Finance for Development Lab

How the UK Can Plug the ODA Hole:

A Modest Proposal for Financial Engineering

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Executive Summary

The decision to reduce ODA spending to 0.3% of GNI has created a £6.2 billion hole in the UK's foreign economic policy. The cuts will lead to development and humanitarian setbacks in low-income countries and threaten political and geopolitical spillovers for the UK and its partners. They will also put significant pressure on the World Bank's balance sheet: World Bank financing commitments will have to rise to fill funding gaps at the same time that the ODA cuts are projected to reduce equity contributions to the World Bank.

The UK can partially mitigate the consequences of its ODA cuts through responsible financial engineering — putting idle foreign reserves into action in ways that are legally and financially sound. This policy note proposes two ways to mobilise a small portion of the UK's largely idle £149.2 billion reserve fund, the Exchange Equalisation Account (EEA), to continue supporting low-income countries. The proposals are to use the EEA to fund Concessional Partner Loans to IDA and to make Bond Purchase Commitments for IDA.

Both proposals are fiscally neutral as they require the issuance of no new debt, the raising of no new taxes, and as their funding through the EEA has no bearing on the UK's fiscal accounts (the CF and NLF). The note proceeds with (1) an overview of the ODA cuts and their effect on IDA, (2) a history and operational review of the EEA, (3) the proposal for Concessional Partner Loans, (4) the proposal for Bond Purchase Commitments, and (5) an annex on the fiscal neutrality of the proposals.

The Proposals:

- Concessional Partner Loans (CPLs) to IDA. A CPL is a low-interest, long-term loan to IDA, generally 0-1.5% for 25 to 40 years. IDA needs CPLs because it runs a significant asset-liability mismatch: borrowing at market rates (currently around 4%) and tenors (7 years), but lending to low-income countries at 0-1.5% for up to 50 years. The UK has provided CPLs in the past to IDA to offset this, but the UK's CPL volumes have fallen in recent years. The decline in CPLs alongside the forthcoming decline in equity contributions will significantly compound pressure on IDA's balance sheet. To mitigate this, the UK should fund CPLs out of the EEA — which would allow for much larger loan volumes. This policy would be entirely consistent with existing EEA operations: the UK already provides zero-rate loans out of the EEA for the IMF's PRGT.

- Purchase Commitments for IDA Bonds. The primary function of the EEA is to buy and hold senior debt securities (bonds) issued by highly rated entities — with specific authorisation to purchase multilateral development bank bonds. As IDA's market borrowing programme has failed to deliver affordable funding over the past two years, the UK should make a purchase commitment for a special series of IDA bonds. These would be denominated in SDRs, a highly favourable funding currency for IDA's asset-liability mismatch as it would reduce IDA's borrowing costs and extend its tenors beyond what markets can provide.

1. Overview: ODA Cuts, the IDA hit, and Why "Balance Sheet Optimisation Measures" Must Come Home

On 28 February 2025, Prime Minister Keir Starmer announced that the UK would cut its spending on Official Development Assistance (ODA) from 0.5% of gross national income (GNI) to 0.3% of GNI starting in 2027. This is projected to be a £6.2 billion ($7.95 billion) reduction in the UK's ODA spending — from £15.4 billion to £9.2 billion. Given that the UK already spends 0.2% of GNI on ODA within the UK, mostly on refugee resettlement, the cuts leave the UK's overseas ODA budget at just 0.1% of GNI.[1] This can be seen in no way other than an abandonment of the UK's international commitments.

A £6.2 billion ODA cut by the world's fourth largest donor will create significant funding gaps in low-income countries. These funding gaps will necessitate an unsustainable (i.e. unfunded) rise in financing commitments from the International Development Association (IDA), the World Bank's low-income country lending arm. The pressure placed on IDA to fill gaps will be complicated further by the fact that an ODA cut of this magnitude is expected not only to reduce the UK's bilateral commitments, but also to reduce its multilateral commitments — specifically to the IDA21 Replenishment.

> IDA21 was seen as a historic achievement as it announced a $100 billion fundraising haul. The potential backtracking of the UK and US risks blowing a 28% hole in the equity share of the replenishment

IDA21 was seen as a historic achievement as it announced a $100 billion fundraising haul. However, most shareholder contributions were pledged without any of the funding actually being secured. This was the case for the UK's £1.98 billion ($2.56 billion) pledge — as well as the US' $4 billion pledge, for which similar concerns exist about backtracking.[2] As shareholders' equity contributions constituted only $23.5 billion of the $100 billion total for IDA21, the potential backtracking of the UK and US risks blowing a 28% hole in the equity share of the replenishment. An equity shortfall will create significant pressures on IDA's balance sheet, undermining its long-run finances, and pulling forward what is known as the "IDA Cliff" — a projected 40% decline in IDA's financing commitments that will start in 2030. The consequences for the developing world of the unraveling of the IDA21 Replenishment and the undermining of IDA's balance sheet will be immense.

As international politics become less conducive to international development, fiscally sound financial engineering — finding clever but sustainable ways to plug gaps left by donors — will become increasingly important.

The World Bank and IMF have gotten an early start on this through analysing and implementing a range of "balance sheet optimisation measures." For the World Bank, adjustments to IBRD's equity-to-loans ratio and the use of portfolio guarantees have allowed it to increase its lending capacity without any new capital contributions from shareholders.[3]

[1] Ian Mitchell and Sam Hughes. "Breaking Down Prime Minister Starmer's Aid Cut." Center for Global Development. 26 February 2025.
[2] World Bank. The United Kingdom Announces Early and Increased Pledge to IDA21." 29 November 2024.
[3] "Boosting MDBs' investing capacity." (2022). An Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks.

For its part, the IMF has engaged in smart and sustainable forms of financial engineering in an effort to scale up the Poverty Reduction and Growth Trust (PRGT). The PRGT is the IMF lending facility that serves low-income countries. It requires subsidy contributions (grants) from donor countries, but as donor countries have been slow to provide grant funding, the IMF undertook a "GRA Distribution" — taking $8 billion in excess income in the IMF's General Resources Account and rechannelling it to the PRGT's subsidy account.[4] This will allow the PRGT to lend $3.6 billion to low-income countries annually, double its pre-Covid average.

Now it is clear that the financial engineering work of doing development with less grant funding — which the UK has strongly supported at the multilaterals — must come home. For the UK, a ready-made tool exists in the form of the Exchange Equalisation Account (EEA), a £149.2 billion fund at HM Treasury which has been largely idle for the past 32 years, the utilisation of which would be fiscally neutral, and which has standing authorisation to conduct a broad range of foreign transactions in the UK's national interest.[5]

2. Why Use the EEA? Background, Legal Authorisation, and the Capacity To Do More

The Exchange Equalisation Account (EEA) was established in 1932, shortly after and as a result of the UK's departure from the gold standard. The EEA was to be a fund of foreign exchange reserves with which the UK Treasury could check "undue fluctuations" in the pound sterling. It became an important part of the infrastructure for the post-war international monetary system, being tasked with maintaining the UK's fixed-but-adjustable peg as part of Bretton Woods. Yet the imbalances in the international monetary system were vast, the EEA struggled to maintain that peg (with devaluations coming in 1949 and again in 1967), and the Bretton Woods system ultimately collapsed in 1971 with the breaking of the dollar-gold peg. After the end of Bretton Woods, there were repeated efforts to recreate a system of exchange rates — the Smithsonian Agreement (1971), the Plaza Accord (1985), the Louvre Accord (1987). The most important agreement for the history of the EEA was its last: the European Exchange Rate Mechanism (ERM), which the UK joined in 1990 at an agreed rate of £1 to DM 2.95, with the capacity to move 6% in either direction. Within two years, the £/DM exchange rate had come under intense pressure, and from August to September 1992, the UK sold $40 billion in reserves to stabilise its peg. It shed $28 billion on 16 September 1992 alone, "Black Wednesday." The intervention failed, the UK exited the ERM, and a norm of a freely floating currency was embraced — with unclear implications for the future use of the EEA.

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Across the pond, the collapse of exchange-rate systems had prompted a reckoning with what to do with the US Treasury's official reserves — the Exchange Stabilization Fund, whose creation in 1935 had been inspired by the EEA's creation two years prior. The ESF would go on to have an important history in the 1980s and 1990s of stabilising partners through bilateral loans and credit facilities as well as by stabilising

[4] IMF. "The IMF Approves Policy Reforms and Funding Package to Support Low Income Countries in a Sustainable Manner." 21 October 2024.

[5] Stephen Paduano. "FOREIGN RESERVES & GLOBAL OBJECTIVES." Finance for Development Lab. 12 October 2023. https://findevlab.org/foreign-reserves-global-objectives/

domestic financial markets through targeted purchases. A comparable modern reimagining of the utility of the EEA never occurred.

The adoption of a free float is the strongest indication that EEA is no longer needed to serve its primary purpose of intervening in FX markets. This is also true as a practical financial matter. As of 2022, the average daily turnover in the sterling-dollar market has grown to $714 billion, nearly four times greater than the EEA's total holdings.[6] If the EEA failed to intervene successfully 32 years ago on Black Wednesday, the growth in FX markets guarantees it cannot and will not be used successfully in a currency crisis today.

The inoperability of the EEA for FX intervention was underscored in October 2022. Amidst the sell-off in the pound sterling and gilts, HMT did not attempt to intervene in FX markets. Instead the Bank of England temporarily reversed its monetary policy stance to conduct a gilt purchase operation. The experience of October 2022 provided a very clear, contemporary test-case for the EEA: its primary purpose of FX intervention conducting FX intervention has lapsed.

As a result, HMT should look to use the EEA in line with the secondary purpose listed in the Exchange Equalisation Act of 1979. HMT defines this as "making investments to further broader economic policy aims."[7]

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Through this secondary mandate, the Exchange Equalisation Account Act of 1979 gives HMT very broad authorisation to use the EEA. HMT makes use of this authorisation when it lends to the IMF. To contribute to the IMF's Poverty Reduction & Growth Trust (PRGT), HMT provides interest-free loans from the EEA to the IMF — $2.004 billion as part of the PRGT's last fundraising round in 2021.[8] HMT has also explicitly declared that the EEA is authorised to purchase bonds issued by MDBs, such as the World Bank.[9]

Although it is legally possible for the EEA to be used similarly to the use of the US' ESF in the 1980s and 1990s — to support partners bilaterally (i.e. provide direct loans and credit facilities to partner countries) rather than channelling financing multilaterally (i.e. to the IMF or World Bank) — there are several reasons why multilateral action is better at this stage. First, while the EEA has standing authorisation to provide zero-rate loans to supranational organisations, it cannot as easily provide such loans to sovereigns with high counterparty risk.

Second, the EEA has standing authorisation to purchase the bonds of supranational organisations—as these are senior bonds issued by AAA-rated entities, which are conventional reserve assets and thus a normal policy operation for the EEA—yet it would be highly unusual for a reserve fund to purchase sub-investment-grade bonds with high non-negligible default risk.

In effect, channelling financing through IDA allows the EEA to support low-income countries while maintaining the features of a conventional reserve fund.

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[6] BIS. "Triennial Central Bank Survey: OTC foreign exchange turnover in April 2022." 27 October 2022.
[7] Exchange Equalisation Account Act of 1979; Exchange Equalisation Account: Report and Accounts, 2022-2023.
[8] IMF. "PRGT Pledges under the 2021 Fundraising Round." 15 October 2024. https://www.imf.org/en/Topics/PRGT
[9] HMT. Exchange Equalisation Account: Report and Accounts, 2022-2023. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1168461/EEA_Annual_Report_and_Accounts_2022-23.pdf

3. Proposal to Scale Up "Concessional Partner Loans" to IDA

The International Development Association (IDA) is the World Bank's low-income country lending arm and the world's pre-eminent multilateral development bank for low-income countries. It funds itself through regular "IDA replenishments" — large package deals that combine equity contributions (grants) from shareholders, debt financing (mostly bond issuances), and a cobbling together of internal funding sources (loan repayments to IDA and income transfers from the IBRD). The last IDA replenishment, IDA21, was agreed in December 2024 with a $100 billion headline figure.

However, shareholder funding for IDA21 was not secured in many countries. It is unclear how much of the UK's £1.98 billion pledge will be delivered given that this comes out of the now-reduced ODA budget. Such cuts will likely continue a long-run trend that has been very damaging for IDA's balance sheet: as shareholders have reduced their equity contributions as a portion of IDA replenishments over successive replenishments, **a greater share of IDA's funding has come from debt financing at the same time that IDA's debt has become more expensive.**

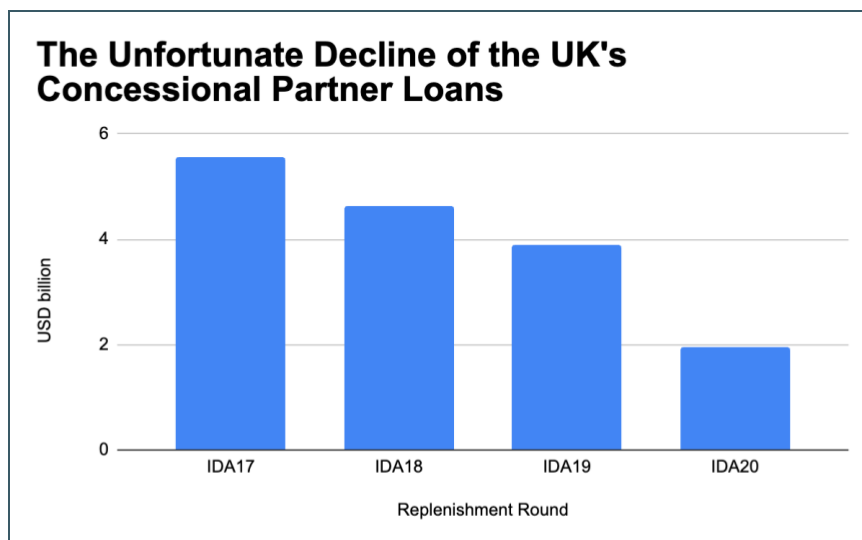
The core balance sheet problem that the UK can focus on solving is IDA's structural asset-liability mismatch. IDA lends at 0-1.5% for up to 50 years, but it borrows at market rates and market durations — generally around 4% for 7 years.

The core balance sheet problem that the UK can focus on solving is IDA's structural asset-liability mismatch. IDA lends at 0-1.5% for up to 50 years, but it borrows at market rates and market durations — generally around 4% for 7 years. IDA's modern financial model was established for a low-for-long interest rate environment, and IDA's market borrowing programme has struggled greatly since the global monetary tightening that followed COVID-19 and Russia's invasion of Ukraine. Higher interest rates exacerbate IDA's asset-liability mismatch and eat more quickly into its capital, complicating IDA's long-run finances and its ability to serve low-income borrowers. IDA's duration mismatch creates a related problem. To manage the refinancing risk that arises from borrowing short and lending long, IDA must retain (rather than lend) a larger portion of its capital. This similarly undercuts IDA's low-income borrowers.

Even if ODA cuts reduce the UK's equity contribution to IDA, the UK can provide meaningful support to the world's low-income countries by scaling up "Concessional Partner Loans" (CPLs) to IDA. A CPL takes the form of a 0-1.5%, long-term loan to IDA, generally 25 or 40 years.

CPLs greatly reduce the interest rate and duration mismatches that arise from IDA's market borrowing programme, but not enough of IDA's liabilities come from CPLs. IDA currently has only $7 billion in CPLs relative to total borrowings of $44.9 billion.[10] The UK was once a generous provider of CPLs, but its CPLs have gradually fallen:

[10] International Development Association. IDA Financial Statement 2024. 30 June 2024. https://thedocs.worldbank.org/en/doc/306d5e3f952ffc4cefb5dcdcceb0bb31-0040012024/original/IDA-Financial-Statements-June-2024.pdf



The only fiscal reason why the UK would see the need to reduce its provision of its CPLs is because it has been funding its CPLs out of its fiscal policy accounts (the CF and NLF) rather than directly out of the EEA. This is an unnecessary policy operation that creates a fiscal impact for the UK where it is not needed — subjecting the UK's IDA funding to fiscal constraints that are not technically necessary (see Section 5). **It is clear that the UK can fund zero-rate foreign currency loans out of the EEA because it already does this for the IMF's PRGT.** The UK provides zero-rate loans to the PRGT because the PRGT has an asset-liability mismatch similar to that of IDA. The PRGT funds itself by borrowing from donors at the SDR interest rate (currently 3.14%), but it lends to low-income countries with zero-interest or highly concessional loans.[11] As a result of this interest rate mismatch, the PRGT requires subsidy contributions (grants) from its donors. Instead of providing grants, the UK simply waives the SDR interest income it would receive on its loans, thereby relieving the interest rate mismatch.

We propose expanding the scope of the EEA's zero-rate, long-term SDR lending from the IMF to the World Bank (IDA). A very small portion of the £149.2 billion in the EEA can easily amplify the CPL share of IDA's debt stock. **Returning the UK's CPL provision to the IDA17 level of $5.57 billion would require a small reallocation of just 3% of the EEA's holdings.** The shared benefits of this would be immense. Without any fiscal impact on the UK, this operation could double the UK's entire 3-year equity commitment to IDA21, and the grant element on the CPL would pull up the UK's equity share at IDA. For IDA, this would relieve the duration and interest rate mismatch pre ssures associated with its debt financing, thereby increasing its lending to low-income countries. An initiative such as this would also set a much-needed example for other countries to follow: as rates remain elevated and ODA cuts bite, IDA's shareholders should be called upon to provide more CPLs rather than having IDA turn to international capital markets and pull forward the IDA cliff.

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[11] IMF. SDR Interest Rate. 13 March 2025. https://www.imf.org/external/np/fin/data/sdr_ir.aspx

HMT may be inclined to say it can provide zero-rate loans to the IMF but not to the World Bank on the basis that the IMF is a "monetary-oriented" institution that is better placed to receive financing from a reserve fund. **However, this would not be grounded in any law.** There is no distinction between the IMF and World Bank in the Exchange Equalisation Account Act, and HMT has not to date provided a formal distinction between different types of supranational organisation as counterparties of EEA financing. The potential impulse for HMT to over-constrain the EEA would be worrying. Even beyond the lack of legal basis, it would demonstrate a disinclination to rise to the challenges of meeting policy commitments in the new fiscal environment, and it would unnecessarily tie the hands of a critical tool with a justifiably broad mandate.

The grant element of the EEA-funded CPL would be important in two regards. First, the grant element would be scored as ODA — thereby creating the possibility of returning the UK's ODA spending back to 0.5%. It should be stressed, of course, that CPLs should come *in excess* of the UK's 0.3% ODA commitment in an effort to return it to 0.5% or 0.7%. It should not be used to fill the 0.3% ODA spending.

Second, per IDA's rules, "the grant element of the CPLs (which reflect the concessionality of the CPL coupon relative to the discount rate) will be **recognised for voting rights** and burden sharing purposes."[12] In effect, the UK would be able to re-establish and indeed expand its leadership role on IDA's Executive Board — making itself a key shareholder of the largest creditor to the developing world — without any fiscal impact on the UK.

4. Proposal for IDA Bond Purchase Commitments

The most standard operation for a reserve fund is the purchase of senior debt securities — i.e., bonds — issued by highly rated entities. HMT provides clear guidance on what the EEA can hold:[13]

> 14. Currently, debt issued by the following types of entity will be considered for eligibility, subject to credit, liquidity and non-financial risk assessment:
>
> - central governments or central banks;
> - regional governments;
> - supranational agencies (multilateral development banks and international organisations); and
> - national public agencies (either guaranteed or otherwise).

This list of eligible securities notably includes bonds issued by multilateral development banks, which of course, encompasses the World Bank. This makes sense given that the World Bank is a AAA-rated entity, and thus, its bonds are a conventional reserve asset. From public filings, it would appear that roughly half of IBRD and IDA bonds are held by official monetary institutions as reserve assets.

[12] IDA. "Implementation of the Concessional Partner Loan Framework." 12 December 2019. https://thedocs.worldbank.org/en/doc/e5b99e86b18614ae4b0fac333003006f-0410012021/original/ida19-cpl-framework.pdf

[13] HMT. Exchange Equalisation Account: Report and Accounts, 2022-2023. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1168461/EEA_Annual_Report_and_Accounts_2022-23.pdf

The EEA's explicit authorisation to purchase bonds issued by IDA is important in the context of how ODA cuts will put more pressure on IDA's market borrowing programme. As we have noted, equity contributions have been falling as a share of overall IDA replenishments and debt financing has been rising. This debt financing is conducted predominantly through market borrowing: $37.9 billion of IDA's $44.9 billion of liabilities has been raised through bond issuances. However, as we have also noted, IDA's bond issuance programme was established in the context of low-for-long interest rates. It cannot sustain having to increase its market borrowing at the same time that its debt has become more expensive given that it cannot pass on higher interest rates to its borrowers — its lending rates remain at 0% or 1.5% even if its borrowing costs rise, meaning IDA absorbs the losses.

Using idle SDRs to purchase SDR-denominated, cash-settled bonds would make the EEA's holdings more liquid as the bonds could be sold into the market like any other cash-settled IDA bond. In other words, reallocating into MDB bonds would make the EEA better able to fulfil its ostensible purpose of rapidly intervening in FX markets if necessary.

IDA needs to shore up its market borrowing programme, and the EEA has standing authorisation to do so. The UK should use the EEA to make a purchase commitment of a special series of bonds. The most natural funding currency for such bonds would be Special Drawing Rights (SDRs), as I have proposed with Brad Setser.[14]

The EEA holds $40.03 billion in otherwise idle SDRs, accounting for 24% of total assets. These SDRs serve no purpose at present for the UK. This is evidenced clearly by the fact that the UK does not use them: the UK has slowly accumulated a surplus of $900 million in SDRs (its holdings above its allocation) because it cannot and will not spend them down.

The idleness of the UK's SDRs is partially a function of the fact that the market for SDRs (the "Voluntary Trading Arrangements" or VTAs) is highly dysfunctional and would not allow the UK to liquidate its SDR holdings if it needed to. It is a serious problem for the EEA that 24% of its assets are technically illiquid, and HMT has recognised this by determining that its SDR holdings are not counted as "policy-ready reserves."

As a starting point, the UK could use the surplus $900 million in SDRs in the EEA to purchase a special series of SDR bonds issued by IDA.

As a result, using idle SDRs to purchase SDR-denominated, cash-settled bonds would perform a basic service to the EEA: it would make the EEA's holdings more liquid as the bonds could be sold into the market like any other cash-settled IDA bond. In other words, reallocating into MDB bonds would make the EEA better able to fulfil its ostensible purpose of rapidly intervening in FX markets if necessary.

In addition, holding an SDR bond is balance sheet neutral for the EEA as it would pay the SDR interest rate just as the EEA's SDR holdings pay the SDR interest rate. Using SDRs to buy SDR bonds would result in no change in the EEA's SDR net income.

For IDA, a long-dated SDR bond would allow it to greatly stretch out its weighted average tenor beyond the 7 years that markets tend to provide it. This provides an immediate benefit for IDA's borrowers: if IDA

[14] Brad Setser and Stephen Paduano. "The Magic on an SDR-denominated bond." Financial Times. 26 January 2023. https://www.ft.com/content/60a9e577-0bd3-4898-ac18-6ea9ff3573dd; Brad Setser and Stephen Paduano. "An SDR-Linked Bond Can Strengthen the Finances of the World Bank Group." Council on Foreign Relations. 22 January 2024. https://www.cfr.org/blog/sdr-linked-bond-can-strengthen-finances-world-bank-group

can reduce its duration mismatch, then it will not have to retain as much capital for its refinancing risk — meaning it will be able to increase its lending to low-income countries right away.

An SDR bond would similarly reduce the interest rate mismatch on IDA's market borrowing. An SDR bond would be issued and purchased at the SDR interest rate — the risk-free rate for SDRs — meaning it would carry a spread of zero. This is important given that IDA's weighted average spreads widened from roughly 30 basis points when the market borrowing programme was launched to up to 70 basis points following Russia's invasion of Ukraine. For longer-dated bonds, IDA's spreads have blown out to 90 basis points. This eats more deeply into IDA's equity at the same time that the UK and others are providing less equity.

Issuing a large volume of long-dated, SDR-denominated bonds with a spread of zero would thus provide real relief to IDA's balance sheet — freeing up more capital to lend and reducing the pressure on IDA's diminished grant resources. However, SDRs are only held by IMF members and other prescribed holders, which means the World Bank cannot practically issue an SDR bond unless a major shareholder commits to purchasing it.

As a result, the UK should use the EEA to make a purchase commitment for a special series of SDR-denominated bonds issued by IDA. As a starting point, the UK could use the surplus of $900 million in SDRs in the EEA to purchase a special series of SDR bonds issued by IDA.

5. How Using the EEA Is Fiscally Neutral — A Note on the Mechanics of UK Fiscal Policy

The use of the EEA for extending loans and buying bonds is, in a fundamental sense, fiscally neutral. The EEA is already funded, which means drawing on it to lend to IDA or buy IDA's bonds requires raising no new taxes or issuing any new debt. The fiscal neutrality of what we propose is perhaps clearest in the sense that the policies we propose do not interact with the UK's fiscal policy accounts.[15]

The fiscal policy of the United Kingdom flows through two accounts: the "Consolidated Fund" (CF), which was established in 1787, and the "National Loans Fund" (NLF), which was established in 1968. The CF accounts for revenue and expenditures; the NLF accounts for lending and borrowing. When there is a deficit in the CF — i.e., revenues do not cover expenditures — the NLF makes up for the difference through public borrowing. If there is a surplus in the CF — i.e., revenues are greater than expenditures — the surplus is remitted to the NLF.

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The EEA interacts with these accounts in a limited manner. The NLF can advance sterling to the EEA, and net sterling income is remitted back to the NLF. However, only the EEA's sterling cash flows may be scored as a liability to the NLF — and thus, only when the EEA deals in sterling does it have a bearing on the UK's fiscal policy. The EEA's gold, foreign currency, and SDRs are all ring-fenced to the EEA. The NLF would not provide a sterling advance to the EEA to use them for the policies

[15] HM Treasury. "National Loans Fund Account 2023-24." October 2024. https://assets.publishing.service.gov.uk/media/671279e5e94bb9726918ee6f/National_Loans_Fund_Account_2023-24.pdf

we propose, no net income in foreign currency or SDR would be owed to the NLF as a result of them, and therefore, the policies would have no interaction with the UK's fiscal policy accounts.

This is clearest as it relates to SDRs and the Exchange Equalisation Account Act of 1979. The law governing the use of the EEA holds that "any SDRs received by the Government must be treated as assets of the EEA, therefore all SDR income is accounted for in the EEA and not the NLF."[16] This further underscores that the EEA's SDRs are ring-fenced and can have no fiscal bearing on the UK.

As a result, when the UK contributes SDRs to the PRGT and RST — currently existing policy operations — neither one runs through or has an effect on the UK's fiscal accounts. When HMT reviews the use of the EEA to extend zero-rate loans to the PRGT or SDR interest rate loans to the RST, it describes these operations in terms of how "the UK supports the IMF outside of the NLF."[17] This is most important as it relates to the UK's zero-rate lending to the PRGT because a zero-rate loan carries an implied loss for the EEA — the UK will receive less SDR income than it otherwise would. Yet this implied loss does not reduce any income that would be remitted to the NLF, as no SDR income can be remitted to the IMF. The same would apply to any SDR-denominated CPL the UK extends to IDA from the EEA.

The neutrality of the purchase of SDR-denominated bonds is even clearer. While extending a zero- or low-interest loan to IDA may result in foregone loan income, the purchase of an SDR bond would carry the SDR interest rate. As a result, there would be no change in the UK's SDR net income. Thus, there would not only be zero impact on the UK's fiscal policy but there would also be zero bearing on the balance sheet of the EEA. The only potential balance sheet effect would be slightly positive: to shift the UK's SDR holdings into an SDR asset that is more liquid than SDRs themselves.

[16] Ibid.
[17] Ibid.

Conclusion

At some point, technical solutions will not be able to mitigate the world's political problems. However, on certain issues — most notably, the funding of international economic commitments — we have not yet arrived at that point. Despite political pressure on the government to cut its ODA budget, the government can still explore technical solutions to mitigate shortfalls and restore its international economic commitments.

We have proposed two ways for the UK to do this: using a small portion of idle resources in the Exchange Equalisation Account to provide IDA concessional partner loans and to make purchase commitments of IDA's bonds. We have also noted how neither policy would have any impact on the UK's fiscal policy, allowing it to restore its foreign economic policy commitments while staying within its fiscal constraints.

At the same time, both concessional loans and bond purchase commitments would provide significant benefits to IDA and the low-income countries it serves. As IDA's financial model is built on a structural asset-liability mismatch — borrowing at market rates and tenors but lending at highly concessional rates and very long tenors — concessional partner loans and bond purchase commitments would allow IDA to fund itself with cheaper and longer liabilities than what markets can offer. This would reduce pressure that arises from falling grant contributions to IDA, and it would free up more capital for IDA to lend.

More work needs to be done to explore the degree to which these policy measures can also be scored as ODA — in effect, returning the UK back to a 0.5% of GNI commitment. **Previously, 31% of a zero-rate loan from the EEA to the IMF's PRGT was scored as an ODA-eligible grant.** However, under the new DAC rules, it has been determined that SDR loans are no longer ODA eligible.[18] It may be important to re-evaluate this given that essentially equivalent Concessional Partner Loans to IDA have a clear framework for calculating the grant element: the concessionality of the coupon relative to the discount rate.[19] Moreover, ODA, in its basic sense, is defined as a concessional "resource flow to a developing country or multilateral organisation" that is "administered with the promotion of the economic development and welfare of developing countries as its main objective."[20] It is clear that both Concessional Partner Loans and IDA bond purchase commitments would satisfy both conditions. To the extent that governments will be more inclined to undertake development-enhancing policy operations if it is scored as ODA, the DAC should make sure that its rules are enabling and encouraging.

[18] FCDO. Statistics on International Development: Final UK Aid Spend 2022. 9 July 2024. https://www.gov.uk/government/statistics/statistics-on-international-development-final-uk-aid-spend-2022/statistics-on-international-development-final-uk-aid-spend-2022

[19] IDA. "Implementation of the Concessional Partner Loan Framework." 12 December 2019. https://thedocs.worldbank.org/en/doc/e5b99e86b18614ae4b0fac333003006f-0410012021/original/ida19-cpl-framework.pdf

[20] HMT. "ODA grant equivalent measure - short technical note." https://assets.publishing.service.gov.uk/media/5dfc916940f0b665957b9356/Grant-Equivalent-Technical-Note1.pdf

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