IMF Response to the World Gold Council

Stanley Fischer
First Deputy Managing Director
International Monetary Fund
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Thank you very much for the copies of the interesting study "A Glittering Future? Gold Mining's Importance to Sub-Saharan Africa and Heavily Indebted Poor Countries" which was commissioned by the World Gold Council. The study and your letter raise a number of important issues.

Let me assure you that I share your concerns about the social impact of the long-term decline in the gold price on many low-income countries. This decline has resulted from a variety of factors, including cyclical developments, the diminished attraction of gold as an investment alternative, expansion of mine output, central bank lending of gold, and the declining role of gold as a monetary asset.

It is important, however, to interpret properly the reasons for the most recent decline in the gold price and the impact on the market from the possible sale of 5-10 million ounces of gold by the Fund. Regarding the fall in the price of gold, possible gold sales by the Fund of 5 million ounces have reportedly been factored into the gold price since 1996, when they were first proposed. The market further adjusted earlier this year to possible sales of up to 10 million ounces, as proposed by a number of government officials during March and April in the run-up to the Fund's Interim Committee meeting. By late April, the price had recovered somewhat, but then dropped sharply by some $30 per ounce on the unexpected gold sale announcement by the United Kingdom on May 7, which led to perceptions of further sales by central banks. The price then recovered somewhat during June, but fell by a further $10 per ounce following the first U.K. auction on July 6. Neither the May nor the July price declines could reasonably be attributed to any new news of possible Fund gold sales.

The lower gold price will regrettably have an adverse economic and social impact, especially on the low-income gold-producing countries, but the impact should not be overstated, particularly in the short term. For most of the countries eligible for the heavily indebted poor countries (HIPC) initiative, a $20 per ounce decline in the gold price (which we regard as well above any reasonable estimate of the impact of IMF gold sales on price) would represent less than ½ of 1 percent of total export proceeds. In Ghana and Mali, the largest HIPC gold producers, the marginal impact of the lower gold price would amount to less than 3 percent of total export proceeds. For South Africa, a $20 per ounce lower gold price implies a loss of export proceeds equivalent to less than 1 percent of total exports.

Any decline in export earnings from declining gold prices in the HIPC-eligible countries, however, would be greatly outweighed by debt relief under the HIPC Initiative. The amount of assistance under the HIPC Initiative for the 15 gold-producing HIPCs with gold exports exceeding 1 percent of total exports is estimated at about $7 billion (in 1998 net present value terms) under the current HIPC Initiative framework and about $14 billion under the proposed enhanced framework. This compares with projected export losses of these countries over the next five years of less than $0.5 billion (in 1998 net present value terms) if the $20 per ounce drop in the gold price was sustained. Moreover, for HIPC-eligible countries that have not yet reached the decision point under the HIPC Initiative, HIPC assistance would increase as gold prices fall, helping partially to offset the lower export proceeds.

On your suggested alternative financing modalities to fund debt relief:

- Since the outset of the discussions on the financing of the ESAF and HIPC initiatives in 1996, bilateral contributions have been considered the main financing source. We will continue to press for further contributions but, realistically, it might be difficult to fully fund the ESAF and HIPC initiatives from this source alone.

- Borrowing from private markets would not provide any grant resources, which are what are needed to fund the ESAF and HIPC initiatives.

- A pure revaluation of the Fund's gold would result only in an accounting gain and would not provide the cash resources needed to fund the initiatives. Moreover, a revaluation of gold is inconsistent with the Fund's Articles of Agreement.

- Under the Fund's Articles of Agreement, an SDR allocation is possible only when there is a "long-term global need...to supplement existing reserve assets," and, therefore, could not be used to finance debt relief for a specific group of members. Even if there were a global justification for allocations, the "recycling" you suggest would, in effect, involve bilateral contributions in grant form, for which a major effort is already underway.

In closing, let me assure you that we share your concern for the impact of falling gold prices on the poorest countries. We seek to find a solution for debt relief that will minimize the impact on the market of the mobilization of the Fund's gold at the same time while obtaining the needed funding for the ESAF and HIPC initiatives on a timely basis.