fund to members), and the Fund, in its dealings in gold must avoid the management of the price, or the establishment of a fixed price, in the gold market. In addition, any sale of gold by the Fund requires a very high special majority--85 percent of the total voting power--and the profits from any such sale (i.e., the excess over the capital value of SDR 35 per ounce) must be placed in the Special Disbursement Account or in the Investment Account (if such an account were to be established).

The purposes for which the proceeds of a sale of gold may be used include: to make transfers of currency from the SDA to the GRA for immediate use in the Fund's regular operations and transactions; to finance other operations and transactions consistent with the purposes of the Fund and for balance of payments assistance for the benefit of members in need, on a uniform basis, or on special terms to developing members in difficult circumstances (for which purpose the Fund must take into account the level of per capita income). The Fund may also distribute directly to developing members that were members on August 31, 1975 a part of the proceeds of a gold sale that the Fund may decide to use for balance of payments assistance to developing countries in need.

The last general review of gold in the Fund since the end of the par value system took place in late 1979/early 1980 in the context of what was essentially a continuation of discussions on the reform of the international monetary system. Following extensive consideration in the Executive Board, the Managing Director proposed to the Interim Committee in April 1980 a three-pronged approach to further use of the Fund's gold, namely, to back a (foreign exchange) Substitution Account, to provide income to the Fund, and to finance interest subsidies on use of the Supplementary Financing Facility. While the Interim Committee discussed these proposals, broad agreement on a package (or on the individual elements) was not reached and these possibilities were not subsequently pursued.

Since then, the Executive Board has discussed ad hoc use of the Fund's gold on various occasions, most notably in the context of providing assurances to lenders to the ESAF Trust. In this regard, the Fund has committed, if it appears there would be a protracted delay in repayment to the lenders to the Trust, "to consider all such initiatives as may be necessary," and it has been made explicit that this includes possible use of gold. In addition, in connection with the use of ESAF under the Rights Approach to overdue financial obligations to the Fund, the Fund has decided to sell up to 3 million ounces of gold if it were determined that resources in the ESAF Trust Reserve Account were insufficient to meet payments from that Account to ESAF lenders because of a failure of rights-related ESAF loans being repaid when due.

The continued holding of gold by the Fund involves both costs and benefits. On the cost side, there is a direct financial cost to the GRA in terms of the remuneration expense the Fund would not incur (or income foregone on SDR holdings) if it held currencies (or SDRs) rather than gold (at the current SDR interest rate, the income foregone amounts to approximately SDR 180 million a year). There is, additionally, the opportunity cost of the income foregone on the unrealized value of the Fund's gold holdings in excess of the value in the financial statements. In general, unless the expected increase in the price of gold in the market on average over the longer run exceeded the expected rate of return on SDR-denominated assets, it could be concluded that a sale of gold by the Fund would improve the overall financial position of the Fund, particularly if the profits from such sale were retained by the Fund and invested. Nevertheless, before looking to such a conclusion, careful consideration should be given to the impact of sales on the market and to the possible impact of such sales on the value of central bank gold holdings and on their balance sheets and of its impact on the level of international liquidity.

As regards the benefits to the Fund holding gold, it may be considered that, while less tangible, the benefits militate against substantial sales of gold at present. These include the role that gold may be perceived to play as contributing to the Fund's liquidity, to the Fund's ability to borrow and to protect members' reserve positions in the Fund, to maintain the Fund's overall financial position, and as assurance against unforeseen contingencies, particularly at a time when the existence of a de facto international financial safety net is certainly of an unquestionable value.

In the staff's view, the balance of these considerations do not indicate an optimal or "right" level at which the Fund should maintain its gold holdings. While the Fund must have discretion as to the amount of gold it believes appropriate to meet its long-term needs, it must weigh these needs against the alternative uses to which the proceeds of a sale of gold would be put. The guiding principle of the Fund's policy on gold should be expressed primarily in terms of the basic objectives or purposes of the Fund and whether these can be better achieved or furthered through a strengthening of its overall financial position both in the short and long run through a sale of gold or by retaining gold. Any final decision nevertheless should take carefully into consideration the concern of maintaining and as much as possible strengthening confidence in the international monetary system, and the holding of unattached gold by the Fund is a modest but not negligible element underpinning its liquidity, and therefore its credibility, at a time when crises can be sudden and of significant magnitude.

Sources and Uses of the Fund's Gold

The Fund's current holdings of 103.4 million ounces, valued at SDR 3,624.8 million, make the Fund the second largest official holder after the United States which holds 261.8 million ounces. Apart from a small transaction with Cambodia in December 1992, the Fund's holdings have remained unchanged since the last auction in May 1980 under the four-year sales program. 1/ Details of the sources and uses of the Fund's holdings of gold are provided in Tables 1 and 2.

1. Sources of gold

The Fund acquired its holdings of gold via four major types of transactions.

a. Subscriptions. Article III, Sections 3 and 4 of the original Articles of Agreement prescribed that 25 percent of initial subscriptions and quota increases were normally to be paid in gold, though some allowances could be made for countries with low gold or reserve holdings. This category represented the largest source of Fund gold, but ceased when subscriptions became payable in SDRs at the time of the Sixth General Review in the mid-1970s.

b. Payment of charges. Article V, Section 8(f) of the original Articles specified that all charges were normally payable in gold, but could be paid in a member's own currency depending on the level of a member's monetary reserves in relation to its quota. The proportion of charges that were paid in gold fell over time, but remained over 50 percent until the early 1970s. Members were given the option of settling charges payable to the General Account in SDRs in December 1969; and the payment of charges in SDRs became obligatory in April 1978.

c. Repurchases. Under Article V, Section 7 of the original Articles, a member was permitted--and in some circumstances could be required--to complete a repurchase by selling gold to the Fund. The proportion of all repurchases occurring in gold was never especially high, and it fell over time in line with the perceived increasing attractiveness of gold relative to currencies as pressures on the fixed price of gold emerged. Members were given the option of using SDRs in repurchases in December 1969.

1/ As part of the normalization of relations with Cambodia, the Fund restituted 21,396 fine ounces of gold to Cambodia--valued at SDR 35 per ounce--in exchange for Cambodian riels and then accepted that gold--valued at market prices--in partial discharge of Cambodia's overdue obligations to the Fund.

Table 1. Sources and Uses of Gold by the Fund 1/

	In millions of SDRs and percent of total		In millions of fine ounces
Sources			
1. Subscriptions	6,596.4	70	
2. Charges	475.8	5	
3. Repurchases	1,582.4	17	
4. Purchases			
a. from South Africa	777.4	8	
b. from others	12.3	--	
Total purchases	789.7		
Total acquisitions	9,444.3	100	
Uses			
1. Sales for currency			
a. Sale of gold for replenishment	3,901.9	67	
b. Auctions			
(i) Competitive bids	823.1	14	
(ii) Non-competitive bids	51.8	1	
c. Restitution	875.0	15	
Total sales for currency	5,651.8	15	
2. Interest on borrowings	103.7	2	
3. Remuneration	63.9	1	
Total reductions	5,819.4	100	
Total gold holdings	3,624.8		

1/ Excludes both the sales of gold that occurred in 1956, 1959 and 1960 for the purpose of investment in U.S. government securities, and the subsequent reacquisition of this gold in 1970 and 1972. Components may not sum to totals due to rounding.

d. Purchases under Article V, Section 6(a). Under this section of the original articles, a member wishing to obtain the currency of another member could acquire it by sale of gold to the Fund. The major use of this provision occurred in respect of sales totalling SDR 777 million by South Africa between January 1970 and July 1971 during the period of the two-tier gold market. Under an agreement with South Africa, the Fund agreed to buy gold at the official price in quantities specified by a prearranged schedule, or in larger quantities depending on South Africa's balance of payments need. 1/

2. Uses of gold

Most reductions in the Fund's gold holdings have occurred through sales of gold for currency, though small amounts were paid out in remuneration and interest on borrowings. It is useful to categorize sales of gold for currency into the three groups.

a. Sales of gold for replenishment (1957-70). Under Article VII, Section 2(ii) of the original Articles, the Fund was authorized to sell gold to replenish its holdings of currency if it were deemed appropriate. The nature of these sales evolved over time. In later years it was not always apparent that a shortage of currency existed at the time of such sales, though the sale of gold under this provision permitted the achievement of other goals that were consistent with the purposes of the Articles of Agreement of the Fund. 2/ The sales of gold for replenishment occurring between 1957 and 1971 can be divided as follows:

(i) In January 1957, following heavy purchases of U.S. dollars by members, the Executive Board decided to replenish the Fund's holdings of dollars and for the first time sold gold equivalent to SDR 300 million to the United States; a similar amount was sold in May 1957. In 1961, in connection with a purchase by the United Kingdom, the Fund sold gold equivalent to SDR 500 million to replenish its holdings of the nine currencies that were being used to meet this purchase. A further sale of gold equivalent to SDR 250 million occurred in December 1964 to finance another purchase by the United Kingdom. On this occasion, some Directors noted that the entire purchase could have been met by borrowings under the newly-instituted General Arrangements to Borrow (GAB). However, the Executive Board as a whole viewed the sale of gold as more appropriate in view of the wish of GAB participants to increase their holdings of gold as a quid pro quo for providing the loans to the Fund. Including some further sales of gold to finance purchases by the United Kingdom and France, the above mentioned sales totalled SDR 2,548 million.

1/ See Press Release No. 776 (12/30/69).

2/ The legal justification for sales of gold for replenishment were discussed in *The Use of Gold to Finance a Trust Fund under the Present Articles of Agreement*, SM/75/174 (7/3/75).

(ii) Sales of gold (totalling SDR 635 million) were made in September 1970, April 1971, and July 1971 following earlier purchases of gold from South Africa. On these occasions some Directors noted that the Fund had ample holdings of usable currencies and therefore no strict need for replenishment. However, it had been understood at the time of the decision to purchase gold from South Africa that the Fund would "recycle" some of this gold to its members, many of whom were eager to increase their gold holdings. 1/ It was therefore agreed that gold would be sold, in amounts corresponding closely to the amounts purchased from South Africa, to other countries on the basis of their net creditor positions in the Fund.

(iii) The Fund sold gold (totalling SDR 719 million) on numerous occasions in 1966, 1970, and 1971 in order to mitigate the effect of payments of quota increases upon the gold holdings of members--the United States in particular--who had sold gold to other members for payment of quota increases. On these occasions, it was noted by some Directors that the Fund was not experiencing a shortage of currencies and that such sales reduced the amount of gold that would otherwise have been received from quota increases. The decision to sell gold was considered appropriate, however, because of the assistance that these members were providing in ensuring the smooth payment of quota increases.

b. Auction and restitution sales. The Fund sold gold between June 1976 and May 1980 under both Article VII, Section 2(ii) of the original Articles in the period immediately prior to the adoption of the Second Amendment, and subsequently under the Second Amendment. The sale of approximately one third of the Fund's gold (50 million ounces) was the outcome of an agreement by Fund members to reduce the role of gold in the international monetary system. Twenty five million ounces of the Fund's gold were sold to members at the then official price of SDR 35 per ounce in proportion to quotas ("restitution"), and another 25 million ounces were sold to the market, with the equivalent of the book value placed in the General Resources Account to maintain the value of the Fund's assets, and the surplus over the official value used to finance a Trust Fund for the developing countries (for further details, see Annex III below).

c. Investment of gold in U.S. Government securities. Discussions about the possibility of the Fund investing part of its currency holdings in U.S. Government securities occurred as early as 1946. Arguments raised against such an investment included: the risk involved from possible devaluation of the dollar; the impairment of the Fund's liquidity; and the fact that investment of the Fund's assets was not one of the transactions that was explicitly mentioned in the Articles. The need for such an investment grew, however, in order to generate income to offset the Fund's operating deficit, while the legal concerns were eased by the argument that

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1/ See *Policy on Replenishment by Sales of Gold, and Related Subjects*, SM/70/71 (4/9/70); and EBM/70/39 (5/4/90).

such an investment could be justified under Article 12, Section 2(g), which permitted rules and regulations appropriate for the business of the Fund. A decision to invest the equivalent of SDR 200 million was made in January 1956, with the Executive Board noting that it was "in the interest of good administration and conservation of the Fund's resources." 1/ A condition of the sale was that the Fund must be able to reacquire the gold at the price of the initial sale. Despite the elimination of the operating deficit following an increase in income from charges, the Board decided in November 1957 that the gold investment program could continue, so as to provide a Special Reserve, and the initial investment was increased to the equivalent of SDR 500 million in July 1959, and to SDR 800 million in November 1960. 2/ A significant build-up in reserves through the 1960s prompted some Directors to argue that the investment should be ended, and in September 1970 the Executive Board approved a decision to reacquire SDR 400 million of gold, while the remaining gold was reacquired in February 1972.

1/ See Executive Board Decision No. 488-(56/5), adopted January 25, 1956.

2/ See Executive Board Decision No. 708-(57/57), adopted November 27, 1957.

Table 2. Sources and Uses of the Fund's Gold 1946-94

(In millions of SDRs)

Calendar Year	Sources						Uses				Gold Holdings (end of period)
	Original Subscription	Quota Increases	Repurchases	Purchases	Charges	Return of Investment	Sales for Investment	Sales for Currencies	Interest and Transfer Charges	Remuneration	
1946	15.4	--	--	--	--	--	--	--	--	--	15.4
1947	1,338.1	--	--	--	3.1	--	--	--	--	--	1,356.6
1948	64.5	6.5	--	6.1	1.9	--	--	--	--	--	1,435.6
1949	12.7	--	1.0	--	1.3	--	--	--	--	--	1,450.6
1950	32.9	--	9.4	--	1.6	--	--	--	--	--	1,494.4
1951	18.3	--	15.7	--	2.1	--	--	--	--	--	1,530.5
1952	98.1	--	59.7	--	3.5	--	--	--	--	--	1,691.9
1953	5.5	--	0.5	--	4.1	--	--	--	--	--	1,702.0
1954	14.4 1/	--	19.9	--	3.3	--	--	--	--	--	1,739.6
1955	5.6	--	61.2	--	1.5	--	--	--	--	--	1,807.9
1956	40.6	3.9	37.1	--	2.2	--	200.0	--	--	--	1,691.7
1957	11.6	5.6	60.8	--	9.9	--	--	600.0	--	--	1,179.6
1958	57.7	--	76.7	--	17.6	--	--	--	--	--	1,331.6
1959	10.0	1,192.7	153.8	--	18.9	--	300.0	--	--	--	2,407.0
1960	--	191.7	131.7	--	8.9	--	300.0	--	--	--	2,439.3
1961	55.3	12.9	55.9	--	13.9	--	--	500.0	--	--	2,077.3
1962	21.5	4.5	67.2	--	23.3	--	--	--	--	--	2,193.8
1963	37.3	6.6	48.5	--	25.8	--	--	--	--	--	2,312.0
1964	-10.2 2/	80.9	19.8	--	28.8	--	--	250.0	2.0	--	2,179.3
1965	-10.9 3/	43.3	41.4	--	27.8	--	--	400.0	12.0	--	1,868.9
1966	8.7	1,156.8	11.4	--	24.9	--	--	147.9	16.0	--	2,906.8
1967	1.9	32.2	10.8	--	22.8	--	--	--	15.0	--	2,959.5
1968	0.5	47.2	85.7	--	32.4	--	--	547.0	19.0	--	2,559.3
1969	7.4	24.3	82.3	--	65.9	--	--	151.5	19.0	--	2,568.7
1970	63.3	1,733.4	15.4	646.1	51.1	400.0	--	920.0	14.3	8.8	4,534.9
1971	4.4	88.2	478.6	137.5	73.1	--	--	385.5	6.4	22.7	4,902.1
1972	60.7	0.2	29.7	--	5.6	400.0	--	--	--	28.5	5,369.8
1973	0.2	--	3.1	--	0.4	--	--	--	--	3.6	5,369.9
1974	--	--	--	--	--	--	--	--	--	0.3	5,369.6
1975	--	--	--	--	--	--	--	--	--	--	5,369.6
1976	--	--	--	--	--	--	--	136.5 4/	--	--	5,233.1
1977	--	--	--	--	--	--	--	628.0 4/	--	--	4,605.1
1978	--	--	--	--	--	--	--	468.6 4/	--	--	4,136.5
1979	--	--	--	--	--	--	--	388.0 4/	--	--	3,748.5
1980	--	--	--	--	--	--	--	128.1 4/	--	--	3,620.4
1981-91	--	--	--	--	--	--	--	--	--	--	3,620.4
1992	--	--	5.0	--	0.1	--	--	0.7	--	--	3,624.8
1993-94	--	--	--	--	--	--	--	--	--	--	3,624.8
Total	1,965.5	4,630.9	1,582.4	789.7	475.8	800.0	800.0	5,651.8	103.7	63.9	3,624.8

1/ Czechoslovakia withdrew from the Fund and SDR 2 million of the original gold subscription was applied to repurchases.

2/ Cuba withdrew from the Fund and SDR 12.5 million of the original gold subscription was applied to repurchases.

3/ Indonesia withdrew from the Fund and SDR 15.5 million of the original gold subscription and SDR 13.7 million of gold subscription for quota increase were applied to repurchases.

4/ Sales of gold in 1976-80, the capital value of which aggregated SDR 1,749.2 million, were to finance the Trust Fund (SDR 874.9 million) and sales to members in proportion to their quotas on August 31, 1975 (SDR 875.0 million).

Valuation of the Fund's Gold

The question of the valuation of gold for purposes of the Fund was considered in some depth by the Executive Board soon after the entry into effect of the Second Amendment to the Articles of Agreement on the basis of a staff paper *Treatment and Valuation of Gold for the Fund's Purposes* (SM/79/40, 2/7/79). 1/ This Annex summarizes the main issues in that paper, including the valuation of gold in the Fund's accounts.

As noted in SM/79/40 (and as elaborated in the legal appendix to that paper), the valuation of gold "is not a simple or unitary concept under the amended Articles: different principles of valuation may apply in different contexts, and the purpose for which the valuation is made may determine the choice of the method." In various contexts the choice of the method is determined by the provisions of the Articles, but in other areas the Fund has discretion to value gold as it sees fit. For example, areas in which the Fund has discretion include the valuation of gold in *members'* reserves for the operational purposes of the Fund (including the operational budget and the designation plan), valuation for statistical or analytical purposes, and valuation under stand-by and extended arrangements in accordance with understandings with members. It was the question of valuation in these areas to which SM/79/40 was mainly addressed.

In discussing legal aspects of the valuation of the Fund's gold, it was noted in the Appendix to SM/79/40 that the provisions of the Articles "imply that gold held by the Fund on the date of the Second Amendment will be valued at the historical official price," i.e., at SDR 35 per fine ounce, and that "newly acquired gold would be valued differently." As further noted, these points are made explicit in Rule J-1(a), which provides that:

> "The accounts of the General Department shall be summarized, and the financial statements relating to them shall be expressed, in terms of the special drawing right. Currencies and other assets denominated in currency shall be valued in accordance with exchange rates under Article XIX, Section 7(a) and decisions of the Fund. Gold held by the Fund on the date of the Second Amendment shall be valued on the basis of one special drawing right per 0.888671 gram of fine gold, and gold accepted by the Fund after that date shall be valued in terms of the

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1/ This paper was considered at EBM/79/48 and 79/49 (3/23/79). The presentation of reserve data in *International Financial Statistics* (including the presentation of gold at different valuations) was the subject of further discussion at EBM/79/82 (5/23/79).

special drawing right in such manner as the Executive Board shall decide." 1/

Executive Directors' comments on the issues raised in SM/79/40 focussed overwhelmingly on the question of valuation for the Fund's operational purposes and on the presentation of gold in the reserves data of members in *IFS*. While Directors' views on the operational and statistical issues differed, as the Chairman noted in concluding the discussion: "There was a large majority in the Board that held the view that, for the time being, the Fund for its operational purposes should continue to use the historical official price...." The Chairman also concluded that, with regard to the presentation of reserve statistics in *IFS*, "there was a clear sentiment in favor of change in the presentation of reserve statistics...." 2/ Following further discussion of the latter issue at a subsequent meeting, the staff revised the presentation of reserve statistics in *IFS* country pages to include data on members' physical holdings of gold expressed in fine troy ounces and data on gold valued according to national valuation practices.

1/ As noted in Section II.2 of this paper, the only gold accepted by the Fund since the Second Amendment was in 1992 in partial discharge of Cambodia's arrears and was valued at a market-related price. See Executive Board Decision No. 10233-(92/149), adopted December 11, 1992.

2/ See the Chairman's concluding statement at EBM/79/49 (3/23/79), which also describes Directors' views on the reporting to the Fund of members' gold holdings and transactions in gold and on the question of the valuation of gold under stand-by and extended arrangements.

The Fund's Gold Sales Program (1976-80)

This annex provides summary information on the Fund's gold sales program in 1976-80, which was undertaken in light of understandings reached by the Interim Committee in Paris (June 1975), Washington, D.C. (August 1975), and Jamaica (January 1976) on reducing the Fund's gold holdings by one third (50 million ounces) over a four-year period. The Fund sold 25 million ounces at public auctions for the benefit of developing countries and distributed the other 25 million ounces to members, in proportion to their Fund quotas, at the then official price of SDR 35 p.f.o. The Interim Committee also called for a Trust Fund to be established and administered by the Fund for the purpose of providing special balance of payments assistance to low income members with the profits from the sale of the Fund's gold, augmented by financing from voluntary contributions or from loans.

As a result of the gold sales program, profits of $4.6 billion were obtained and channeled to the Trust Fund for the benefit of developing countries, of which $1.3 billion was distributed to these countries in proportion to their Fund quotas and the remaining $3.3 billion was made available for Trust Fund loans. The capital value of the total gold sold (SDR 1.75 billion) was placed in the Fund's General Resources Account (GRA).

An overview of the two elements of the gold sales program is provided in Chart 1.

I. The Fund's Gold Auctions

1. Implementation

The sale of 25 million ounces for the benefit of developing countries was conducted by public auctions over the envisaged four-year period. In order to implement this part of the gold sales program under the then existing Articles of Agreement, the Fund until April 1978 replenished its holdings of currency by selling gold to creditor members at SDR 35 p.f.o. and these members transferred the gold to the Trust Fund at the same price against the payment of currency. 1/ The Fund, as Trustee of the Trust Fund, sold the gold in periodically-held public auctions. The capital value of the gold transferred and auctioned, i.e., its value at SDR 35 p.f.o., was retained in the GRA.

A major part of the profits from gold sales, together with income earned on their temporary investment, was used to provide long-term low-

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1/ Under the original Articles, the Fund could sell gold to members only at the then official price of SDR 35 p.f.o. When the Second Amendment became effective in April 1978, the Fund was empowered to sell gold at prices based on market prices.

interest (Trust Fund) loans to eligible low-income developing countries. A portion of the profits from gold sales, corresponding to the shares of the 104 developing countries in total Fund quotas, was transferred directly to these countries. Among the developing countries, members that preferred to have their share in profits in the form of gold specie rather than in currency were given the option of submitting noncompetitive bids at the auctions held by the Fund after the Second Amendment came into effect. 1/

In May 1976, the Executive Directors announced the terms and conditions for the first auction, and the approximate timetable of the auction program, indicating that 12.5 million ounces would be offered in the first two years of the auctions. Fund members (or agents acting on their behalf) were not allowed to submit bids at a price above SDR 35 p.f.o. The Bank for International Settlements (BIS) was allowed to bid for its own account. The Fund reserved the right to reject any or all bids. The Fund also announced immediately after each auction the total quantity bid, the total quantity awarded, and the maximum, average, and minimum prices of successful bids. 2/ The main terms and conditions of the auctions were modified as warranted by experience, as indicated below:

a. Frequency of auctions and amount sold

The Executive Board initially decided that the auctions would be conducted at intervals of approximately six weeks and that a fixed amount of gold, 780,000 ounces, would be offered at each auction. After the first six auctions, the auctions were held on a monthly basis starting in March 1977, and the amount offered at each auction was lowered to 525,000 ounces; the decision to conduct monthly auctions aimed at reducing market uncertainty about the timing of gold auctions. The auction amount was further reduced in June 1978 (to 470,000 ounces) and in June 1979 (to 444,000 ounces) in order to take into account the effect of noncompetitive bids from members after the Second Amendment entered into effect (Table 1). 3/

b. Pricing method

In its first half of the auction program, the Fund alternated between two pricing methods: the "bid price method" under which the successful

1/ The amount of such a bid was limited to that part of the 25 million ounces of gold that corresponded to the member's share in total Fund quotas as of end-August 1975.

2/ The Fund supplemented this information with press releases giving the statistical distribution of the prices and amounts submitted in valid bids, as well as the names of successful bidders.

3/ Noncompetitive bids were permitted in the 12 auctions in June 1978 through May 1979 and were awarded in addition to the fixed amount of 470,000 ounces offered to competitive bidders. These bids reduced the amount that could be offered for the remainder of the auction program.

Chart 1. Gold Sales

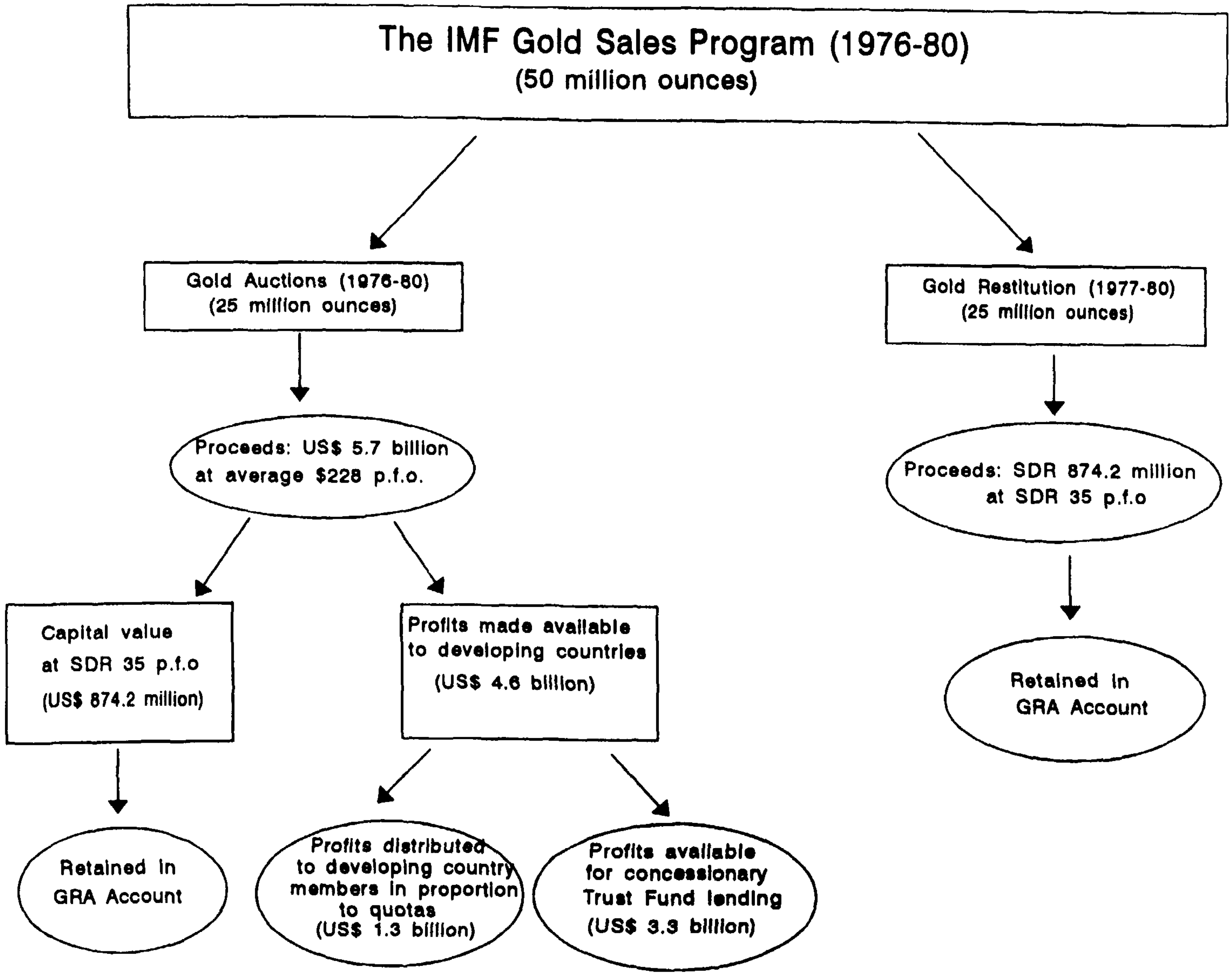


Table 1. The Fund's Gold Auctions (1976-1980)

No.	Pricing Method	Place of Delivery	Date	Ounces bid (thousands)	Ounces Awarded (thousands)	Subscription Ratio	Ounces Awarded to non-competitive bidders (thousands)	Competitive Bids: Number of bidders Total	Competitive Bids: Number of bidders Succesful	Price range of successful bids	Average award price	Profits in millions of US dollars
1	Common	New York	Jun 2, 1976	2320.0	780.0	2.97	--	30	20	126.00-134.00	126.00	67.10
2	Common	New York	Jul 14, 1976	2114.0	780.0	2.71	--	23	17	122.05-126.50	122.05	64.00
3	Bid	New York	Sep 15, 1976	3662.4	780.0	4.70	--	23	14	108.76-114.00	109.40	53.82
4	Bid	New York	Oct 27, 1976	4214.4	779.2	5.41	--	24	16	116.77-119.05	117.71	60.25
5	Common	London	Dec 8, 1976	4307.2	780.0	5.52	--	25	13	137.00-150.00	137.00	75.35
6	Common	New York	Jan 26, 1977	2003.2	780.0	2.57	--	21	15	133.26-142.00	133.26	72.50
7	Bid	New York	Mar 2, 1977	1632.8	524.4	3.11	--	21	7	145.55-148.00	146.51	55.60
8	Bid	New York	Apr 6, 1977	1278.0	524.8	2.43	--	18	11	148.55-151.00	149.18	57.02
9	Bid	New York	May 4, 1977	1316.4	524.8	2.51	--	17	14	147.33-150.26	148.02	56.37
10	Common	New York	Jun 1, 1977	1014.0	524.8	1.93	--	14	13	143.32-150.00	143.32	53.87
11	Common	Paris	Jul 6, 1977	1358.4	524.8	2.59	--	15	15	140.26-145.00	140.26	52.16
12	Common	London	Aug 3, 1977	1439.2	524.8	2.74	--	18	16	146.26-150.00	146.26	55.31
13	Bid	New York	Sep 7, 1977	1084.4	524.8	2.07	--	15	11	147.61-149.65	147.78	56.24
14	Bid	New York	Oct 5, 1977	971.2	524.8	1.85	--	17	12	154.99-157.05	155.14	59.97
15	Bid	London	Nov 2, 1977	1356.4	524.8	2.58	--	18	7	161.76-163.27	161.86	63.29
16	Common	New York	Dec 7, 1977	1133.6	524.8	2.16	--	19	19	163.03-165.00	160.03	62.13
17	Common	New York	Jan 4, 1978	984.8	524.8	1.88	--	19	19	171.26-180.00	171.26	67.68
18	Common	Paris	Feb 1, 1978	598.4	524.8	1.14	--	17	17	175.00-181.25	175.00	69.65
19	Bid	New York	Mar 1, 1978	1418.0	524.8	2.70	--	19	16	181.13-185.76	181.95	72.92
20	Bid	New York	Apr 5, 1978	1367.0	524.8	2.60	--	21	15	177.61-180.26	177.92	70.78
21	Bid	London	May 3, 1978	3104.0	524.8	5.91	--	24	17	170.11-171.50	170.40	66.83
22	Bid	New York	Jun 7, 1978	1072.4	470.0	2.28	925.2	21	15	182.86-183.92	183.09	195.64
23	Bid	New York	Jul 5, 1978	797.2	470.0	1.70	20.8	22	19	183.97-185.01	184.14	68.96
24	Bid	New York	Aug 2, 1978	1467.6	470.0	3.12	70.0	21	20	203.03-205.11	203.28	85.84
25	Bid	New York	Sep 6, 1978	773.2	470.0	1.65	133.6	20	10	212.39-213.51	212.50	101.42
26	Bid	London	Oct 4, 1978	805.6	470.0	1.71	134.4	18	12	223.57-224.62	223.68	107.74
27	Bid	New York	Nov 1, 1978	689.6	470.0	1.47	80.0	14	7	223.03-230.00	224.02	98.37
28	Bid	Paris	Dec 6, 1978	1965.2	470.0	4.18	20.0	16	13	195.51-196.75	196.06	74.23
29	Bid	New York	Jan 3, 1979	1479.6	470.0	3.15	16.4	17	9	219.13-221.00	219.34	84.73
30	Bid	New York	Feb 7, 1979	1489.6	470.0	3.17	59.2	19	5	252.47-252.77	252.53	109.60
31	Bid	London	Mar 7, 1979	1534.4	470.0	3.26	--	18	17	241.28-243.26	241.68	92.62
32	Bid	New York	Apr 4, 1979	1186.8	470.0	2.53	--	17	14	238.71-240.27	239.21	91.37
33	Bid	New York	May 2, 1979	1514.8	470.0	3.22	20.0	20	17	245.86-247.01	246.18	98.79
34	Bid	New York	Jun 6, 1979	1452.4	444.0	3.27	--	19	5	280.22-281.37	280.39	104.73
35	Bid	New York	Jul 3, 1979	1518.8	444.0	3.42	--	20	13	281.06-281.87	281.52	104.84
36	Bid	New York	Aug 1, 1979	1138.8	444.0	2.56	--	20	16	288.95-291.07	289.59	107.84
37	Bid	Paris	Sep 5, 1979	1646.0	444.0	3.71	--	21	4	332.01-333.50	333.24	127.73
38	Bid	New York	Oct 10, 1979	665.6	444.0	1.50	--	16	9	412.51-420.80	412.78	163.20
39	Bid	New York	Nov 7, 1979	1798.4	444.0	4.05	--	16	13	391.77-398.01	393.55	154.26
40	Bid	London	Dec 5, 1979	1746.0	444.0	3.93	--	18	15	425.40-429.31	426.37	169.27
41	Bid	New York	Jan 2, 1980	1342.4	444.0	3.02	--	10	5	561.00-564.01	562.85	229.17
42	Bid	New York	Feb 6, 1980	1939.6	444.0	4.37	--	17	5	711.99-718.01	712.12	295.24
43	Bid	New York	Mar 5, 1980	1412.4	444.0	3.18	--	16	14	636.16-649.07	641.23	263.52
44	Bid	New York	Apr 2, 1980	802.8	444.0	1.81	--	16	16	460.00-503.51	484.01	194.97
45	Bid	New York	May 7, 1980	1822.0	443.2	4.10	--	21	21	500.20-511.15	504.90	203.51
	Total				23518.0	2.94	1479.6				228.65	4640.43

bidder paid the price actually bid, and the "common price method" in which all successful bidders paid a uniform (cut-off) price, which was equal to the lowest acceptable price. In the absence of evidence that the common price method encouraged wider participation or higher bidding relative to the market price, the Fund adopted the bid price method for all auctions for the second half of the sales period. 1/ Members submitting noncompetitive bids after the Amendment of the Articles came into effect paid the average of the prices of accepted bids.

c. Other terms and conditions

The Fund auctioned gold of 0.995 fineness or better, with bids being received in Washington D.C. To facilitate participation, the minimum bid requirement of 2,000 ounces in the first auction was lowered to 1,200 ounces for all subsequent auctions. Regarding the place of delivery, the Fund's depositories in New York, London, and Paris were used so as to leave the distribution of the Fund's remaining holdings of gold broadly unchanged. Originally, the Fund required each submitted bid to be accompanied by a deposit of $50,000. Unsuccessful bidders' deposits were returned promptly, while the balance due from a successful bidder was to be paid on delivery of the gold within four weeks of an auction. Following the review in December 1976 of experience in the previous five auctions, the final payment and delivery period was shortened to 10 days from the auction. The bid deposit was also changed from the previously flat sum to the greater of $25,000 or $10 per ounce bid in June 1977, and subsequently to $40 an ounce bid in March 1980 following the very sharp rise in the gold price at the time.

2. Results of the gold auctions

In the period between June 2, 1976 and May 7, 1980, the Fund sold a total of 24.998 million ounces of gold in 45 public auctions; 23.518 million ounces of this amount were sold to 51 separate bidders and 1.48 million ounces were awarded to 13 member countries that submitted noncompetitive bids (Table 1). The proceeds from these gold sales amounted to $5.713 billion, of which $1.073 billion represented the capital value at SDR 35 p.f.o. and was retained in the GRA. The remaining $4.640 billion constituted the profits that were channeled to the Trust Fund for the benefit of developing countries; $1.289 billion of these profits was distributed directly to 104 developing countries and the remaining

1/ There was no statistically significant evidence from the Fund's experience that the pricing method in an auction had an effect on participation or bidding in the auction in terms of the subscription ratio, the average number of bidders, or the number of bids for the two types of auctions.

$3.351 billion was allocated to concessionary lending. 1/ Trust Fund loans of SDR 2.99 billion were extended to 55 developing country members over the period of July 1, 1976 to March 31, 1981.

Participation in the auctions was substantial and generally included the major gold dealers. The Fund's gold sales at its auctions fetched prices that were generally close to prices prevailing in the major gold markets on the day of the auction (Chart 2). Over the four-year period, the average award price of US$228.56 p.f.o. was somewhat below the (unweighted) average of the London fixings during the four-year period of US$234.52 p.f.o., principally because the sale of gold in the third year to member countries in noncompetitive bidding reduced the amount of gold sold during the fourth year of the program when market prices were highest.

II. "Restitution"

As mentioned, 25 million ounces of gold were sold at the official price of SDR 35 an ounce ("restituted") to the 128 countries (plus Papua New Guinea) that were members on August 31, 1975. 2/ Restitution referred to the transfer to members of the ownership of gold then owned by the Fund, on the basis of the then prevailing Fund quotas, and in exchange for currency at the former official price of gold. Restitution was carried out once a year during each of the four years of the gold sales program, and was calculated in proportion to the members' quotas on August 31, 1975.

Before the Second Amendment came into effect, restitution of gold initially involved the replenishment of the Fund's holdings of usable

1/ Seven oil-producing countries (Iraq, Kuwait, Libya, Qatar, Saudi Arabia, the United Arab Emirates, and Venezuela) made irrevocable transfers of the full amounts of their profit shares to the Trust Fund. In addition, the former Yugoslavia transferred one third of its share of profits, and Romania lent 10 percent of its share, to the Trust Fund. The total value of the amounts transferred to the Trust Fund by these members added $125 million to the resources available for loans to eligible developing countries.

2/ The membership resolution for Papua New Guinea was adopted by the Board of Governors on that day.

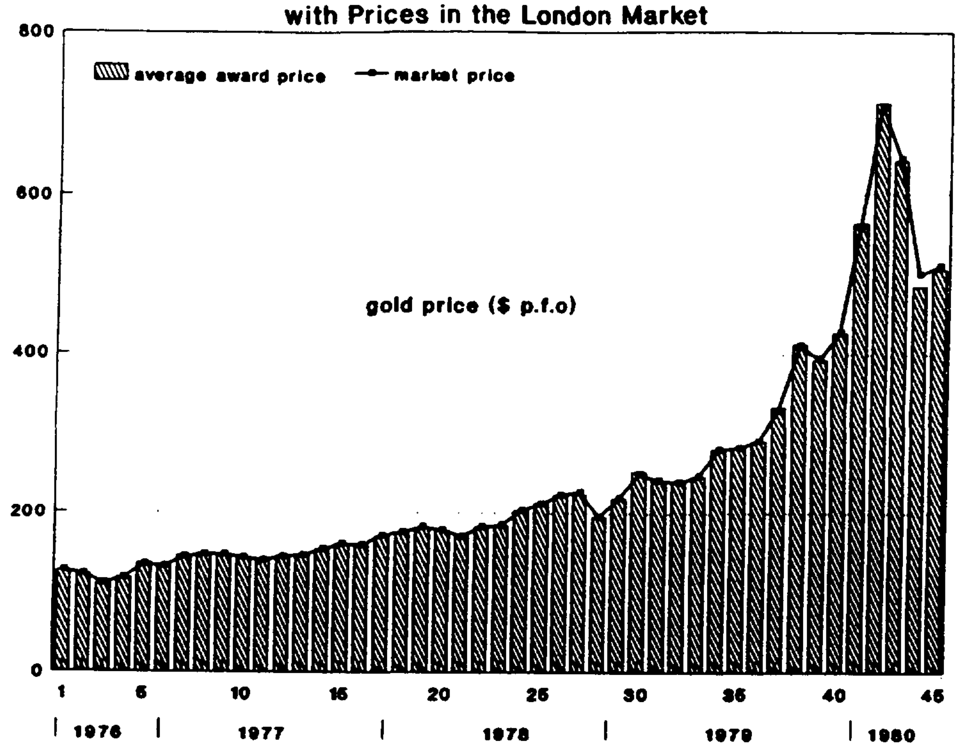
currencies. 1/ The sale of gold to members with creditor positions against their currencies was deemed to be restitution of their shares. In addition, creditor members also acted as a channel for indirect restitution of gold to other members whose currencies in the Fund could not be replenished because the Fund held their currencies above 75 percent of quota. A member who received restituted gold in this manner made arrangements to pay the creditor member with a currency acceptable to the member transferring the gold. Members that had a balance of payments need at the time were authorized to postpone their participation in gold restitution until after the coming into effect of the Second Amendment, which allowed these members to acquire gold, subject to such postponement, against payment in their own currencies.

The restitution program was carried out in four annual installments beginning in January 1977 and ending in April 1980 (Table 2). For balance of payments reasons, 18 members postponed their participation in the first or second annual installments. 2/ A total of 24.978 million ounces of gold was restituted to 127 member countries in the four-year period.

1/ The original Articles of Agreement did not contain any provisions authorizing the return of gold to members, except at the withdrawal of a member from the Fund or in the event of liquidation of the Fund. Restitution through replenishment operations pursuant to Article VII, Section 2, and through general deposits of gold were the two alternative techniques discussed extensively by the Executive Board before taking the decision to use the Fund's power of replenishment (SM/75/256, 10/17/75). The Second Amendment empowered the Fund to restitute gold to a member against payment of currency.

2/ Cambodia did not participate in the restitution program of 1976-80. The Executive Board decided on December 11, 1992 that 21,396 ounces of fine gold would be restituted to Cambodia, equivalent to its share in the 1976-80 program of restitution of gold, and immediately accepted the gold in partial discharge of Cambodia's overdue obligations.

Chart 2.
Comparison of Average Prices in Fund Gold Auctions
with Prices in the London Market



Premium of Award Price over Market Price

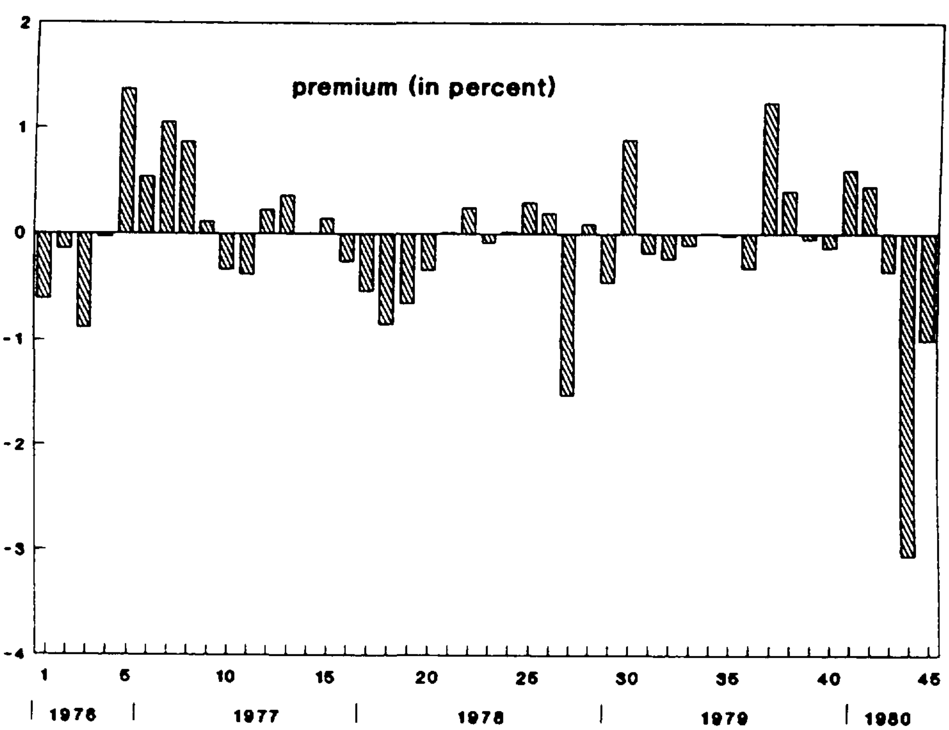


Table 2. The Fund's Restitution Sales of Gold (1977-1980)

	Million Ounces Sold for Distribution				
	Total	Direct	Indirect	Receipts from sales (In millions)	Participating members
1977	5.998	3.497	2.501	SDR 209.95	112
1978	6.090 1/	3.620	2.380	SDR 213.16	114
1979	6.297	6.297	--	SDR 220.40	126
1980	6.593	6.593	--	SDR 230.80	127
Total	24.978	20.007	4.881	SDR 874.22	127

1/ Includes the distribution to members of 9,000 ounces of gold held by the Fund under earmark for members.

Special Voting Majorities for
Use of the Fund's Gold and Related Aspects

Article	Section	Subject	Majority
III	2(b)	Adjustments of quotas resulting from the transfer of assets from the Special Disbursement Account to the General Resources Account	85%
V	12(c)	Sale of gold	85%
V	12(d)	Acceptance of gold instead of SDRs or currency in payments to the Fund	85%
V	12(e)	Sale of gold at official price	85%
V	12(f)(i)	Transfer of assets from the Special Disbursement Account to the General Resources Account	70%
V	12(f)(ii)	Operations and transactions not authorized by other provisions but consistent with purposes of the Fund	85%
V	12(f)(iii)	Distribution to developing members in proportion to quotas on August 31, 1975	85%
V	12(g)	Transfer of proceeds of sale of gold in excess of capital value to the Investment Account	85%
XII	6(f)(ii)	Transfer to the Investment Account of currencies held in the General Resources Account for immediate investment	70%
XII	6(f)(vi)	Termination of the Investment Account or reduction of investment prior to liquidation of the Fund	70%

Developments in the Gold Market

This annex describes (1) supply and demand factors in the gold market, (2) gold price developments, and (3) recent official transactions in gold.

1. Market supply and demand

Under the par value system, the price of gold was maintained by monetary authorities at or close to the official level of $35 p.f.o. by absorbing any imbalances between market supply and demand, and the gold market thereby functioned more as a distribution mechanism for the physical supply of gold, rather than as a price-setting device. The structure of the gold market changed substantially after the establishment of a two-tier market in March 1968 in which the price of gold for nonofficial participants was determined freely by market conditions, while central banks, until August 1971, refrained from dealing in gold in the free market but agreed to transact gold among themselves at the official price. 1/ With official transactions generally absent from the private market from the late 1960s to the mid-1970s, and in the face of a relatively steady flow of supply, upward pressures on gold prices during that period were for the most part generated by the strength of investment demand and moderated by a fall-off in fabrication demand (Chart 1).

The supply of gold, including official sales, subsequently picked up sharply in the mid-1970s, reflecting mainly sales by the former Soviet Union, the United States, China, Eastern European countries, and the Fund. Fabrication demand also recovered from recession-induced lows, and investment demand strengthened after the gold price had established a rising trend in 1976-77, as investor confidence returned on the ease with which the market absorbed the Fund's gold sales that began in 1976, and in response to the accelerating rate of inflation (and negative real interest rates) in the major industrial countries. In the early 1980s, a slowdown in sales from official gold holdings and from former CMEA countries reduced market supply, but fabrication demand and investment demand also eased in the late 1970s and early 1980s, respectively, in response to the record high levels of the gold price and to worldwide recessionary conditions. Since then, the major components of supply and demand for gold, and associated price developments, have exhibited a lesser degree of fluctuation, compared with the experience of the 1970s.

Since 1980, and particularly in recent years, increases in fabrication demand and in supply to the gold market have tended to move together, but

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1/ In August 1971, the two-tier market ended when the U.S. dollar's convertibility into gold was formally suspended, and since then, a global market for gold as an asset in its own right and as a commodity has developed.

investment demand has tended to fall and has thereby exerted a general downward pressure on prices (Chart 1 and Table 1). Structural developments in the mining industry in the main producing countries have contributed to the generally steady increase in supply over the past decade and a half; a slowdown in output in the former Soviet Union and South Africa was more than offset by strong gains in mine output from technological advances in the United States, Canada, Australia, and China. 1/ (The United States has recently become the second-largest producer, replacing the former Soviet Union.)

Demand for fabrication purposes (jewelry, industry) has tended to rise steadily in line with the growth of incomes worldwide since 1980, during which period such demand has consistently exceeded new mine production. In the past four years, this component of demand peaked at 3,143 tons in 1992 in response to a surge in demand in the fast-growing Asian economies, encouraged by the liberalization of their domestic gold markets. 2/ Overall, gold demand has remained strong in 1993-94, and after a period of consolidation during the first half of 1994, jewelry demand rose sharply in the second half of the year. In general, fabrication demand does not seem highly sensitive to price changes. 3/

Investment demand has been weak in recent years, and some investors, including central banks (see below), have contributed to supply through dishoarding. The decline of investment demand is attributed for the most part to the global easing of inflationary pressures and increases in real interest rates which have reduced the attractiveness of gold as a hedge against inflation. Investors in Europe and North America have been the main net sellers, and hoarding in the Middle and Far East reportedly declined sharply in 1991-92. More recently, the relatively low volatility of the gold price has also adversely affected investment demand.

1/ In the early 1970s, the rise in the price of gold above the official price of $35 p.f.o. was accompanied initially by a fall in mine production (particularly in South Africa), and it took until 1984 for production to respond significantly to the record rise in the gold price in the late 1970s and early 1980s. The lag between price movements and changes in mine capacity has been attributed to adjustment costs: after a price rise, resources are needed to discover, finance and construct new mines; after a price fall, capacity continues to rise as new mine operations are opened, and much of the capacity rendered marginal by the price fall is not immediately made inoperative. Instead, mines attempt to cut costs, including labor costs, before cutting back on production.

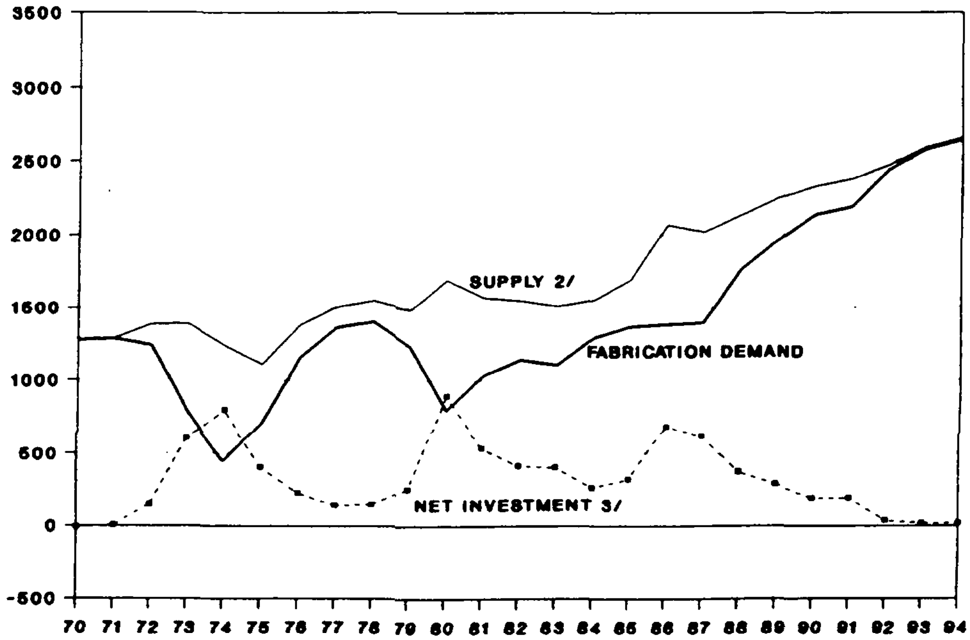
2/ Singapore alone is reported to have imported a record 414 tons of gold in 1992--nearly a quarter of Western output--after importing 270 tons in 1991.

3/ Estimates of the price elasticity of fabrication demand range from -0.2 to -3.0, with the estimate based on the most recent data at about -0.4.

CHART 1.

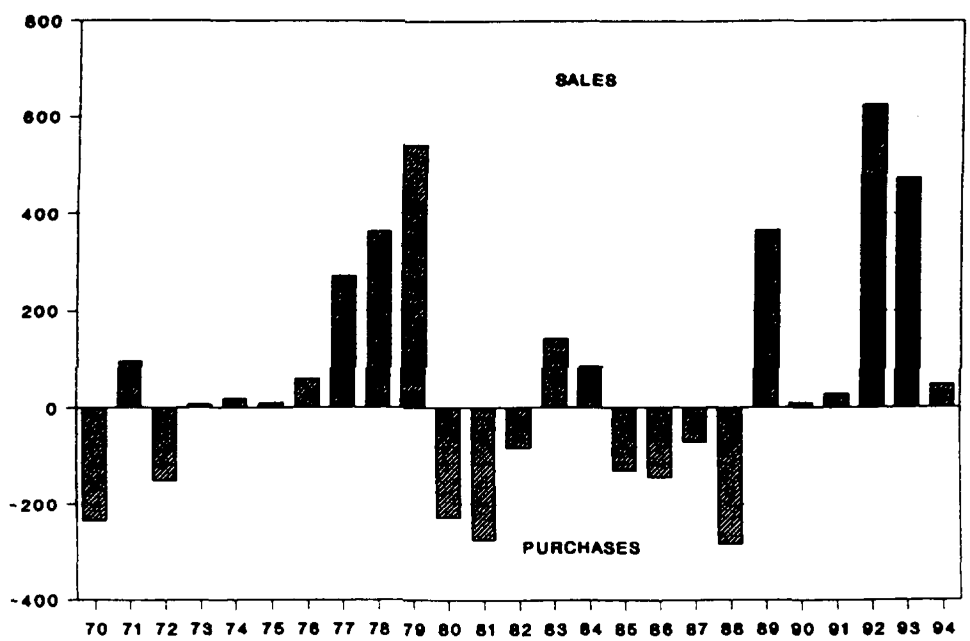
ANNUAL FLOW OF GOLD SUPPLY AND DEMAND (1970-1994) 1/

(IN TONS)



NET OFFICIAL TRANSACTIONS (1970-1994) 4/

(IN TONS)



1/ CMP Group; 1994 figures are estimates.

2/ Supply = Mine production + Scrap + Net socialist sales; i.e., supply excludes official sales and dishoarding by investors.

3/ Net investment = Supply - Fabrication demand = Net official purchases + Net private bar hoarding.

4/ Gold Fields Mineral Services; 1994 figure is estimate.

Table 1. Gold Market: Components of Global Supply and Demand 1/

(In metric tons)

	1990	1991	1992	1993	1994 2/
Total Supply	3,080	3,114	3,570	3,538	3,156
Mine production	2,133	2,161	2,237	2,281	2,304
Net Official Sales	187	119	602	522	46
Old gold scrap	524	461	463	535	...
Gold loans	5	--	--	--	...
Forward sales	224	96	165	198	11
Option hedging	7	15	103	2	...
Implied residual disinvestment	--	263	--	--	...
Total Demand	3,080	3,114	3,570	3,538	3,156
Fabrication demand	2,639	2,816	3,143	2,989	...
Jewelry	2,145	2,306	2,693	2,501	2,469
Electronics	217	206	176	183	191
Other	277	305	274	304	...
Bar hoarding	224	252	273	137	...
Gold loans	--	45	85	65	...
Implied residual investment	218	--	69	348	...
Memorandum items:					
Sales by transition economies	388	230	65	175	...
Average London gold price (US$ p.f.o.)	383.59	362.26	343.95	359.82	384.24

Source: Gold 1994, Gold Fields Mineral Services, Ltd.

1/ The aggregate data for production and fabrication demand in this table include more recent data from FSU countries and China, and are therefore somewhat higher than data presented in Chart 1.

2/ Estimate.

2. Price developments

The crucial short-run determinants of gold prices have been investment demand and official activity in the gold market. 1/ The collapse in fabrication demand in the late 1970s and investment demand in the early 1980s had brought about a steep decline in the gold price from a peak of $850 p.f.o. in the second half of 1980 to just under $300 p.f.o. in mid-1982, and except for a temporary rise in 1982 and a surge between 1984 and 1987, the gold price tended to ease. The recent weakness in the gold price dates back to December 1987 when it approached $500 p.f.o., though the price has moved within a narrow range of $370 p.f.o. to $396 p.f.o. since the end of 1993. Price volatility has thus been quite limited, particularly since the latter part of the 1980s.

Among the main forces that weighed on the gold price from 1987 to 1993 were increased supply into the market by former CMEA countries and Middle Eastern investors' sales, particularly in 1989 and 1990, and weak investment demand for gold, already mentioned, particularly on occasions when the U.S. dollar strengthened. Forward sales by producers have also tended to be a limiting factor on upward price movements. More recently, however, gold prices have firmed somewhat, from an average of $360 p.f.o. in 1993 to an average of almost $385 p.f.o. in 1994, which may be attributed to tensions in currency markets in major European countries, political uncertainties in Russia and South Africa, and fear of emerging inflationary pressures in the United States.

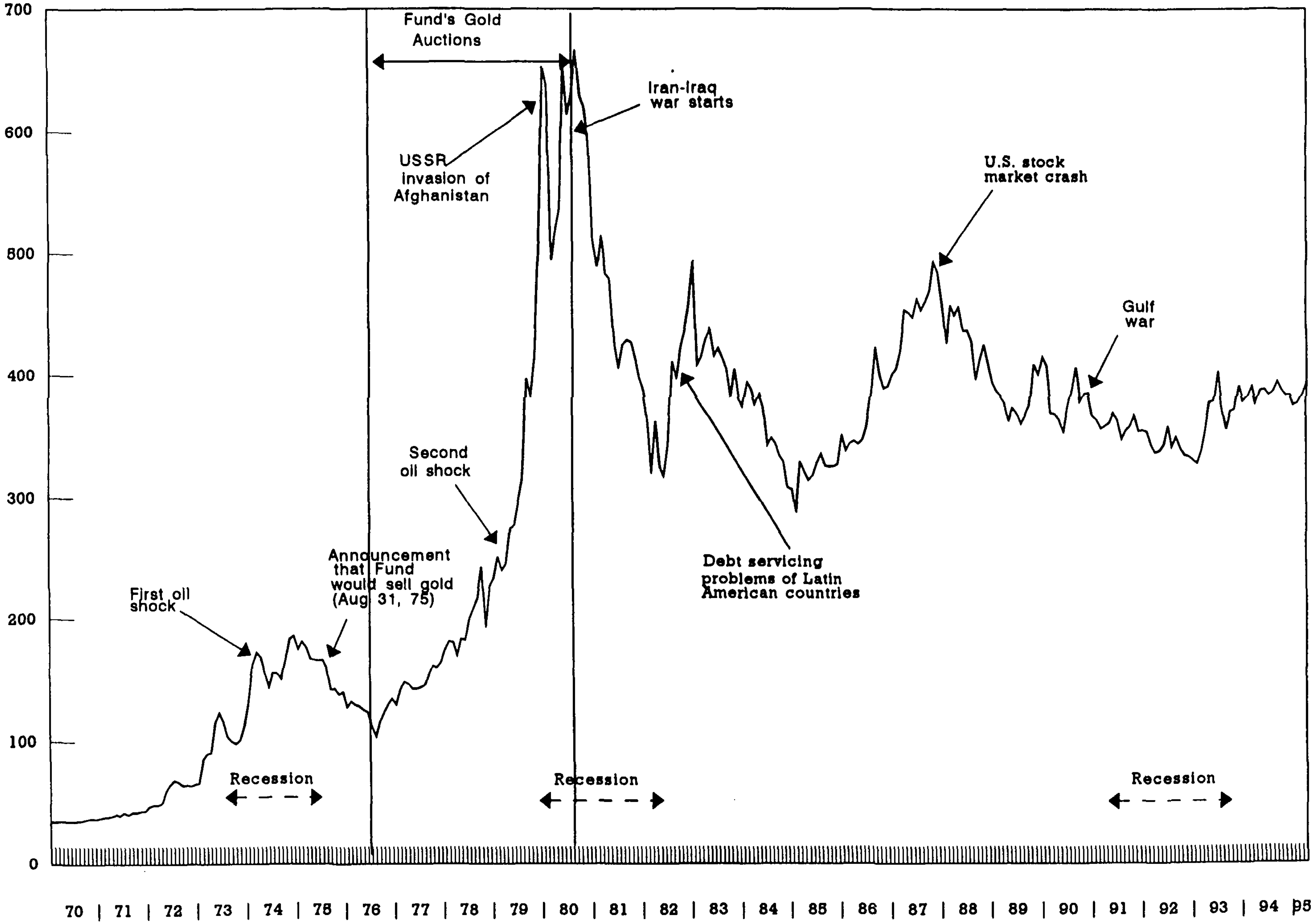
3. Recent official sector transactions

The official sector was a large net seller of gold in the period between 1975-1979, when the U.S. Treasury (in 1975 and 1978-79) and the International Monetary Fund (in 1976-80) sold about 18 million ounces (570 tons) and 25 million ounces (777 tons) of gold, respectively, through public auction programs. The official sector has again become a net seller since 1989, with the pace of official sales accelerating sharply in 1992 and 1993 (Chart 1). Since early 1993, central banks have continued to sell steadily but in small amounts.

Official sector sales in 1989-94 were dominated by the activities of Canada, the Netherlands, and Belgium (Table 2). Canada has had a sales program under its official gold policy since 1980 (see below). The sales by the Bank of Netherlands in 1992/93 and by Belgium in 1989 and 1992 were of a one-off nature. Canada continued to be the largest single seller in 1993

1/ The stock of gold held by central banks and international institutions as well as estimates of gold held by private investors represents about 24 years of new supply or consumption, and shifts in investor and central bank sentiment tend to have a relatively large short-run impact on gold market prices.

Chart 2. LONDON GOLD FIX
US Dollars per Ounce (End of month)
(Jan 1970 - Apr 1995)



ANNEX V

Table 2. Changes in Official Gold Holdings (1988-1994) 1/

(In million ounces)

	1989	1990	1991	1992	1993	1994	Stock as of 1994	Cumulative Change (1989-1994) In million ounces	In tons
Net Decrease in Holdings									
Canada	-1.04	-1.34	-1.80	-3.02	-3.89	-2.15	3.90	-13.24	-410.4
The Netherlands	--	--	--	--	-8.89	-0.28	34.77	-9.17	-284.3
Belgium	-3.44	--	--	-5.19	--	--	25.04	-8.63	-267.5
Austria	-0.49	-0.27	-0.36	-0.10	-1.33	-0.63	17.97	-3.18	-98.6
Mexico	-1.52	-0.11	--	-0.23	-0.21	-0.05	0.43	-2.12	-65.7
Hungary	-0.09	-1.20	-0.04	-0.16	0.01	--	0.11	-1.48	-45.9
Israel	--	-0.18	-0.42	-0.41	--	--	0.01	-1.01	-31.3
Uruguay	--	-0.21	-0.14	-0.23	-0.33	--	1.70	-0.91	-28.2
Colombia	-0.49	0.02	0.23	-0.38	-0.18	-0.02	0.28	-0.82	-25.4
Peru	0.26	0.24	-0.38	-0.01	-0.52	-0.18	1.12	-0.59	-18.3
United Kingdom	-0.01	-0.05	-0.05	-0.28	-0.16	-0.01	18.44	-0.56	-17.4
Former U.S.S.R.	-2.14	-9.66	-6.28	...	...	...	9.35 2/	-18.08 3/	-560.4 3/
Other official institutions									
EMCF	-0.34	-0.09	0.03	-1.29	-2.66	0.29	89.86	-4.11	-127.5
BIS	-0.03	1.17	-1.23	0.20	1.86	-1.37	7.26	-0.66	-20.5
Net Increase in Holdings									
Spain	1.68	-0.11	0.01	--	--	--	15.62	1.58	50.0
India	--	0.24	0.59	0.07	0.11	0.34	11.80	1.35	41.9
Romania	0.72	0.04	0.04	0.06	0.06	0.23	2.60	1.15	35.7
Brazil	0.25	1.59	-2.55	0.21	0.70	0.71	3.64	0.91	28.2
South Africa	-0.39	1.01	2.38	0.18	-1.89	-1.19	3.57	0.10	3.1

Source: IFS, O'Callaghan (1993), IMF Economic Reviews - Russian Federation.

1/ 1994 figures correspond to November for Canada; October for the Netherlands, Belgium, Austria, Spain, India and South Africa; September for Hungary, Romania, Israel, Peru, and EMCF; August for Uruguay, Brazil, and BIS; July for Mexico, Colombia, and the United Kingdom.

2/ 1991.

3/ Gives the change between 1988 and 1991.

and again in 1994. In addition to these countries, a number of gold-producing countries have also supplied official gold to the market. A few countries (notably Spain and India) have, however, added small amounts to their gold holdings in recent years.

Official sector sales reflect a variety of motives on the part of the central banks, including a deliberate policy of reducing the gold component of official reserves and use of gold reserves to finance payments or budget deficits. The regular sales of Canada reflect its policy of gradually reducing the share of gold in official reserves. The sale by the Netherlands reportedly aimed at reducing the share of gold in total reserves to a level similar to the European Community average and improving the performance of the central bank's reserve portfolio. Similarly, Belgium reportedly wished to improve the liquidity of its reserves and to provide some marginal assistance in reducing the budget deficit. Other countries (the United States, the United Kingdom, and Austria) also have reduced official holdings at the margin through the production of official/commemorative coins. Gold sales by Hungary reflected its central bank's activities as a regular market-maker in gold.

Central banks of gold-producing countries sell gold to dispose of previously accumulated mine production in their reserves, to convert gold reserves into foreign exchange, and for balance of payments objectives. The Central Bank of Brazil sold gold in 1991 initially also to intervene in the local market to control the foreign exchange value of its domestic currency. Uruguay disposed of gold in part to reduce its foreign debt. South Africa disposed of large amounts in 1993 and 1994, when the need to maintain large monetary gold reserves was significantly reduced following the lifting of international sanctions against the country.

As regards the mechanics of gold sales by central banks, it is widely believed that the BIS and other central banks played a key role in facilitating Belgium's sale to the market in 1992, in contrast with its sale in 1989, when reportedly some of the gold was acquired by other central banks. A large part of the sale by the Netherlands in 1992 is believed to have been undertaken for forward delivery in February 1993; it is also thought that these operations were conducted by other official intermediaries, with only a small quantity being placed through private agents, and that the sale was eventually absorbed by the private market. Canada is believed to sell its official gold through private bullion dealers.

Table 3. Official Gold Holdings, 1968-1994

(In millions of ounces)

	Stocks at Year-End				Changes			Memo Items:	
	1968 (1)	1975 (2)	1980 (3)	1994 (4)	1968-75 (5)	1975-80 (6)	1980-94 (7)	Gold received in restitution from IMF (1976-80) (8)	Gold holdings at the EMCF, 1994 1/ (9)
1. G-10 industrial countries (plus Switzerland)	885.54	825.31	739.54	701.39	-60.23	-85.77	-38.15	15.05	--
Of which:									
United States	311.20	274.71	264.32	261.77	-36.49	-10.39	-2.55	5.73	--
Germany	129.69	117.61	95.18	95.18	-12.08	-22.43	--	1.37	23.80
France	110.77	100.93	81.85	81.85	-9.84	-19.08	--	1.28	20.46
Italy	83.52	82.48	66.67	66.67	-1.04	-15.81	--	0.86	16.67
United Kingdom	42.09	21.03	18.84	18.44	-21.06	-2.19	-0.40	2.40	4.61
Canada	24.66	21.95	20.98	4.09	-2.71	-0.97	-16.89	0.94	--
Japan	10.17	21.11	24.23	24.23	10.94	3.12	--	1.03	--
Switzerland	74.97	83.20	83.28	83.28	8.23	0.08	--	--	--
Belgium	43.53	42.17	34.18	25.04	-1.36	-7.99	-9.14	0.56	6.26
Netherlands	48.51	54.33	43.94	34.77	5.82	-10.39	-9.17	0.60	8.69
Sweden	6.43	5.79	6.07	6.07	-0.64	0.28	--	0.28	--
2. Other industrial countries	86.59	78.43	74.34	66.53	-8.16	-4.09	-7.81	2.24	9.37 2/
3. Developing countries	135.23	116.12	141.64	141.48	-19.11	25.52	-0.16	7.69	--
4. Other official sector									
BIS (net)	-9.97	5.83	7.54	7.26	15.80	1.71	-0.28	--	--
EMCF	--	--	85.63	89.86	--	85.63	4.23	--	89.86
IMF	65.37	153.43	103.43	103.43	88.06	-50.00	--	(24.98)	--
Total official holdings	1,163.60	1,179.11	1,152.14	1,109.97	15.51	-26.97	-42.17		
(Percentage change)					*(1.33)*	*(-2.29)*	*(-3.66)*		

Source: IFS.

Note: For EMS countries, gold deposited with the EMCF is reflected in declines in the gold holdings of countries as reported in IFS. Gold deposits of individual countries with the BIS are, however, included in the figures shown for individual countries; BIS gold holdings are therefore shown net of such gold deposits.

1/ Twenty percent of the gold holdings of the EMS countries.
2/ Includes the holdings of Denmark, Greece, Ireland, Luxembourg, Portugal, and Spain.

Table 4. Major Gold Producers: Mine Output and Changes in Official Stocks, 1968-94

	Mine Output (In tons per year)			Change in Official Stocks, 1968-94 1/	
	Average 1968-80	Average 1981-90	Average 1991-93	Million ounces	Tons
South Africa	819.7	643.7	611.6	-31.6	-984.1
United States	38.8	133.2	320.4	-49.5	-1,538.1
Former Soviet Union	225.3	272.6	244.3	-24.1	-750.4
Australia	19.3	96.4	242.3	0.6	17.4
Canada	61.4	105.2	162.6	-20.7	-643.2
China	...	68.1	118.3	-0.1 2/	-3.1 2/
Brazil	14.9	70.2	76.9	2.6	79.6
Philippines	18.5	36.2	28.6	1.1	33.3
Papua New Guinea	13.4	27.7	64.6	-- 2/	0.9 2/
Colombia	8.8	25.6	29.0	-0.6	-19.0

Sources: IFS, Gold Fields Mineral Services, and O'Callaghan (1993).

1/ As of 1991 for the former Soviet Union; September 1994 for China and Brazil; October 1994 for the Philippines; and November 1994 for the remaining countries.
2/ 1977-94.

Hypothetical Simulation of Returns from Selling Gold

This annex illustrates the long-term cost of holding gold to the Fund by means of a hypothetical simulation under which the Fund would have continued to sell gold after completion of the 1976-80 gold sales until all holdings would have been sold, and compares the outcome with retention of the remaining holdings of 103 million ounces, as in fact occurred.

Accordingly, hypothetical calculations have been made of the results of selling gold at the same rate (6.25 million ounces per year) as in the 1976-80 gold sales program. The calculations assume that gold sales of 520,000 ounces would have been conducted at the beginning of each month, continuing the sales program that had ended in May 1980. Under these assumptions, the Fund's gold stock would have been exhausted in December 1996. Furthermore, it is assumed that cumulative sales proceeds would have been realized at the historical market prices and invested in currencies or SDR-denominated assets at the SDR (basket) interest rate. The average return on selling the gold and investing the cumulative sales proceeds is then compared with the hypothetical rate of return from the change in market value of unchanged gold holdings of 103.4 million ounces.

As can be seen in Table 1, the average annual return from keeping the gold over the period (June 1980-December 1996) is negative (-2.8 percent) and compares unfavorably with the average SDR interest rate (7.34 percent) and the average rate of return from selling the gold progressively over the same period (1.37 percent). 1/ Column (5) of Table 1 presents the cumulative value of the proceeds from sales, the investment income earned on these proceeds, and the market value of the remaining gold during the 1980-96 period. By end-1996, this cumulative value would have reached a level of SDR 55.5 billion, approximately twice as much as the current market value of the gold stock (SDR 27.1 billion). This substantial difference in the outcomes reflects mainly the difference between the average SDR interest rate which would have been earned on progressively larger amounts of cumulative proceeds from gold sales, and the negative return on gold. However, these calculations reflect an assumption that the hypothetical gold sales program would have had no impact on the market price of gold. If the sales program had a negative impact on the gold price, then the cumulative value of the portfolio and the average return on investment (Col. (6)) would have been lower, depending on the impact of the sales on the market price of gold. 2/

1/ For example, a 10 percent discount on the historical market price would reduce the cumulative value from SDR 55.5 billion to SDR 49.3 billion, and the average return on investment from progressive gold sales would fall to about 1.28 percent.

2/ Although the average annual rates of return would differ slightly with the selection of a different base year, the qualitative conclusions would remain essentially unchanged as a result of the relatively high nominal interest rates for the SDR (see Table 1).

Table 1. Simulation of Results of Hypothetical Gold Sales Program, June 1980-1996

(In SDR billions, except as indicated)

	Stock of gold held at year-end (million ounces) (1)	Value of gold held at year-end (at historical market prices) (2)	Annual proceeds from sale of 520,000 ounces per month 1/ (3)	Investment income for the period 2/ (4)	Cumulative value of gold held and proceeds, including investment income (5)	Average return on investment in percent per annum 3/ (6)	Memo items: Value of 103.44 million ounces at historical market prices at year-end (7)	Memo items: Average SDR interest rate, in percent per annum (8)	Memo items: Average return from keeping the gold, in percent per annum 4/ (9)
May 1980	103.44						42.24	12.81	
1980 5/	99.80	46.13	1.60	0.06	47.79		47.81	11.33	18.92
1981	93.56	31.95	2.23	0.42	36.26	-24.13	35.33	13.55	-26.11
1982	87.32	36.17	1.89	0.61	42.98	18.53	42.84	11.17	21.28
1983	81.08	29.54	2.25	0.72	39.32	-8.50	37.69	8.60	-12.02
1984	74.84	23.54	1.99	1.01	36.32	-7.65	32.53	8.92	-13.69
1985	68.60	20.42	1.74	1.11	36.05	-0.74	30.79	7.81	-5.35
1986	62.36	19.93	1.72	1.09	38.36	6.40	33.06	6.39	7.35
1987	56.12	19.15	1.92	1.17	40.67	6.04	35.30	5.87	6.78
1988	49.88	15.21	1.81	1.45	40.00	-1.67	31.53	6.25	-10.66
1989	43.64	13.32	1.63	2.21	41.94	4.86	31.56	8.27	0.09
1990	37.40	10.12	1.56	2.79	43.09	2.76	27.99	9.09	-11.31
1991	31.16	7.70	1.43	2.70	44.81	3.98	25.57	7.72	-8.65
1992	24.92	6.04	1.31	2.43	46.88	4.64	25.07	6.26	-1.96
1993	18.68	5.31	1.38	1.97	49.51	5.60	29.42	4.64	17.35
1994	12.44	3.26	1.47	1.97	50.89	2.79	27.10	4.29	-7.87
1995 6/	6.20	1.62	1.42	2.44	53.12	4.37	...	...	...
1996 6/	0.00	0.00	1.41	2.64	55.54	4.56	...	...	...
1981-1996 6/						1.37		7.34	-2.80
1982-1996 6/7/						3.06		6.92	-1.24
1983-1996 6/7/						1.96		6.62	-2.85

1/ The choice of 520,000 oz. per month is based on the assumption that the hypothetical annual gold sales would continue at the same pace as during the 1976-80 sales program. The sale proceeds shown are based on historical prices of gold in the market.
2/ Cumulative sales proceeds invested at SDR (basket) rate of interest.
3/ Calculated as the increase in value (in SDR terms) of the portfolio comprising gold and proceeds from gold sales, including investment income.
4/ Change in value of portfolio comprising only gold (103.44 million ounces).
5/ June-December.
6/ For 1995 and 1996, the gold price and the SDR interest rates are assumed to remain unchanged from that at the end of 1994.
7/ Calculations for this range of years have been included to illustrate that the choice of the starting period has not had an undue influence on the qualitative results.