CAFOD

Catholic Agency for Overseas Development

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Briefing Note February 2022

Leveraging the UK's reserves injection of Special Drawing Rights to increase global vaccinations

Executive summary

Due to the ongoing nature of the coronavirus (COVID-19) pandemic and the shockingly low vaccination rates in many countries in the global south, **the UK should immediately donate £5 billion to global initiatives supporting the global vaccine roll out** to reduce the chances of new variants appearing.

This briefing shows that if there is *sufficient political will* then the Chancellor has room for manoeuvre to make this donation. This is because **the UK's reserves have just received a £19 billion boost of new Special Drawing Rights (SDRs)** which the International Monetary Fund (IMF) created in August 2021 to tackle COVID-19. The UK is planning to lend 4 billion SDRs via the IMF to facilitate low interest loans through the IMF's Poverty Reduction and Growth Trust and a new Resilience and Sustainability Trust. Our proposal for donations complements this plan.

There is guidance in place about how the UK uses its reserves. In this unprecedented pandemic, if the Government chose to do so, it could sell £5 billion worth of foreign currency reserves to make donations to global initiatives to increase access to vaccines. This briefing shows how this would be **consistent with UK legislation and the Chancellor's fiscal rules on borrowing and debt.**

While selling some foreign currency reserves would weaken the policy readiness of the reserves (because SDRs are not as flexible as foreign currency) **the UK would still have higher reserves overall than it did prior to the IMF SDR allocation**. And crucially, investing a relatively small amount now would increase the chances of the Government being able to meet its fiscal rules in 2024-2025 because increasing vaccination rates would likely contribute to avoiding significant costs associated with the impact of future COVID-19 variants.

These donations could unlock similar actions by other G7 and G20 countries to also leverage their SDRs to make donations to significantly speed up global vaccination rates. If other G7 countries matched the UK's £5 billion donation this could generate significant funds to plug funding gaps – which would also contribute to making progress on their own vaccine commitments.[1]

Of course, funding is not the only issue in access to vaccines. Covering these funding shortfalls will have a much larger impact if it is complemented by concrete progress on technology transfer, intellectual property waivers and investing in healthcare systems to safely maximise production so that any nation can produce or buy sufficient and affordable doses of vaccines, treatments and tests. The UK should also pressure pharmaceutical companies to participate in the COVID-19 Technology Access Pool (C-TAP).

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1. State of Global Vaccinations and the UK Government's commitments

Current vaccine inequality is immoral and self-defeating. Since this pandemic began several variants have emerged in developing countries precisely due to low vaccination rates. Therefore, it is an urgent priority for all concerned to increase access to vaccines in the global south.

At the G7 meeting in Cornwall in June 2021, the UK Government called on fellow G7 Leaders to vaccinate the whole world by the end of 2022[2]. However, this is far from the current reality. Under 10% of Africans have been fully vaccinated to date.[3] This is in comparison with the UK where, by late January 2022, 91% of over 12s had had a first dose (with over 64% having had three doses or two doses and a booster).[4]

Under current plans of global vaccine distribution, this doesn't look like changing. Between 11th November and 21st December 2021, the EU, UK and US received 513 million doses of vaccines while countries in Africa received just 500 million throughout the whole of 2021.[5] At the current rate of delivery by vaccine manufacturers, it will take until April 2023 for everyone on the continent to receive just their first dose.

We welcome that the UK Government has been part of a multilateral response to COVID-19 which has included commitments of donating £548 million and 100 million doses to the vaccines pillar of the Access to COVID-19 Tools Accelerator (COVAX).[6] But much more needs to be done. The UK Government should be donating more doses and exploring all avenues[7] to help increase the dangerously low vaccination rates in the global south.

As an immediate step the UK Government should donate £5 billion to World Health Organisation (WHO) initiatives such as COVAX which has an estimated funding shortfall of £12 billion.[8]

Funding is not the only issue in access to vaccines. Covering these funding shortfalls will have a much larger impact if it is complemented by technology transfer, intellectual property waivers and investing in healthcare systems to get vaccines to community level. For example, the UK should pressure pharmaceutical companies to participate in the COVID-19 Technology Access Pool (C-TAP[9]), a technology transfer programme established in May 2020 to share the recipe and knowhow needed to manufacture coronavirus vaccines, tests and treatments.

What can the UK Government do to tackle COVID-19?

Two years into the COVID-19 pandemic it is clear more people need access to vaccines, treatments, and tests - and they need them right now and they need to be free.

CAFOD is a member of the People's Vaccine Alliance[10] which is calling on governments to:

- support open sharing of vaccine technology (via initiatives such as C-TAP)
- back international efforts for an intellectual property waiver on COVID-19 vaccines, tests and treatments
- support an immediate and large investment of public money into manufacturing more vaccine doses, especially in manufacturing hubs in the global south

2. The current limited proposals by the UK Government for using its Special Drawing Rights

Special Drawing Rights are a unit created by the IMF which are added to the reserves of member countries so that they have more finance available in a crisis. SDRs are not money. They are an international reserve asset which can shore up the national reserves (thus reducing the pressure to divert other resources to do this) or can be exchanged for hard currency such as US dollars and Euros.

The UK supported the record $650 billion SDR issuance through its G7 Presidency.[11] As the largest IMF shareholders, the lion's share of new SDRs went to countries such as the United States, Japan, China, Germany and the UK. The UK received 19,317.8 SDRs on 23rd August 2021 which on that day's SDR exchange rate[12] was equivalent to around $27.4 billion (approximately £19.9 billion based on the £/$ exchange rate for 23rd August 2021[13]). In January 2022 this was around $27 billion (£19.8 billion[14]).

Since the start of 2021 there has been a fast-evolving debate about how some of these countries might voluntarily channel a portion of their SDRs towards lower-income countries, who have greater need of increased financial support and stronger reserves to respond to COVID-19.

To date we have seen pledges to channel SDRs from the United States (circa £15 billion), China (£7.5 bn), UK (£4 bn), France (£4 bn), Italy (£3 bn) and Canada (£2.2 bn).[15] Despite the growing debt crisis and the need for grants[16] these countries are likely to lend some of their SDRs to the IMF's Poverty Reduction and Growth Trust (PRGT) which in turn will be used to provide concessional finance to low-income countries.[17] They will also probably lend SDRs to a new IMF Resilience and Sustainability Trust which could have a focus on pandemic preparedness and climate change.[18] When these countries lend their SDRs via the IMF they will retain their reserve asset characteristic. Lending SDRs to the PRGT is seen as low risk because they will earn interest like SDR holdings would and are fully liquid (i.e., could be sold readily and quickly for cash) so could in theory, if needed, be returned to the UK.

In August 2021, the UK Treasury received approximately £19 billion worth of SDRs from the IMF which has been deposited in the UK's foreign currency reserves, known as the Exchange Equalisation Account (EEA). In response to various parliamentary questions[19], the UK has said it will lend 4 billion SDRs via the IMF to facilitate low interest loans[20] and that it 'considers the current size of the reserves to be appropriate' to meet the objectives of the reserves – such as protecting the value of sterling and meeting the UK's commitments to the IMF.[21] In other words, the UK is willing to on-lend its new SDRs to the IMF's Poverty Reduction and Growth Trust and Resilience and Sustainability Trust, but it is not willing to do more than that.

As we set out in a joint statement with Bond, Oxfam GB, Christian Aid, Jubilee Debt Campaign and the Trades Union Congress, lending SDRs via the IMF is not ambitious enough and could increase debts and damaging conditionality.[22] Lending SDRs via the IMF is the minimum that should happen. The UK and other G7 countries should be exploring how to make the most of the billions of SDRs they have received to provide grants to tackle global public problems such as the pandemic and climate change.[23] The UK Government has yet to recognise the enormous additional potential for SDRs to contribute to the step change that is needed for meeting the commitment to vaccinate the world by the end of 2022.

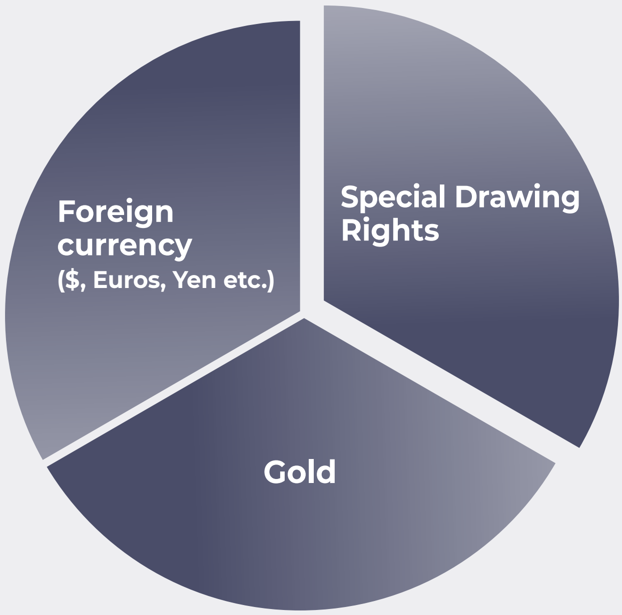
In September 2021 CAFOD joined over 250 civil society organisations around the world calling for any SDR channelling going through the IMF to follow as closely as possible a number of principles such as
a) zero or close to zero interest rates,
b) limited economic policy conditionality such as imposing austerity measures,
c) ensuring access for middle income countries, and
d) transparency.

3. How the UK can use the influx of SDRs to support a step change in global vaccination efforts in 2022

This briefing now shows how SDRs can be leveraged to support global vaccinations. **Figure 1** shows the areas that make up the UK's reserves. In August 2021 the UK received 19 billion SDRs (worth around £19 billion). The Government has said the UK will lend 4 billion SDRs via the IMF. This would leave the other 15 billion SDRs untouched in the UK's reserves. Our proposal to make a donation is complementary and does not interfere with this plan. Making donations of £5 billion to WHO initiatives would mean a reduction in foreign currency but not a decrease in the amount of SDRs held. There would still be an additional 15 billion SDRs untouched in the UK's reserves.

FIGURE 1: **Composition of the UK's reserves**

Source: Author based on *Management of the Official Reserves*



By not touching the SDRs, the UK would still have the majority of its new SDRs received from the IMF. This will enable the UK to continue to have sufficient liquidity to take part in Voluntary Trading Arrangements with the IMF to provide liquidity through SDR trading as needed depending on when low- and middle-income countries wished to exchange their SDRs with the UK for hard currency.

Meanwhile, the UK could sell some of its foreign exchange reserves (held in things like US Government bonds) to free up £5 billion to donate to the World Health Organisation and related initiatives that increase vaccine access.

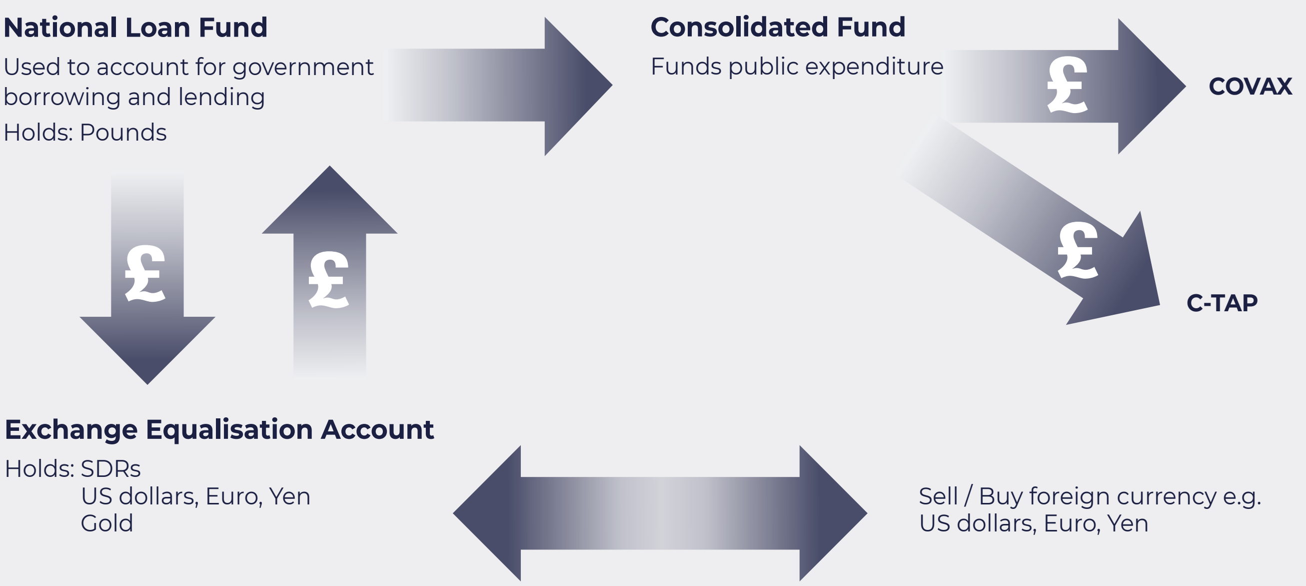
Doing so is consistent with UK legislation on how the Government manages the reserves. According to Section 2 of the Exchange Equalisation Account Act 1979 (as amended by the Finance Act 2000), 'If at any time the Treasury are of opinion that the assets in sterling of the Account are for the time being in excess of what is required for the purposes of the Account, the Treasury may direct that the excess shall be paid into the National Loans Fund.'[24] The UK would still have higher reserves than it had in August before the IMF allocation.

As set out in **Figure 2** the Treasury could determine that the assets of the EEA are now in excess of what is required for the purposes of the EEA and thus return to the National Loans Fund (NLF) at least part of these excess reserves. Central government uses the NLF[25] to put pound sterling into the Exchange Equalisation Account which uses these funds to purchase foreign currency with a particular emphasis on US dollars (around 40% of the EEA), Euros (around 40%) and Yen (around 20%). The EEA also holds the UK's SDRs and gold. If the EEA sells foreign currencies for pounds sterling this is returned to the NLF[26] from where it could go via the Consolidated Fund to make donations.

The Center for Global Development concludes: 'If the UK were to donate to support LICs [Low-Income Countries]…this external donation would in a real sense be costless. The donation would not have taken place without the SDR allocation, it would not add to government debt, and it would not affect domestic demand. Thus, there would be a strong case for this spending to be added to the existing budget.'[27]

FIGURE 2: Transfers of funds from the EEA to COVAX and C-TAP via the Consolidated Fund

Source: Authors based on *EEA Annual Report 2020*



There is room for manoeuvre and the UK total reserves would still be up overall

Over the last decade, the UK has completed a programme to take total reserves of a range of foreign currencies from £39 billion in 2009, to £150 billion. The Government finished this planned £72 billion programme of additional reserve financing in 2019-2020, taking the UK's gross official reserves from approximately £39 billion in July 2009[28] to £134 billion in July 2021. The new influx of SDRs in August has contributed to the UK's gross official reserves reaching approximately £150 billion in December 2021.[29]

If the UK rebalanced its reserves to take account of the new SDRs and sold £5 billion of foreign currency to donate, the reserves would still be higher overall than they were before the new SDRs arrived in August, and higher than the level targeted by the additional reserve financing exercise. The £19 billion windfall of SDRs would still more than outweigh any reduction in foreign currency reserves used to finance a donation. The effect of our proposal would be a change in the composition (a rebalancing) of the reserves.

To date the Government has made it clear that it 'considers the current size of the reserves to be appropriate' for policy readiness and therefore is not in favour of reducing the reserves' size. The purpose of the reserves includes managing undue fluctuations in the exchange rate, providing foreign exchange services for government departments and meeting the UK's financial commitment to the IMF. The UK's reserves have three central goals: Readiness, Risk Tolerance and Return. The reserves have to contain sufficient resources available for when needed (Readiness) and for that reason it cannot take on high risk investments that could have a fiscal impact (Risk Tolerance). It is in that context that the UK seeks to generate income (Return) from its reserves in ways which do not undermine Readiness and Risk Tolerance.[30]

If there is *sufficient political will* then there is room for manoeuvre to reduce the size of the reserves by a relatively small amount (approximately £5 billion from gross reserves of £150 billion). The UK Government could choose to respond to the urgency of low vaccination rates in the global south by declaring there to be excess reserves (as set out at the start of **Section 3**). It is true that selling foreign currency reserves would mean the UK had lower foreign exchange reserves with which to achieve these policy priorities.

However even if the reserves were reduced, there would still be an overall increase in UK reserves when compared to before the IMF SDR allocation in August 2021: the composition would have changed through an increase in SDRs and a fall in foreign exchange. There are downsides to having more SDRs relative to foreign currency. Selling some foreign currency reserves would weaken the policy readiness of the reserves as SDRs are not always a policy ready asset. There are bureaucratic conventions in place guiding how the UK manages its reserves (including SDRs) but ultimately this is a political decision on whether to perceive that there are excess reserves which can be sold to facilitate donations to increase access to vaccines.

Consistent with the UK's fiscal rules

Above we showed that the UK could reduce its reserves (to facilitate a donation) and would still have sufficient reserves to protect sterling and meet its commitments to the IMF. We build on our May 2021 briefing on SDRs and vaccines[31] to show that this donation would be in line with the Chancellor's fiscal rules, which he set out in the Autumn 2021 Budget and Spending Review,[32] so that by 2024-2025:

- Everyday spending is to come from taxation and not borrowing.
- Public Sector Net Debt (excluding the Bank of England) is falling as a percentage of Gross Domestic Product (GDP).

Our proposal to sell £5 billion foreign currency reserves to then make a donation to WHO related initiatives would have the following results:

- Selling foreign currency reserves (to cover donations) would lead to foregone interest – in effect a change in the composition (a rebalancing) of the reserves.
- Increasing donations would increase Public Sector Net Borrowing - but still leave the Government within its fiscal rules.

Taking these impacts into account, this donation would still be with consistent with the fiscal rules on borrowing and debt. Investing a relatively small amount now would increase the chances of the Government being able to meet its fiscal rules in 2024-2025 because increasing vaccination rates would likely contribute to avoiding significant costs associated with the impact of future COVID-19 variants.

According to the Autumn Budget and Spending Review the 'new fiscal rules will allow the Government to continue funding first-class public services and drive economic growth through record investment, while ensuring that debt falls over the medium term.'[33] The goal is to 'create the stable conditions required for economic growth, help to anchor inflation expectations and provide space in the future to respond to economic shocks if needed.'

Fiscal Rule	Outcome of our proposal
Everyday spending is to come from taxation and not borrowing by 2024-2025.	The Government's 'fiscal rules do not require the current budget to be in balance *until* the third year of the rolling forecast period'. Investing £5 billion now to increase vaccines fits within this timeframe and would *de-risk* meeting this rule by 2024-2025.

Investing £5 billion in WHO related initiatives would increase Public Sector Net Borrowing (PSNB) today. However, this is a relatively small amount (in 2020-2021 PSNB was £319.9 billion and in 2021-2021 the Office for Budget Responsibility (OBR) forecasts it will be £183 billion[34]) and would be a worthwhile investment with long-term benefits. It is perhaps the most important 'invest to save' proposal we can make.

Providing financial support now to increase vaccines does not jeopardise the Government's position that the 'fiscal rules do not require the current budget to be in balance *until* the third year of the rolling forecast period, allowing fiscal policy to support the economy to secure a durable recovery and tackle public service backlogs caused by COVID-19'.[35] In fact, increasing vaccine donations de-risks achievement of the fiscal rules in the medium term:

- Increasing access to vaccines contributes to a durable economic recovery by reducing the threat of new variants disrupting economic activity in the UK and globally.
- Avoiding future lockdowns from new variants is vital to keep within the fiscal rules on borrowing and debt. To illustrate this just consider that the Chancellor's 2021-2022 £407 billion COVID-19 spending was described by the Treasury as the 'largest peacetime support package for the economy on record'.[36]
- Sustaining a rebounding economy is vital to meeting the UK's fiscal rules. For example, the OBR found that between March and October 2021 a faster recovery contributed an additional unexpected £8.9 billion in revenue for the Treasury and lowered forecasted borrowing by £51 billion.[37]

Fiscal Rule	Outcome of our proposal
Public Sector Net Debt is falling as a percentage of GDP by 2024-2025.	The Office of National Statistics (ONS) finds that the UK's new SDRs reduced PSND. Under our proposal the UK's *actual* SDRs would not be touched, they would sit in the reserves, and therefore would still contribute to falling PSND as a percentage of GDP by 2024-2025.

The unusual public accounting treatment for SDRs means there is a benefit to Public Sector Net Debt in not actually donating the SDRs themselves. Part of the complexity is because the OBR and the Office of National Statistics have slightly different ways of accounting for SDRs in the national accounts.

- The OBR's position is that the SDR allocation results in an *equal increase* in both the UK's assets and liabilities and has no effect on wider balance sheet aggregates.
- The Office for National Statistics however, highlights that PSND has been reduced by the arrival of the new SDRs in the UK's reserves. The ONS finds that: 'According to *statistical guidance*, Special Drawing Rights are recorded as both a financial asset and an equivalent financial liability. However, there is *more than one definition for debt*. Public Sector Net Debt does not include the liability category for SDRs, but PSND does include the asset category for Official Reserves, which is where the UK's SDR allocation is held. This means that **the new SDR allocation has reduced PSND in August by around £18.7 billion**.'[38] The ONS reports that the SDRs helped improve the UK's balance of payments by contributing to an increase in the UK's reserves assets of £20.6 billion.[39]

The OBR argues that this ONS assessment 'produces the fiscal illusion of lowering PSND when more SDRs are issued'.[40] The OBR illustrated the influx of SDRs reducing PSND in its *Table 3.32* which lists sources of year-on-year changes in PSND.[41] This shows that International Reserves (mainly the new SDRs from the IMF in August 2021) have reduced PSND by £21.7 billion[42] (see **Figure 3**).

FIGURE 3: **Sources of changes in PSND in 2021-2022 (International Reserves includes new SDRs)**

Source: *OBR October 2021 Economic and Fiscal Outlook*

Valuation effects (c)	**-3.3**
of which:	
Gilt premia	-8.0
Asset Purchase Facility gilt premia	2.1
Index-linked gilts uplift	24.3
International reserves	-21.7

- The Treasury position is that there has been no significant change to the UK's reserves position, because the Treasury *chooses* to count SDRs as an *equal-sized* asset and a liability.

The Government could correctly point out that if the UK were to exchange its own SDRs for hard currency that this could be counted as a liability as it would have to pay the SDR interest cost. That is why our proposal specifically does not touch the UK's SDR: we *do not* suggest exchanging SDRs or donating SDRs. The reserves are simply rebalanced in the wake of the SDRs windfall. The SDRs themselves would remain in the reserves and would therefore contribute to meeting the OBR's latest estimates that PSND will be falling as a percentage of GDP by 2024-2025.[43]

In our opinion the ONS is correct to count PSND as having decreased following the SDR allocation, because in practice SDRs offer much more by way of assets than they cost as liabilities. We do not think it is precise to count SDRs equally as an asset and a liability. In the case of SDRs they are not a loan to the IMF[44] but there is the *expectation* the UK will hold sufficient SDRs to be able to meet its commitments to the IMF including as part of Voluntary Trading Arrangements (which it would be able to do as under our proposal the UK would hold on to the majority of its new SDRs). However, an *expectation* (what could be seen as a notional liability) is different from a fixed reason why the Treasury should count SDRs as a liability in the strict sense.

Perhaps under more normal circumstances the UK Government could continue to publicly refuse to acknowledge the boost to its reserves by £19 billion in new SDRs from the IMF by claiming these SDRs are an *equal-sized* asset and liability. But amid the pandemic, and when these SDRs were created in the IMF's own words as a 'shot in the arm'[45] to tackle the COVID-19 economic crisis, it is not good enough for the UK to sit on these new assets when some of this new resource could be used to immediately increase global vaccination rates.

There is room for manoeuvre here if the Chancellor chooses to act. This is a political decision which is fully justified in this unprecedented pandemic. The Government has to find a balance with how it manages the economy through this unprecedented pandemic. But ultimately choosing not to act now is short-sighted. The global economic impact of COVID-19 is estimated to be above $3 trillion a year with the UK hit with an annual loss of around $145 billion,[46] which could undermine the Chancellor's remarks in December 2021 that the UK economy is recovering.[47] Yet if the global community makes the wrong choices about the global roll out of a vaccination programme, significant new losses lie ahead. In May 2021 the IMF found: 'saving lives and livelihoods should need no justification but a faster end to the pandemic could also inject the equivalent of $9 trillion into the global economy by 2025 due to a faster resumption of economic activity.'[48]

Conclusion

In its response to a number of parliamentary questions on the influx of Special Drawing Rights the Government said that the reserves are 'are held on a precautionary basis in the event of any unexpected shocks.'[49] We understand that reserves have specific objectives that have to be met but there is a broader point here: what is the use of sitting on emergency funds if you don't use them when there is a real emergency happening?

The UK Government called on fellow G7 Leaders to vaccinate the whole world by the end of 2022.[50] This briefing has shown that there is room for manoeuvre in the UK's foreign currency reserves enabled by the £19 billion boost to the UK's reserves following the injection of new Special Drawing Rights (SDRs) from the IMF in August 2021. The UK could therefore sell £5 billion worth of foreign currency reserves to make additional donations to global vaccine initiatives and it would still have higher reserves overall than it did prior to the IMF SDR allocation.

If the UK were to make donations immediately this could trigger other G7 countries to match with their own donations.[51] If other G7 countries matched the UK's £5 billion donation this could generate significant funds to plug funding gaps. This is not the time for G7 countries to hoard new reserve assets but to maximise this special opportunity to increase global vaccination rates to counter the threat of perpetual new variants and lockdowns. It's time that the poorest countries, who are least able to save the lives of those infected with the virus, are prioritised.

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