Policy note

Foreign Reserves & Global Objectives

How the UK's Idle Foreign Exchange Reserves Can Support the UK's Global Economic Interests

Stephen Paduano

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Foreword

The UK is currently in the process of drafting a White Paper on International Development. One of the central questions being asked by the Foreign Commonwealth and Development Office is how they can maximise the UK's impact around international goals on growth, poverty and climate despite current fiscal constraints.

This paper by guest author Stephen Paduano is therefore extremely timely. The way in which the UK manages its foreign exchange reserves matters to international flows of concessional finance. The UK is already using its international reserves to enable IMF financing operations. However, as the author shows there is potentially scope to do much more.

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1. Introduction

In recent weeks the United Kingdom has been expected to play a leadership role at the G-20 summit in New Delhi and the UN General Assembly meetings in New York. In the coming weeks, it will be expected to do so again at the World Bank-IMF Annual Meetings in Marrakech and the COP Climate Summit in Dubai. The extent to which the UK remains willing to be a leader on issues facing the global economy and international system is not, at the moment, entirely clear. The extent to which it is *able* is also facing new doubts. Domestic economic priorities – i.e. fiscal consolidation – are putting pressure on the UK's development and climate spending and are hampering the UK's ability to contribute to global economic initiatives. The long-run costs of spending cuts to the UK's interests and standing in the international system may be severe.

In order to minimise these costs, UK policy-makers should make more sophisticated and ambitious use of readily available funds. The UK's Exchange Equalisation Account – the government's $190 billion reserve fund – offers a way forward. Established for the purpose of maintaining an active exchange rate policy, the Exchange Equalisation Account has become increasingly idle in the post-Bretton Woods period, particularly after the failed defence of the Exchange Rate Mechanism in 1992. Given that the government has formally embraced the norm of a freely floating currency, and given that daily turnover in foreign-exchange markets has increased 14-fold since the early 1990s – from $500 billion to $14 trillion – it is clear that the Exchange Equalisation Account will remain idle: it has become much too small to intervene effectively in foreign-exchange markets, if for some reason the UK were to want to attempt this again. With the primary function of the Exchange Equalisation Account consigned to history, the UK should give careful attention to its secondary function: 'making investments to further broader economic policy aims'.

This paper discusses how the Exchange Equalisation Account can support the UK's global economic objectives in a way that fits fully within the account's legal remits and financial constraints. The paper gives particular attention to the UK's Special Drawing Rights (SDRs), given the UK's interest in rechanneling these trapped funds through the World Bank and other multilateral development banks. It demonstrates how doing so would not only serve the UK's foreign policy and foreign economic policy interests, but also how it would fall within the four corners of the Exchange Equalisation Account Act and indeed buttress the UK's foreign exchange reserves (by buttressing the liquidity of the fund).

2. Beyond the 20% SDR rechannelling pledge

At the IMF-World Bank Spring Meetings in April 2023, the UK announced that it had fully met its pledge to rechannel 20% of the

SDRs it had received in the IMF's 2021 allocation. Of the $26 billion in SDRs that the UK had received, it would contribute $2 billion to the IMF's Poverty Reduction & Growth Trust (PRGT) and $3.3 billion to the Resilience & Sustainability Trust (RST).

This was a substantial achievement, but the UK should not declare victory just yet. Although 20% is a respectable sum, the UK now risks getting left behind by the more ambitious SDR rechannelling plans of other G-20 countries. Saudi Arabia has pledged to rechannel 29% of the SDRs it received in the last allocation, China 34%, Australia 39% and France and Japan 40%. By contrast, the UK's 20% has begun to look like a good first step.

Fortunately, the UK has both the tools and resources to go further – not only matching the pledges of its peers, but also providing much-needed leadership for the international financial architecture. Where other countries face legal and political hurdles in SDR rechannelling, the UK is perhaps alone in its capacity to make productive use of the SDR system.

Given the UK's additional $40 billion in SDR holdings – and given the powerful and underused $190 billion account in which the UK's SDRs are held – the government should take a closer look at mobilising its idle reserves for financing its global economic objectives.

3. SDRs and SDR rechannelling

SDRs are the reserve asset of the IMF that members can sell to other members for dollars, pounds, euros, yen and yuan. The IMF allocates SDRs to each of its members, with the most recent being a $650 billion allocation in 2021 in response to Covid-19. Members pay the SDR interest rate (currently 4.033%) on what they have been allocated and they collect the SDR interest rate on what they actually hold. This means that once a country makes use of its SDRs – by selling its SDRs for the hard currency of another IMF member – its SDR holdings drop below its SDR allocation, and it pays more SDR interest than it receives. In effect, IMF members pay the SDR interest rate to use their SDRs. The counterparty in that exchange, the IMF member that provides currency in exchange for SDRs, will then have its holdings rise above its allocation, and it will earn interest on the difference.

The significance of the SDR system can be thought of in three ways. First, it provides affordable financing to low- and middle-income countries. As the SDR interest rate is a basket of the yields on three-month government bonds of the US, the UK, China, Japan and euro area government bonds with a rating of AA or above, SDRs effectively allow low- and middle-income countries to borrow at rich country rates.

Second, SDRs offer the world a way to make use of idle official reserves. The SDR system, if it is working properly, allows countries in need of foreign exchange to borrow from countries with surplus foreign exchange. As there is currently $12.04 trillion in official foreign-exchange reserves – and as there is no shortage of development and climate change challenges in need of financing – the SDR is a powerful tool to allow the world to make use of funds that would otherwise be parked in the safe assets of advanced economies.

Third, the SDR system creates a unique political opportunity. Of the $881 billion in SDRs currently in existence, G-20 countries hold $605 billion. Rich countries neither need nor use their SDRs: if they want to borrow at around 4%, they can easily do so by more conventional means. This means rich countries can be called upon to 'rechannel' these surplus funds and may be eager to do so, given that they will not and cannot use the funds themselves. In this way, SDRs can finance global economic objectives and generate international goodwill without necessitating any new taxation or borrowing.

In 2021 the G-20 committed to rechannelling $100 billion in SDRs to low- and middle-income countries. The primary avenue for doing so at the time was the PRGT, the IMF's primary lending vehicle for poor countries. The IMF subsequently created the RST, which would thrust it into the realm of climate-oriented lending.

However, the funding target of the PRGT is just $19 billion – $2 billion of which would come in the form of subsidy resources, which are provided in currency rather than SDRs. The current funding target of the RST is $44 billion. What this means is that the current SDR rechannelling architecture can only carry $61 billion in SDRs. Absent new ways of rechannelling SDRs, the G-20's $100 billion rechannelling pledge is not currently attainable.

4. Rechannelling SDRs beyond the IMF: the hybrid capital proposal

As a result of the limited absorptive capacity of the PRGT and RST, there has been a push to rechannel SDRs beyond the IMF – to the multilateral development banks that are 'prescribed holders' of SDRs.

Two proposals have been put forward for MDB rechannelling. The African Development Bank (AfDB) and Inter-American Development Bank (IDB) have proposed a hybrid capital loan, under which SDRs would be lent by IMF members to the banks, which would score those SDRs as equity. As a result, the AfDB and IDB could leverage the SDRs 3-4x. Given the need to preserve the reserve asset characteristic of the SDR, the SDRs contributed under the scheme would be encashed through a 'liquidity support agreement', which would retain 25% of the SDR contributions, allowing contributing countries to draw down these resources in the event of a balance-of-payments problem.

The challenge for the AfDB is that key G-20 countries face political, legal or technical obstacles to making a hybrid capital loan or purchasing subordinated debt. In the US, both a loan and a subordinated bond would require the US Treasury to seek new authorisation from Congress, which has been slow to approve any form of SDR rechannelling. In the eurosystem, the European Central Bank (ECB) has concluded that loss-absorbing hybrid capital and subordinated debt would be in violation of the prohibition on monetary financing, meaning that the eurosystem countries, which hold $200 billion in SDRs, cannot participate in the proposal either. The UK has expressed other technical reservations related to pricing hybrid capital and how further rechanneling of SDRs would consume a greater proportion of the UK's 'policy ready reserves' — i.e., the non-SDR hard currency held in the Exchange Equalisation Account — as the IMF compels countries to participate in more SDR exchanges when their SDR holdings fall. As we will return to, the most specific technical restriction for the UK is that its Exchange Equalisation Account is only licensed to purchase those assets that meet the Basel III High Quality Liquid Asset (HQLA) rules – which hybrid capital does not.

Countries with large external reserves and fewer restrictions on their use of reserves – such as China, Japan, Singapore, Saudi Arabia, the UAE, Qatar and perhaps Switzerland and Norway – should be able to go forward with the hybrid capital proposal. Unfortunately, several of these countries (China, Japan, and Norway) have been explicitly reluctant to do so, while the others have been slow to move. Whatever comes of these countries' ability to go forward with the hybrid capital proposal, it is clear that the technical, legal and political restrictions in traditional donor countries – the UK, US, Europe, etc. – demand an alternative rechannelling mechanism that works for them, too.

5. Rechannelling beyond the IMF: the SDR bond

In January 2023 Brad Setser and I put forward an additional SDR rechannelling proposal – for MDBs to issue an 'SDR bond'. This would be a senior bond denominated in SDRs and settled in currency. It could be of any maturity, though the expectation is that the bond would roll over in perpetuity. Its primary appeal is its viability. The senior bonds of AAA-rated MDBs are perfectly conventional reserve assets, and are routinely purchased as part of countries' reserve management operations. Roughly a third of World Bank bonds are currently held by central banks and official institutions. As an SDR bond would settle in an SDR currency (dollars, pounds, euros, yen, yuan), it could trade normally in a secondary market beyond IMF members, and it would functionally be no different than the senior MDB bonds that governments already own. By purchasing the SDR bond at issuance, rechannelling countries would also receive the SDR interest rate, providing a perfect offset for the cost of SDR utilisation – meaning that there would be no fiscal cost with buying an SDR bond.

In the US, the Exchange Stabilization Fund in which SDRs are held is authorised to purchase senior bonds freely. In the eurosystem, national central banks are also able to purchase the senior bonds of MDBs, no matter the denomination, as part of their reserve management. In the UK, the Exchange Equalisation Account is similarly authorised to purchase such securities freely and it can do so without the technical uncertainty that accompanies hybrid capital. In the case of the UK, which is also particularly attentive to the liquidity of its foreign-exchange reserves, an SDR bond would provide the added value of boosting the liquidity of the UK's SDR balance.

The trade-off of the SDR bond's convenience and viability is that it is less potent than hybrid capital. A senior bond naturally cannot be levered the way hybrid capital can. However, an SDR bond would provide 'additionality' to the MDBs that issue it by strengthening the MDBs' liability structure and putting them on a firmer footing to reduce their leverage ratios.

In effect, an SDR bond would provide inexpensive and perpetual financing from the most reliable creditor base: the MDBs' own shareholders. By tapping an entirely idle and captive pool of resources – the world's surplus SDRs – and being purchased by governments, the SDR bond would also provide MDBs with a form of debt financing that is not exposed to conventional market dynamics and that is superior to conventional market borrowing. As a result, the SDR bond would function as a permanent contribution to the MDBs' resources and would strengthen their liability structure.

Strengthening the liability structure of the MDBs is particularly important today given ongoing discussions about capital adequacy framework reform, which would entail reductions in MDBs' equity-to-loan ratio limits. Many stakeholders hope that the World Bank will go further than the 20% to 19% reduction that is currently being considered. However, certain credit rating agencies have expressed concerns about the safety of additional borrowing by the MDBs. An SDR bond could help address these concerns – and therefore help MDBs expand their lending capacity – by providing a superior form of additional borrowing. As credit rating agencies regularly provide preferential scoring for entities and instruments that may benefit from 'extraordinary government support' and other political attributes, they should also be able to identify the logic and advantages of an SDR bond.

6. Should the UK explore further SDR rechannelling?

The UK finds itself an interesting position with respect to the new rechannelling proposals.

On the one hand, the UK is particularly well placed to conduct further SDR rechannelling. It holds $40.7 billion in SDRs which it will not otherwise use, of which $1.33 billion is entirely surplus – that is, holdings above allocation. Moreover, the UK faces neither the legal constraints that are obstructing Europe's rechannelling nor the political constraints that are obstructing the US.

On the other hand, the UK has already satisfied its 20% rechannelling pledge.

In essence, the question comes down to whether the UK feels the need to provide a leadership role in the international financial architecture. The answer to that question is most likely to be'yes'. However, in an age of fiscal consolidation it appears that the UK will be unlikely to engage in any further taxation or borrowing to finance its international financial leadership.

In 2021, the UK notably cut its official development assistance (ODA) from 0.7% of Gross National Income (GNI) to 0.5%, which amounted to a 21% decline in aid spending. In 2022, the UK revised this downward once more, cutting the Foreign, Commonwealth & Development Office's aid budget from an initially announced £9.3 billion to £7.58 billion. In July, the UK announced that it would also be abandoning its pledge to provide £11.6 billion in climate finance to low- and middle-income countries.

In addition to slashing spending, questions have also emerged around the domestic reorientation of development spending. Due to refugee resettlement costs following the Taliban's takeover of Afghanistan in 2021 and Russia's invasion of Ukraine in 2022, the UK's domestic refugee spending has risen from 3.2% of total aid spending in 2016 to 9.1% in 2021 to 28.9% in 2022 – trebling twice over this period. This means that, in addition to cutting global development spending, nearly one-third of global development spending is spent not globally but domestically.

As a result, the UK should take stock of the resources and tools at its disposal – its $40.7 billion in SDRs and the relatively unrestricted workings of the $190 billion Exchange Equalisation Account in which those SDRs are held – and put them to work.

7. How the UK can lead: understanding the Exchange Equalisation Account

The UK's unique ability to lead the SDR agenda and pioneer the rechannelling of SDRs to MDBs is a function of the Exchange Equalisation Account.

The Exchange Equalisation Account is the foreign-exchange reserve fund of the Treasury. As of July 2023, it holds $190.07 billion in official reserves – a far larger sum than the Bank of England's $22.19 billion in reserves.

The Exchange Equalisation Account was established in April 1932, shortly after (and as a result of) the UK's departure from the gold standard in September 1931. This was a period of intense volatility in sterling's exchange rates, due in large part to intense currency speculation, and the purpose of the Exchange Equalisation Account was to conduct foreign-exchange intervention and "remov[e] undue fluctuations in the exchange value of £," as Chancellor of the Exchequer Neville Chamberlain declared at the time. The Exchange Equalisation Account was initially authorised to borrow £150 million to this end.

The role of the Exchange Equalisation Account in maintaining an active exchange-rate policy was understandable throughout the Bretton Woods era. The end of Bretton Woods, however, created uncertainty for advanced economies' reserve funds given the paradigm shift to floating currencies and the magnification of foreign-exchange rate markets in which speculators could bet against and put pressure on countries' exchange rate policies. For the UK, this came to a head in the early 1990s.

In October 1990, the UK joined the Exchange Rate Mechanism at an agreed rate of £1 to DM 2.95, with the capacity to move 6% in either direction. The £/DM exchange rate came under intense pressure from currency speculators in August and September 1992, obliging the UK to intervene to keep sterling within its agreed trading band. During those two months, the UK sold $40 billion in reserves – $28 billion on 16 September 1992 alone, 'Black Wednesday'. The foreign-exchange intervention failed and the UK exited the Exchange Rate Mechanism.

Since 1992, the UK has embraced a free-floating exchange rate policy, a norm among advanced economies. This policy naturally raises an under-asked question: what is the function of the government's $190 billion in foreign-exchange reserves?

8. Reserve funds in the era of free-floating currencies: the EEA and the ESF

Technically, the government is still licensed to intervene in foreign-exchange markets if need be. As a result, the government's reserves are held on a 'precautionary basis'.

However, an honest appraisal of the UK's exchange rate management policy would indicate that there will be no recourse to foreign-exchange intervention under any circumstances any time soon. Although the Exchange Equalisation Account's $190 billion is a substantial sum, it is much too small to stabilise currency markets if the need were to arise. Turnover in the GBP/USD market from 2013–2022 averaged $409 billion *per day*. The periods of elevated stress during which the Exchange Equalisation Account would theoretically be most likely to intervene would also presumably entail much greater levels of currency speculation, meaning that the Exchange Equalisation Account would be even less capable of intervening successfully. The fact that total Treasury and Bank of England reserves collectively amount to just $210 billion, hardly more than half the GBP/USD turnover, would also not be lost on currency speculators in the event that the government endeavoured to intervene.

Moreover, recent episodes of market stress indicate that the UK's central policy concern is not exchange rates – it is interest rates and bond prices. During the 2022 'Gilt Crisis', when the pound fell to an all-time low of $1.03, the Bank of England suspended its quantitative tightening programme and stepped in with £5 billion a day in long-dated bond purchases – totalling £65 billion in market support over 13 days. Sterling returned to a more normal trading range in due course.

Having not conducted foreign-exchange intervention since 1992 and having foregone the opportunity to do so again during the crisis of 2022, the question still stands: *what is the function of the government's $190 billion in foreign-exchange reserves?*

A small and purely practical purpose of the Exchange Equalisation Account is to provide 'foreign currency services' to different government departments and agencies – e.g., provide dollars to FCDO if it needs to make a payment somewhere in the world in dollars. However, it is clear that this is not a meaningful use of the Exchange Equalisation Account. Instead, understanding its purpose can be determined as a statutory matter – the Exchange Equalisation Account Act of 1979 spells out four core functions:

1. 'Checking undue fluctuations in the exchange value of sterling;
2. **Securing the conservation or disposition in the national interest of the means of making payments abroad;**
3. The purpose specified in section 1(3) of the International Monetary Fund Act 1979 (payment of charges under section 8 of Article V of the Articles of Agreement of the International Monetary Fund); and
4. Carrying out any of the functions of the Government of the United Kingdom under those of the said Articles of Agreement which relate to special drawing rights.'

With its first purpose eliminated, it is clear that the Exchange Equalisation Account's primary role today – and going forward –

should revolve around issues pertaining to the 'national interest', payments to the IMF, and buying and selling SDRs.

The Exchange Equalisation Account is used to do the latter two, but its role in 'securing the conservation or disposition in the national interest of the means of making payments abroad' remains unclear – and, seemingly, undefined. The best definition the Treasury has offered recently is 'making investments to further broader economic policy aims'.

A comparison to the US Treasury's Exchange Stabilization Fund is helpful. As with the Exchange Equalisation Account, the Exchange Stabilization Fund was set up with the purpose of managing a dollar policy. However, as with the UK, when the US moved away from an active exchange rate management policy the function of the Exchange Stabilization Fund became unclear.

In the 1980s and 1990s, an ambitious role for the Exchange Stabilization Fund emerged. Amidst the emerging market crises of those decades, the US used the Exchange Stabilization Fund to support partners and extend credit around the world. This included 37 bridge loans to debtor countries, mostly in Latin America. Financing was provided to Eastern European countries during their transitions as well, most notably Poland. The use of the Exchange Stabilization Fund to respond to Mexico's peso crisis in 1995, providing $20 billion in loans and credits, is perhaps most notable. In 2008, the use of the Exchange Stabilization Fund extended to stabilising US money-market-mutual funds, using $50 billion of the Exchange Stabilization Fund's assets to guarantee payments of MMF liabilities.

Such operations are likely within the scope of the Exchange Equalisation Account's existing authority – as defined under the Exchange Equalisation Account Act of 1979 (1.3.B) – but they are of course complex. AAnd if they are too complex, it is understood that they may create friction between the Treasury and the Bank of England, the Exchange Equalisation Account's day-to-day manager.

9. What can the Exchange Equalisation Account actually do?

This challenge of technical complexity applies to the Exchange Equalisation Account's ability to go forward with the AfDB's hybrid capital proposal. The UK has considered the AfDB's proposal and concluded that it would not be technically viable. The most material reason for this is that the Exchange Equalisation Account's 'universe of eligible securities is those eligible under the Basel III Liquidity Coverage Ratio (LCR).' This is a self-imposed rule that is not found in the Exchange Equalisation Account Act, but its use creates a temporarily insurmountable problem as the Basel III list of eligible securities does not include hybrid capital.

Other definitions of reserve assets, such as those used by the EU, would also not include anything with 'loss absorption capacity' – which is, by definition, hybrid capital and subordinated debt. A proper evaluation of the AfDB's 'liquidity support agreement' should mitigate loss absorption concerns, but it appears that reserve managers' assessment criteria are limited to the financial instrument itself. The supporting encashment regime, in practice, does not appear to be taken into consideration. The non-eligibility of the hybrid capital and subordinated debt also poses a coordination problem for the management of the Exchange Equalisation Account, as the Bank of England is more sensitive to issues of 'reserve asset status'.

Beyond the question of eligibility, a technical difficulty with the AfDB proposal is the pricing of subordinated debt. As subordinated debt does not already exist for other MDBs, the Treasury and the Bank of England have no clear benchmark or guidance on how to proceed. This difficulty may be solved in due course as other MDBs, such as the World Bank, develop their own hybrid capital proposals and a market for MDB subordinated debt develops. However, the issue of reserve asset status will inevitably obstruct the emergence of any hybrid capital proposal, be it in SDRs or any other currency, given that most of the largest MDB shareholders (large Western countries) are legally not able to purchase hybrid capital.

In the longer term, the UK should embrace a more ambitious way to make use of its idle $190 billion – including by expanding or removing the self-imposed constraints of Basel III eligibility rules. In the near term, however, the UK should consider an immediately actionable proposal: purchasing SDR bonds and other development-oriented senior bonds that can serve the dual purpose of being reserve assets while also 'furthering [the UK's] broader economic policy aims'.

10. The technical viability of the SDR bond within the Exchange Equalisation Account

As a senior bond issued by a AAA-rated entity that settles in currency, there is no material difference between the SDR bond and any conventional reserve asset. An SDR lies squarely within the scope of both the Exchange Equalisation Account Act of 1979 and the Basel III Liquidity Coverage Ratio criteria.

It should also be noted that the Exchange Equalisation Account is explicitly licensed to purchase securities of any denomination issued by supranational entities such as multilateral development banks. The Treasury provides the following guidance:

An SDR bond that can trade like an MDB bond of any other denomination would also not introduce technical complexities around pricing and risk assessment that may prove problematic for the Treasury or the Bank of England.

This demonstrates the technical viability of the SDR bond for the Exchange Equalisation Account. It should also be noted that the SDR bond can introduce *technical* advantages for the Exchange Equalisation Account.

11. The technical advantages of the SDR bond for the Exchange Equalisation Account: policy-ready reserves and the liquidity of the Voluntary Trading Arrangements

One issue for the UK and all other SDR holders is the thinness of the SDR market, the Voluntary Trading Arrangements (VTAs). It is reported that only 40 prescribed holders of SDRs participate in the VTAs and many SDR holders have expressed concerns with the liquidity of their SDR balance. In other words, if the UK wanted to convert its SDRs into currency, it would struggle to do so. A particular reason for this is that SDR holders with large external reserves under-participate in the VTAs. Moreover, if the UK rechannels some portion of its SDRs, it will paradoxically be moved up the queue to be the counterparty in VTA transactions – meaning that SDR rechannelling creates a drag on the Exchange Equalisation Account's 'policy-ready' foreign-exchange reserves.

To be sure, there is technically and legally no reason why there should be a problem within the SDR market. The world's $881 billion in SDRs is backed by $12 trillion in global reserves – there is more than enough currency to provide in exchange for SDRs. Moreover, the IMF has a 'designation mechanism' which allows it to compel SDR holders to be the counterparty in any SDR transaction. The queuing system of the SDR market is also not found in the Articles of Agreement and thus likely can be changed as an internal policy matter without going to the Board and creating a fight among IMF members.

The VTAs should be reformed such that countries with large external reserves participate in the bulk of SDR transactions, such that liquidity issues do not obstruct SDR rechannelling, and such that the UK can credibly categorise its SDRs as 'policy-ready reserves'. Short of VTA reform, however, the UK should also see the SDR bond as a mechanism for promoting the liquidity of its SDR balance.

In practice, an SDR bond that is settled in currency will actively be converting the Exchange Equalisation Account's illiquid SDRs into liquid SDRs. Because an SDR bond would settle in currency, it can trade in the secondary market beyond just the prescribed holders of SDRs – if it so chooses, the UK could sell its SDR bonds into the market for the currency in which the SDR bond is settled.

Given that an SDR bond would be purchased at issuance and thus pay the SDR interest rate, it is important to note again that the SDR bond would carry no fiscal cost for the UK. From the vantage of a reserve manager, all that an SDR bond would do is make the reserve fund's SDR balance more liquid.

Promoting the liquidity of the Exchange Equalisation Account's SDR balance should be a priority for the Treasury and the Bank of England. At present, they do not actively count SDRs as 'policy-ready reserves' – meaning that we must fully subtract the UK's $40 billion in SDRs from the Exchange Equalisation Account's $190 billion in foreign-exchange reserves. This means that shifting the UK's SDRs into SDR bonds would effectively re-add the UK's SDRs to its policy-ready reserves and therefore grow its reserves by a full 21.0%. Opportunities to boost reserves to such a degree are not normal and should be taken seriously.

12. Conclusion: financing 'Global Britain'

The UK has considerable global economic interests and objectives. Yet in an age of fiscal consolidation, successive governments have cut the budgets to pursue those interests and objectives. Moreover, with interest rates rising, it has become increasingly difficult to mobilise private capital and leave the private sector to carry out the public sector's work. As a result, there is an evident lack of both official and commercial finance. The idea and project of 'Global Britain' – or whatever we might call the UK's global economic interests and objectives – is thus sorely in need of financing.

This paper has highlighted the potential role of the UK's $40 billion in SDRs and its $190 billion Exchange Equalisation Account. In the current conversation on SDR rechannelling, the UK's surplus SDRs and unencumbered Exchange Equalisation Account allow it to play a serious international financial leadership role that the US and Europe are struggling to fill as a result of political and legal difficulties related to their use of SDRs. In essence, the UK has the resources and the tools to open a new frontier in the international financial architecture and pioneer the rechannelling of SDRs to multilateral development banks.

Certain technical challenges obstruct the UK's ability to participate in the AfDB's hybrid capital proposal. However, this paper has demonstrated both the immediate technical viability of an SDR bond for the Exchange Equalisation Account, as well as the material technical advantages which an SDR bond would provide to the Exchange Equalisation Account.

Given that foreign-exchange markets have grown beyond the UK's capacity and interest to intervene in them, this paper has also endeavoured to start a conversation about making productive use of the the Exchange Equalisation Account's $190 billion. A brief history of the United States' use of the Exchange Stabilization Fund in the 1980s and 1990s was provided as an example of what the UK could be doing.

It is important to note that this could touch policy priorities unrelated to SDRs. For example, the Exchange Equalisation Account could be used to resuscitate the UK's recently abandoned £11.6 billion climate finance pledge. Although the purchase of securities is not the highest-value way to fulfil this pledge, committing £11.6 billion or more from the Exchange Equalisation Account to purchase Basel III-eligible green and blue bonds of low- and middle-income countries or supranational organisations is both entirely viable and indisputably superior to abandoning the pledge. Such a policy commitment could help to create a market for those instruments and bring forward the issuance of more green bonds while also bringing down borrowing costs for the issuers – which are closely connected to the UK's international climate finance objectives. In effect, the UK would be swapping one investment grade, interest bearing, dollar denominated reserve asset (e.g. a US Treasury bond) for another (a country's or institution's green bond).

Whatever shape the new role of the Exchange Equalisation Account may take, the conversation about creative ways to finance the UK's global economic interests and objectives ought to begin now.