FOR AGENDA

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April 16, 2009

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Financing the Fund's Concessional Lending to Low-Income Member Countries—Resource Needs and Options**

Attached for consideration by the Executive Directors is a paper on financing the Fund's concessional lending to low-income member countries—resource needs and options, which is tentatively scheduled for discussion on **Tuesday, April 21, 2009**. Issues for discussion appear on pages 14 and 15. To accommodate discussion ahead of the 2009 Spring Meetings, the circulation period for this paper has been abbreviated.

The staff does not propose the publication of this paper after the Executive Board completes its discussion.

Questions may be referred to Mr. Lin (ext. 37299) and Mr. Njoroge (ext. 38785) in FIN, and Ms. Weeks-Brown (ext. 36896) and Mr. Steinki (ext. 38222) in LEG.

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INTERNATIONAL MONETARY FUND

Financing the Fund's Concessional Lending to Low-Income Countries—Resource Needs and Options

Prepared by the Finance and Legal Departments

(In consultation with the Strategy, Policy, and Review Department)

Approved by Andrew Tweedie and Sean Hagan

April 15, 2009

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I. Introduction

1. At the London Summit on April 2, 2009, the G-20 Heads of State indicated that, consistent with the new income model, additional resources from agreed sales of Fund gold should be used, together with surplus income, to provide US$6 billion additional concessional and flexible finance for the poorest countries over the next 2 to 3 years. They called on the Fund to come forward with concrete proposals at the Spring Meetings.

2. This paper seeks to respond to this request. It discusses the financing needs associated with a doubling of the Fund's concessional lending capacity, as called for by the G-20 leaders, and presents proposals on possible options for mobilizing the necessary resources. Based on Directors' views, staff will come back to the Board with more specific proposals in the period after the Spring Meetings.

II. Financing Needs

A. Demand Projections

3. **Latest staff estimates of potential demand for concessional lending from the Fund are laid out in a companion paper on modification of PRGF-ESF access policies**.[1] As noted in that paper, a reasonable central estimate for near-term use of PRGF-ESF resources is about SDR 2 billion per year over the next two years, and about SDR 1.5 billion per year thereafter. These projections take account of the proposed doubling in access limits, and plans to improve the flexibility of the Fund's concessional lending facilities. They are also consistent with the G-20 leaders' call for a doubling of the Fund's concessional lending capacity (Table 1).

Table 1. Demand Projections, 2009-15

Annual commitments	Actual	Projections							**Total**
	2000-08 1/	2009	2010	2011	2012	2013	2014	2015	**2009-15**
In billions of SDR	0.7	2.0	2.0	1.5	1.5	1.5	1.5	1.5	**11.5**
In billions of US$ 2/	1.0	3.0	3.0	2.3	2.3	2.3	2.3	2.3	**17.3**

1/ Excluding the very high level of lending committed to Pakistan in the aftermath of 9/11, and to Liberia in 2008 following arrears clearance.
2/ Assuming exchange rate of US$ 1.5 per SDR.

[1] *Modification of Access Policies for the Poverty Reduction and Growth Facility and the Exogenous Shocks Facility* (SM/09/89, 4/10/09). See also *The Fund's Facilities and Financing Framework for Low-Income Countries* (SM/09/55, 2/25/09) and *Update on the Financing of the Fund's Concessional Assistance and Debt Relief to Low-Income Member Countries* (forthcoming).

B. Loan Resources

4. **Additional loan resources will need to be mobilized promptly to meet this demand.** Available PRGF-ESF loan resources stood at SDR 2.5 billion at end-2008, and have since fallen to SDR 2 billion. This includes the commitment by France to provide a new loan of about SDR 0.7 billion in the context of the Exogenous Shocks Facility (ESF). Based on the above projections, additional loan resources of SDR 9 billion (SDR 11.5 billion less SDR 2.5 billion) would need to be secured to cover projected demand over the short and medium term (Table 2). Loan resources have traditionally been easier to mobilize than subsidy resources, as lenders generally receive a market return linked to the SDR interest rate. Nonetheless, it will be important to begin discussions with potential lenders soon on a plan for mobilizing the needed loan resources.

Table 2. PRGF-ESF Trust—Loan Resources
(Billions of SDRs; end-2008)

Available resources 1/	**2.5**
Total available	16.4
Cumulative commitments to LICs	14.0
Projected demand	**11.5**
2009-10	4.0
2011-15	7.5
Additional resources required	**9.0**

1/ Includes France's pledge of US$ 1 billion in the context of the ESF.

5. **The G-20 leaders' call for a general SDR allocation of US$250 billion could provide an additional vehicle for mobilizing loan resources**.[2] Specifically, some member countries may be willing to make part or all of their SDR allocations available to finance the principal of concessional lending to LICs. If there is sufficient interest, staff could explore options that may be available with respect to the lending of SDRs to the PRGF-ESF Trust.

C. Subsidy Resources

6. **Available subsidy resources for new PRGF-ESF lending are estimated at SDR 1 billion at end-2008** (Table 3). This excludes the SDR 0.3 billion needed to subsidize existing PRGF-ESF loans. These resources include actual balances held in the PRGF-ESF and PRGF-HIPC Trusts, and contributions that have been committed but not yet received, including those committed in the context of the ESF.

Table 3. Subsidy Needs and Availability
(Billions of SDRs; end-2008 NPV terms)

Estimated needs 1/	2.5
Minus: available resources	1.0
Remaining needs	**1.5**

1/ Consistent with projected demand for concessional lending of SDR 11.5 billion in 2009-15.

[2] Staff plans an informal seminar on an SDR allocation before the Spring Meetings, and will prepare a formal paper on the subject for Board consideration shortly after the Spring Meetings. A general SDR allocation must be approved by the Board of Governors with an 85 percent majority of the total voting power.

7. **The Fund has sufficient subsidy resources to meet projected PRGF-ESF loan demand for the next two years.** Based on current projections, available subsidy resources could subsidize new lending of about SDR 4.5 billion. As explained in SM/09/55, the sharp decline in SDR interest rates has reduced estimated subsidy needs for existing PRGF-ESF credit and new loans, thus allowing available resources to subsidize a higher projected level of new lending.[3] However, additional subsidy resources of about SDR 1.5 billion (end-2008 NPV terms) will be needed to subsidize projected demand for concessional lending through 2015.

8. **It has long been envisaged that, once available subsidy resources are depleted, new concessional lending could be subsidized using resources from the PRGF-ESF Trust Reserve Account (RA)**.[4] Based on current projections, it would be feasible to make an allocation of RA resources of about SDR 0.74 billion to help meet LIC subsidy needs, which would cover about half of the additional subsidy needs through 2015. This would still leave sufficient resources in the RA to ensure its long-term "self-sustained" subsidization capacity of about SDR 0.7 billion after 2015 as discussed in SM/09/55.[5] Adoption of this approach would require an amendment of the PRGF-ESF Trust Instrument by a Board decision adopted with an 85 percent majority of the total voting power and with the consent of all 12 current bilateral lenders to the PRGF-ESF Trust. This would leave a need to mobilize additional subsidy resources of about SDR 0.74 billion (end-2008 NPV terms). Also, while the Fund has adequate subsidy resources to support PRGF-ESF Trust lending in the short term, new contributions may be needed earlier if new facilities are agreed as part of the current facilities reforms.

III. FINANCING OPTIONS

9. **As noted, G-20 leaders called for concrete proposals that include use of additional resources from agreed sales of IMF gold, together with surplus income, consistent with the new income model**. This section explores several possible sources of financing, including additional bilateral contributions, delaying reimbursement of the GRA

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[3] These projections assume that the SDR interest rate returns to its long-term average by 2014. The estimates are also sensitive to the assumed path of annual commitments.

[4] The RA is designed to provide security to PRGF-ESF lenders in the event of a delay or nonpayment by borrowers. The account is funded by repayments from Trust Fund loans and loans under the SAF, which had been funded with proceeds from Fund gold sales during 1976–80; it also includes income from the investment of these resources held in the account. As of end-2008, the balance of the RA stood at SDR 3.8 billion.

[5] See FO/DIS/08/23 (3/19/08) for a discussion of the sensitivity of the self-sustained capacity to assumptions regarding the rate of investment earned on the RA balance, interest rates, and resumption of reimbursement of the GRA for PRGF-ESF administrative expenses.

for PRGF-ESF administrative costs, and use of part of the income stream or profits from the agreed gold sales.

A. New Bilateral Contributions

10. **Bilateral subsidy contributions have traditionally played a critical role in securing the financing needed for the Fund's concessional lending.** Support from bilateral contributors, together with use of the Fund's own resources, have underpinned the operations of the ESAF/PRGF since its inception in 1988. Also, contributions to the Fund's HIPC debt relief were financed through a combination of bilateral and Fund resources. The Fund has also sought bilateral subsidy contributions from members in the context of the introduction of the ESF in 2005 and for the subsidization of its emergency assistance to LICs.

11. **In present circumstances, it may not be realistic to seek the full amount of subsidy resources needed through bilateral contributions.** Many members are facing very tight budget constraints in the context of the global economic recession and financing needs associated with correcting weaknesses in financial sector balance sheets. Nonetheless, given the importance of addressing the fallout from the global crisis on the Fund's poorest members, some countries may be willing to contribute additional subsidy resources to help ensure that the Fund has adequate concessional financing capacity to support these members. Thus, a limited fund-raising effort, say, of the order of SDR 0.1–0.3 billion, could be considered as part of a proposed package of measures that would also include use of the Fund's own resources.[6]

B. Delaying GRA Reimbursement for PRGF-ESF Trust Administrative Expenses

12. **One important element of the new income model is the resumption of reimbursement of the GRA for the expenses of operating the PRGF-ESF Trust.** Such reimbursement is to resume in the financial year in which the Fund adopts a decision authorizing the sale of the current stock of post-Second Amendment gold (currently assumed to take place in FY2010). However, the Board decision also notes expressly that the PRGF-ESF Trust's capacity for concessional lending will be kept under close review, and that the Fund should temporarily suspend reimbursement if the resources in the Trust are likely to be insufficient to support anticipated demand for PRGF-ESF assistance and the Fund is unable to obtain additional subsidy resources.[7] It could be argued that these circumstances exist at present in light of the sharp increase in demand envisaged as a result of the global recession and spillovers from the financial crisis in major markets, coupled with the limited availability of bilateral subsidy contributions. Accordingly, the Board could decide to delay

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[6] This would be broadly consistent with the subsidy resources (SDR 0.2 billion) committed by 11 countries in 2005 in the context of the establishment of the ESF (compared with the target of SDR 0.5 billion).

[7] Decision No. 14093-(08/32), adopted April 7, 2008.

reimbursement of the GRA for PRGF-ESF administrative costs for a specified period and to authorize transfer of the equivalent amount to LIC subsidy accounts.[8]

13. **If this approach is pursued, consideration would need to be given to the period for which reimbursement should be suspended**. One possibility would be to suspend reimbursement for 3 years, covering the peak concessional lending period associated with the current crisis. This would also coincide with the period when the Fund's GRA lending income is projected to peak, such that the absence of income from PRGF-ESF reimbursement could be more easily accommodated. Longer periods, say 4–5 years, could also be considered though, as discussed below, the Fund's medium-term income position would be negative in 2015 if PRGF-ESF reimbursement was suspended for 5 years under the baseline scenario. Based on current estimates, PRGF-ESF administrative costs are of the order of SDR 50 million per annum, suggesting the potential to generate subsidy resources of SDR 0.1–0.2 billion over 3 years.

C. Profits from Gold Sales

14. **A central element of the new income model involves the limited sale of a portion of the Fund's gold and investment of the profits in an endowment to generate income**.[9] Specifically, it is envisaged that the Fund will sell the 403.3 metric tons (12.97 million ounces) of gold acquired after the date of the Second Amendment ("post-Second Amendment gold"), and that the profits will be placed in the Investment Account (IA) and invested with the objective of generating investment returns to contribute to the Fund's income while preserving the long-term real value of these resources (Box 1).

15. **Consideration could be given to using part of the proceeds from the agreed gold sales (or the resulting investment income) to support the Fund's concessional lending.** Given developments since the new income model was agreed, notably the sharp pickup in Fund lending from the GRA and higher gold prices, it could be argued that the Fund has additional resources that could be used to support the Fund's concessional lending, consistent with the new income model. Three broad options are discussed below.

16. **Under all the options presented, the procedures for making part of the resources from gold sales available to support the Fund's concessional lending would involve indirect transfers of these resources.** Specifically, there would first need to be a distribution to members of resources related to these proceeds, followed by a return by these

[8] This approach was used in the context of fund-raising for the HIPC Initiative, where the Board took decisions to suspend reimbursement and transfer the corresponding amount to the PRGF-HIPC Trust. These transfers amounted to SDR 0.4 billion over a seven-year period.

[9] *Report of the Managing Director to the International Monetary and Financial Committee on a New Income and Expenditure Framework for the International Monetary Fund* (IMFC/Doc/17/08/7, 4/10/08).

members of these resources (or broadly equivalent amounts) as subsidy contributions (Box 2). A direct transfer to LIC subsidy accounts of resources from gold sales is not possible because, under the Articles of Agreement, profits from the post-Second Amendment gold that is to be sold under the new income model are assets of the GRA and—in light of uniformity of treatment requirements that apply to such assets—cannot be transferred to subsidy accounts for the benefit of only low-income members.[10] A related complication is posed by the fact that the proposed amendment of the Articles of Agreement to expand the investment authority of the Fund under the new income model provides for the direct placement in the Investment Account of all profits from the sale of post-Second Amendment gold. Thus, decisions would be required under all three options to transfer from the IA to the GRA (either as investment income or through a reduction in the IA's investment) resources that are linked to gold profits or to the investment income from such profits; such resources could then be distributed to members in proportion to quotas either as a distribution of part of the Fund's net income in the year of the sale or as a distribution of part of the Fund's general reserves. The amounts distributed to members—subject to some likely leakage—would then be returned by them as bilateral subsidy contributions (Box 3).

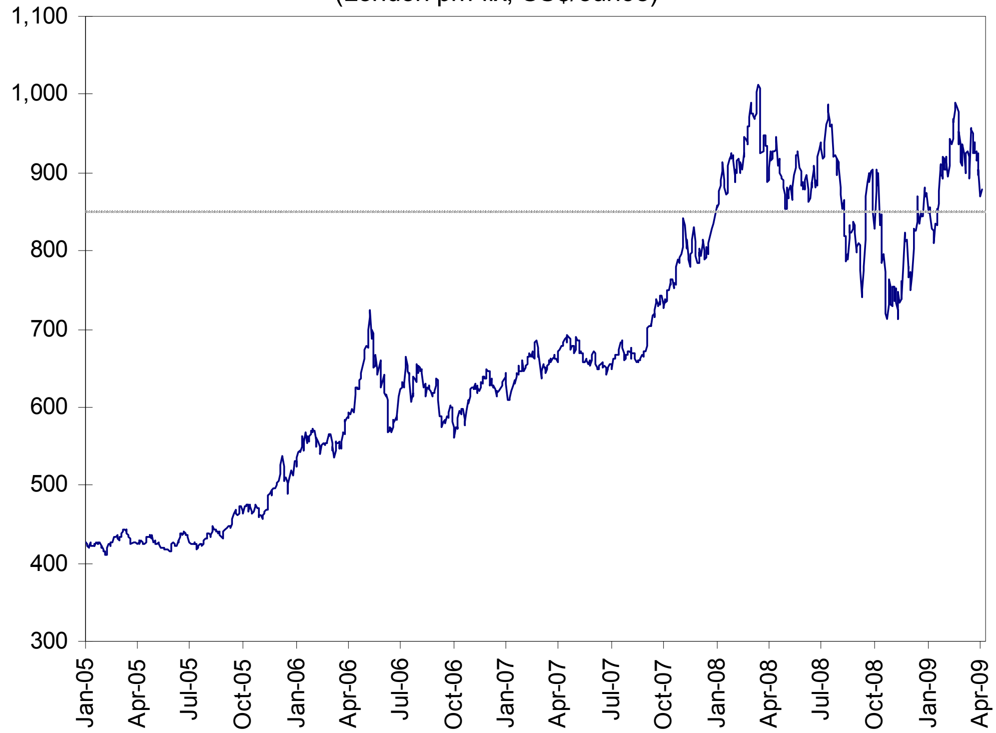
Option 1. Use of windfall gold profits

17. **One option would be to make available part or all of any windfall profits from higher-than-assumed gold prices as subsidy resources.** Under the new income model, gold sales were assumed to take place at an average price of US$850 per ounce. In recent months, the price of gold has fluctuated above that level, raising at least the possibility that the Fund could obtain a windfall profit over and above that assumed for the income model (Figure 1). In addition, reflecting the recent pickup in GRA lending, the staff's latest update of the medium-term income and expenditure framework suggests that, under the baseline scenario, the Fund would record a small operational surplus in the medium term even with a slightly lower average gold price of US$810 per ounce (the recent two-year average).[11] Thus, a decision could be taken to transfer part or all of any such windfall profits to the GRA for distribution to members, to be returned by them as subsidy contributions.

[10] This is in contrast to profits from sales of pre-Second Amendment gold, which Article V, Section 12(f)(ii) specifically authorizes may be transferred to the Special Disbursement Account and used to provide concessional assistance to members on a basis that takes into account their income level.

[11] *The Consolidated Medium-Term Income and Expenditure Framework* (EBAP/09/63, 4/9/09).

Figure 1. Gold Price, January 2005 - April 2009
(London pm fix, US$/ounce)



18. **One difficulty with this approach is that there is no certainty that the Fund will indeed obtain a windfall profit from gold sales.** While gold prices have recently been above that assumed for the new income model, it has also fluctuated quite widely in recent years, and it is conceivable that, when the agreed gold sales actually take place, the average price could be close to or lower than assumed for the income model. Moreover, it is envisaged as part of the new income model that any on-market sales will be phased (the medium-term income projections assume a phased sale over three years), which in turn creates uncertainty over the extent to which the current higher gold prices would remain until the sales are substantially completed.[12] Accordingly, if the assumed windfall did not eventuate, or if their phased nature implied timing lags between recognition of the profits and the need for subsidy resources, consideration would need to be given to alternative means of obtaining the needed subsidies.

Option 2. Use of net investment income from gold profits

19. **A second option would be to retain the gold sales profits in the IA but use part of the investment income from the endowment to provide subsidy resources.** Again, this would need to be done through one or more GRA distributions to members that would then

[12] Off-market sales to official holders could, however, be completed more rapidly.

be returned by them as subsidy contributions. This would preserve the corpus of the gold sales profits as capital in the IA endowment, while allowing use of a specified part of the income to provide LIC subsidies rather than supporting the Fund's GRA activities. Under this approach, subsidy resources would only be generated after some time following the sale and investment of the gold proceeds.

20. **Careful consideration would need to be given to the scope for using future income to provide subsidies without leading to operational losses in the GRA**. This would require assumptions on both the payout ratio and the Fund's broader income outlook. For example, assuming a 3 percent payout ratio, total income from the gold endowment is projected at about SDR 0.13 billion a year beginning in FY 2013 (the latest medium-term income projections assume that the payout would commence when the gold sales have been completed). Under the baseline scenario, the bulk of these transfers are needed to support the Fund's medium-term income position, suggesting that any use of investment income for subsidy resources would need to be spread over a relatively long period. Greater flexibility to pursue this approach would be possible in the high lending scenario.

Option 3. Use of a pre-determined amount of gold sales proceeds

21. **A third option would be to transfer a pre-determined amount of resources from the IA that are linked to gold sales proceeds to finance LIC subsidy needs.** Under this approach, the Board could take a decision—regardless of future gold prices—to transfer a specific amount from the IA to the GRA for distribution to members (again, with the expectation that these resources would be returned by them as subsidy contributions). The size of the distribution could also take into account factors such as the overall estimated subsidy needs less the amount targeted from additional bilateral contributions and transfers from the PRGF-ESF Reserve Account in lieu of reimbursement of the GRA.

22. **This approach is illustrated in Table 4.** Subsidy contributions from gold sales proceeds in the range of SDR 0.5–0.6 billion could be needed after assumed new bilateral contributions and a suspension of PRGF-ESF reimbursement. Assuming that leakage from the dividend distribution can be held to a low level (say, 10 percent), this would correspond to a distribution of about US$0.8–1.0 billion from total projected gold profits of US$6.5 billion.[13] This approach would provide more up-front certainty over the contribution to subsidy resources linked to gold proceeds. The full risks of a lower gold sales price than assumed in the medium-term income calculations would be borne by the GRA; however, these risks could be mitigated by the prospect of higher lending income.

[13] Assuming an average gold sales price of US$810 per ounce.

Table 4. Subsidy Needs and
Possible Sources of Financing
(Billions of SDRs; end-2008 NPV terms)

	Total
Subsidy requirements	
Estimated needs	1.49
Minus: subsidization from PRGF-ESF Reserve Account	0.74
Remaining needs	**0.74**
Possible sources of financing	
1. New bilateral contributions	0.1-0.3
2. Transfer from PRGF-ESF Reserve Account 1/	0.1-0.2
3. Distribution of gold profits	0.5-0.6

1/ In lieu of reimbursing the GRA for PRGF-ESF administrative costs.
Assuming transfers are made once a year, starting in FY2010.

IV. Consistency of Financing Options with the New Income Model

23. **As noted in the G-20 leaders' communiqué, proposals for using additional gold proceeds should be consistent with the new income model.** The new income model remains a critical element of the overall governance and financial reforms of the Fund. Once fully in place, it envisages that (i) the Fund would rely on broader and more sustainable sources of income to finance its diverse activities (rather than continuing to rely primarily on lending income), and (ii) relatedly, that the margin for GRA lending would cover only the Fund's intermediation costs and the buildup of reserves. The three options presented in this paper provide a means by which the Fund, mainly in the transitional period leading to full implementation of the new income model, could use additional resources beyond those anticipated when the new model was agreed in a manner that would preserve the Fund's ability to implement the new income model and ensure that the Fund's finances are placed on a sustainable medium-term footing. This approach would also be consistent with the principle endorsed by the Board in designing the new income model that the framework should be sufficiently flexible to enable the Fund to respond appropriately to future developments.[14]

24. **Staff has updated the medium-term income and expenditure outlook in light of recent developments, including the rise in GRA lending.**[15] In this regard, the following points appear relevant:

[14] *Chairman's Summing Up—Developing a New Income Model for the Fund* (BUFF/07/115, 7/23/07).

[15] EBAP/09/63.

- While the short-term income outlook has improved as a result of the rise in GRA lending, the medium-term position is only modestly improved in the baseline scenario, taking into account loan arrangements currently in place.

- A more significant improvement is envisaged in the high lending scenario, which incorporates possible new arrangements. In this case, the higher income from lending will support the more rapid accumulation of precautionary balances needed to protect the Fund against increased credit risks. Even in the high lending scenario, however, the boost to the Fund's income is temporary.

- Despite the higher short-term income from lending, the new income model remains critical to ensure a sustainable and diversified medium-term income position.

- The rest of the income model is being implemented on schedule. In particular, the front-loaded internal restructuring plan aimed at cutting structural spending by US$100 million (one quarter of the US$400 million financing gap) is on track, notwithstanding the pressures on the Fund associated with addressing the global crisis.

- The new income model remains heavily reliant on the uncertain proceeds of planned gold sales. While the gold price has recently been higher than assumed when the model was agreed, it has also been highly volatile and a significant price decline would affect the medium-term outlook. The sustainable payout ratio from the gold endowment is also uncertain.

25. **Against this background, staff has prepared an initial and very preliminary assessment of the potential impact of the above financing options on the income outlook** (Table 5). These estimates take as a starting point the latest medium-term income projections presented in EBAP/09/63. For illustrative purposes, staff has examined the impact of a financing package along the lines set out in Table 4: namely, an overall subsidy resource target of about SDR 0.74 billion financed through a combination of (i) new bilateral contributions; (ii) temporary suspension for 3 years of reimbursement of the GRA for PRGF-ESF Trust expenses; and (iii) a GRA distribution of SDR 0.6 billion linked to the proceeds of the envisaged gold sales that is assumed to be substantially returned by the membership as subsidy contributions. Under this approach, the Fund's own resources from surplus income and gold proceeds would provide most of the financing, supported by new bilateral contributions of, say, SDR 0.1–0.3 billion.

Table 5. Illustrative Impact of Financing Options on the Fund's Operational Income
(In millions of SDRs)

	FY 2010	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
I. Baseline scenario balance (gold price of $810 per ounce) 1/	**290**	**15**	**60**	**162**	**82**	**45**
Illustrative impact of :						
(a) a delay in PRGF-ESF reimbursement of the GRA until FY 2013	(50)	(53)	(56)	(5)	(6)	(8)
(b) a distribution of SDR 0.6 billion in gold profits for LIC subsidies	-	-	-	(19)	(21)	(22)
Adjusted baseline scenario balance	**240**	**(38)**	**4**	**138**	**55**	**15**
Other key sensitivities on adjusted balance						
(a) Gold prices lower by $100 per ounce	240	(38)	4	112	26	(16)
(b) Gold prices lower by $100 and pay-out ratio reduced to 2 percent	240	(38)	4	82	(7)	(52)
II. High lending scenario balance (gold price of $810/ounce) 2/	**738**	**367**	**482**	**595**	**465**	**348**
Illustrative impact of :						
(a) a delay in PRGF-ESF reimbursement of the GRA until FY 2013	(50)	(53)	(55)	(6)	(6)	(8)
(b) a distribution of SDR 0.6 billion in gold profits for LIC subsidies	-	-	-	(18)	(21)	(21)
Adjusted high lending scenario balance	**688**	**314**	**427**	**571**	**438**	**319**
Other key sensitivities on adjusted balance						
(a) Gold prices lower by $100 per ounce	688	314	427	544	409	287
(b) Gold prices lower by $100 and pay-out ratio reduced to 2 percent	688	314	427	514	376	252

1/ See Table 1 of EBAP/09/63.
2/ See Table 2 of EBAP/09/63.

26. **Based on the latest income outlook, such an approach appears consistent with the new income model.** The impact of delaying reimbursement of the GRA for PRGF expenses would be felt in the first 3 years when income from lending is expected to be relatively high. While this could leave the Fund in the baseline scenario with low or even negative operational income, significant surcharge income is expected during this period such that the Fund's overall income position would remain positive. The main effect would be somewhat lower accumulation of precautionary balances, with second round income effects over time. A distribution of part of the gold proceeds would reduce income from the endowment in the outer years, but the overall income position would remain slightly positive in the baseline scenario (with suspension of PRGF reimbursement for 5 years, however, the medium-term income position would be negative).

27. **In the high lending scenario, projected surpluses would remain sizable through FY 2015.** This is likely to overstate the Fund's structural income position (for example, if members repay the Fund early in response to the recently introduced time-based surcharges). However, there would still be an additional buffer to handle an approach along the lines discussed in this paper. The higher surpluses would also play an important role in protecting the Fund against the higher credit risks through the more rapid accumulation of precautionary balances. Overall, staff estimates suggest that precautionary balances would be SDR 0.2–0.3 billion lower in the medium term under this approach compared to the latest estimates provided to the Board.

28. **This said, the income model is not yet in place and remains vulnerable to uncertain developments in several areas.** As noted elsewhere, projected income from lending associated with the global crisis is highly uncertain, though the current expectation is that the Fund will be called upon to provide additional support to members beyond those arrangements already in place. A second key unknown is the average price at which the agreed gold sales take place, which directly affects the size of the endowment and future income from this source. A third unknown is the sustainable payout ratio from the endowment, which depends on uncertain future investment returns and on Board decisions regarding the scope of the broadened investment mandate.

29. **To illustrate these effects, Table 5 also provides a sensitivity analysis for the effects of a lower gold sales price and a lower payout ratio**. This analysis indicates that, in the baseline scenario, the integrity of the new income model could be vulnerable to downside risks for the gold price and a lower payout ratio, with negative income projected in the outer years if one or both of these risks materialize. The model is more robust to these risks over the projection horizon in the high lending scenario, though as noted, the full lending income may not materialize in later years if members repay the Fund early.

V. ISSUES FOR DISCUSSION

30. **This paper presents initial considerations for mobilizing the additional subsidy resources needed to support a doubling of the Fund's concessional lending over the medium term**. Based on Directors' views, staff will come back to the Board with a more detailed set of proposals and discussion of the operational modalities following the Spring Meetings. At this stage, Directors may wish to comment on:

- The overall scope for using a modest part of the agreed gold sales proceeds, or the resulting investment income, to generate subsidy resources for the Fund's concessional lending in light of the improvement in the Fund's income outlook since the new income model was agreed.

- The merits of the proposals presented in this paper, including the possible role for new bilateral contributions, a temporary suspension of reimbursement of the GRA for PRGF-ESF expenses, and use of resources linked to gold sales.

- The relative contributions that could be expected from these alternative sources. In particular, what are Directors' views on the possible target for new bilateral contributions in the current environment, and on the period for which suspension of reimbursement of the GRA for PRGF-ESF expenses could be considered as part of the Fund's contribution to the needed fund-raising?

- Which of the three options discussed above for using part of profits from the agreed gold sales appears most promising? Do Directors consider that staff should develop some or all of these options further, including the modalities for securing subsidy resources through a distribution of GRA resources to all members in proportion to quotas, accompanied by understandings on the return of those funds by members as subsidy contributions for the Fund's concessional lending?

Box 1. The New Income Model and Modalities of Gold Sales

Key elements of the new income model

The new income model for the Fund was endorsed by the Executive Board on April 7, 2008, and approved by the Board of Governors on May 8, 2008. The model is based on more robust and diverse sources of revenue, and would put the Fund's income on a sustainable footing. Key elements of the model include:

- The creation of an endowment with the profits from the limited sale of 403.3 metric tons (12.97 million ounces) of gold acquired by the Fund after the Second Amendment ("post-Second Amendment gold"). The Executive Board agreed that all profits from these gold sales should be placed in the Investment Account and invested with the objective of generating investment returns to contribute to the Fund's income while preserving the long-term real value of these resources.

- A broadening of the Fund's investment authority to enhance the average expected return on the Fund's investments and enable the Fund to adapt its investment strategy over time. The investment policies would reflect the public nature of the funds to be invested and include safeguards to ensure that the broadened investment authority does not give rise even to perceived conflicts of interest.

- Resumption of the long-standing practice of reimbursing the GRA for the cost of administering the PRGF-ESF Trust, to be become effective in the financial year in which the Fund adopts a decision authorizing the gold sales. This cost recovery should not affect the Fund's ability to provide concessional lending to low-income countries.

Modalities of the Gold Sales

At its discussion on February 20, 2008, the Board provided guidelines to govern any gold sales that it may authorize in the context of the new income model. These guidelines include: (i) sales should be strictly limited to the current stock of post-Second Amendment gold; (ii) sales should not add to the announced volume of sales from official sources; (iii) the scope for sales of gold to one or more official holders should be explored, given the advantages of this approach; (iv) absent sufficient interest from other official holders to purchase gold directly from the Fund, phased on-market sales would represent the most appropriate modality for gold sales; and (v) gold sales conducted by the Fund should have a strong governance and control framework, together with a high degree of transparency.

Box 2. Mobilizing LIC Subsidy Resources Through Use of Resources from Gold Sales

The effectiveness of mobilizing LIC subsidy resources through a limited distribution of resources linked to gold sales would depend critically on members' willingness to return to the Fund resources distributed to them from net income or from general reserves pursuant to Article XII, Sections 6(a) or (d), respectively. While the Fund has not had experience in effecting such distributions in the past, it has mobilized subsidy resources through similar exercises in the context of the HIPC Initiative and Liberia's debt relief:

- In the case of the former, to facilitate fund-raising for the PRGF-HIPC Trust, the Board decided to terminate the Second Special Contingent Account (SCA-2) and refund the full balance of SDR 1 billion to the members that had contributed to the account in proportion to their contributions (with a ratio of 3 to 2 between creditors and debtors). In the end, two-thirds of the refunds were returned to the Fund to finance the PRGF-HIPC Trust.

- In the case of Liberia, the Fund took a decision to make a partial distribution of SDR 525 million from the First Special Contingent Account (SCA-1) to contributors, which was conditional on firm commitments from members that they would either contribute their SCA-1 distributions and refunds from Liberia's deferred charges, or make other commitments to finance Liberia's debt relief, up to a certain minimum amount. In this case, the return rate was also about two thirds.

If the Board decided to distribute to members resources linked to the profits from agreed gold sales to help mobilize LIC subsidy resources, it would seem reasonable to expect a significantly higher return rate.

- First, unlike the previous distributions from the SCA-1 and SCA-2, the proceeds from post-Second Amendment gold sales do not reflect members' previous contributions as such, but rather signify resources that belong to the Fund and the membership as a whole. As such, it would be reasonable to effect distributions linked to gold sales only where the Fund has a high degree of assurances that the participation rate in providing contributions to support LICs would be very high.

- Second, the distribution would be in proportion to quotas (unlike distributions of SCA-1 and SCA-2 resources, which were linked to individual debtor and creditor members' actual contributions to those Accounts). As shown below, if all G-20, other advanced, and fuel exporting countries were to return their distributions, this would amount to 87 percent of the total share. As in the case of Liberia, many developing countries could also be expected to wish to contribute to this initiative, which would further limit the leakage from the distribution.

Member Countries' Quota Share in the Fund
(In percent)

G-20	79.1
Other advanced countries	3.6
Fuel exporting countries	4.2
Other developing countries	13.1

Box 3. Distribution of Resources from Gold Sales

Under the Articles of Agreement, the proceeds from the sale of gold acquired by the Fund after the Second Amendment belong to the General Resources Account. Under the provisions of the proposed amendment to expand the investment authority of the Fund, all profits from the sales of such gold are to be automatically placed in the Investment Account (IA) upon a sale of the gold (or upon effectiveness of the amendment, in the case of post-Second Amendment gold sold prior to entry into force of the amendment); an amount equal to the acquisition price of the gold will be retained in the GRA.

The Fund does not have the authority to use GRA resources, including profits from the sale of post-Second Amendment gold, to provide subsidies for concessional lending to LICs, as the use of GRA resources for the benefit of only low-income members would not be consistent with the requirement of uniformity of treatment that applies to these resources. (In contrast, Article V, Section 12(f)(ii) specifically provides that the Fund may take into account members' income level when deciding how to use profits from the sale of pre-Second Amendment gold.)

To make resources linked to post-Second Amendment gold profits available to members through a distribution, the Executive Board could adopt decisions to transfer such resources to the GRA from the Investment Account.

Two key options exist for removing from the IA resources that are linked to gold proceeds: (i) the Fund could decide, by a majority of the votes cast, to transfer IA investment income to the GRA (Article XII, Section 6(f)(iv)); or (ii) the Fund could decide, by a 70 percent majority of the total voting power, to reduce the amount of resources in the Investment Account (Article XII, Section 6 (f)(vi)) and transfer a corresponding amount to the GRA.

As discussed in detail in the main part of this paper, there are a number of options for how to link transfers from the IA to the GRA to profits from the envisaged sale of post-Second Amendment gold. Irrespective of how such a link is established, transfers from the IA to the GRA would be expected to take place under one of the two preceding options.

Investment income transferred from the IA may be used to meet the expenses of conducting the business of the Fund, while transferred resources representing a reduction in the amount of the IA's investment are available for "immediate use" in the Fund's operations and transactions. These resources could be transferred to contribute to net income of the GRA in a given year. Under the Articles of Agreement, the Fund has two primary options for distributing GRA resources to members: (i) the Fund has the authority to distribute all or a part of any net income it earns in a given year with an Executive Board decision taken by a majority of the votes cast (Article XII, Section 6(a)); and (ii) the Fund has the authority, with a 70 percent majority of the total voting power to distribute to members at any time any part of its general reserve (Article XII, Section 6(d)). Both distributions of net income and of general reserves are to be made to all members in proportion to their quotas (Article XII, Sections 6(c) and (d), respectively).