Foreign Aid Without Cost:

Monetary Sovereignty, Sterling Tradability, and the Real Economics of UK International Assistance

Dave Broadway BSc

AIMS — Advisory Initiative on Monetary Sovereignty Ltd

aims-uk.co.uk

davebway@me.com

ORCID: 0009-0009-8823-3362

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Contents

Abstract

Foreign aid is universally framed as a fiscal burden on donor states, requiring higher taxation, borrowing, or reduced domestic expenditure. This paper challenges that premise for countries that issue their own internationally traded currencies. Focusing on the United Kingdom and sterling, we show that foreign aid paid in domestic currency does not necessarily constitute a transfer of real resources from the donor economy. Under identifiable monetary and market conditions, such aid functions primarily as an external monetary injection, expanding offshore currency holdings rather than displacing domestic activity. Drawing on Modern Monetary Theory (MMT), international monetary theory, and a constraint-based approach to inflation, we argue that well-designed sterling-denominated aid is macroeconomically neutral or positive for the UK, while supporting global development and financial stability. The analysis reframes foreign aid from a budgetary sacrifice into a tool of monetary circulation and capacity management.

1 Introduction

Foreign aid occupies an uneasy position in British political economy. It is simultaneously defended as a moral obligation and criticised as a fiscal indulgence, particularly during periods of domestic economic stress. Whether framed as humanitarian assistance, development cooperation, or geopolitical influence, foreign aid is almost universally understood as a claim on national resources: money sent abroad is presumed to be money not available for domestic use.

This understanding rests on a deeper assumption about the nature of public finance. It presumes that the British state must first acquire money—through taxation, borrowing, or foreign exchange earnings—before it can spend. Under this view, aid appears as a discretionary transfer of scarce financial resources away from British citizens toward foreign recipients.

This paper argues that this framing is incorrect for a monetarily sovereign state issuing its own internationally traded currency. The United Kingdom does not finance its spending in the manner assumed by conventional budgetary discourse. It creates sterling when it spends and deletes it when taxes are paid (Wray, 2023). The question, therefore, is not whether the UK can afford to disburse pounds abroad, but whether such disbursements impose real constraints on domestic production, employment, and price stability.

2 Foreign Aid as a Monetary, Not Real, Transfer

When the UK government authorises a payment of foreign aid, no physical stock of goods is shipped abroad by default. What is transferred is a set of monetary claims denominated in pounds sterling. These claims exist as bank deposits and reserve balances within the UK's financial system and are reallocated to foreign holders through international payments.

The economic significance of this distinction is profound. A monetary transfer does not become a real resource transfer unless and until the recipient uses the currency to command the issuer's productive capacity. If foreign aid recipients hold sterling as savings, reserves, or working balances, or if they use it to settle transactions with third countries, the UK has not given up any goods, labour, or materials. It has merely expanded the offshore circulation of its currency.

The conventional conflation of aid with exports obscures this difference. Exports of physical goods reduce domestic availability and require production. Exports of money balances do not. The two only coincide when foreign currency holders choose to exercise their claims on domestic output.

3 Sterling, International Use, and External Absorption

Sterling is not a marginal or peripheral currency. It is one of the world's principal media of exchange (Bank for International Settlements, 2025), unit of account, and store of value in international finance. London remains a central hub for foreign exchange trading, international banking, derivatives markets, and cross-border capital flows. Sterling is widely used in trade invoicing, financial contracts, and reserve portfolios.

This international role gives sterling what may be termed *external absorption capacity*. Foreign economic agents are willing and able to hold and transact in pounds without immediately converting them into other currencies. As a result, very large quantities of sterling circulate outside the UK at any given time, supporting international trade and financial activity.

This property is crucial for understanding the macroeconomics of foreign aid. A currency that is thinly traded or distrusted will be quickly sold when it enters foreign hands, creating exchange rate pressure. A currency that is liquid, widely used, and institutionally

embedded in global markets can be absorbed into offshore portfolios and payment systems with little immediate price impact.

3.1 Sterling and the Structure of Currency Markets

The capacity of a currency to absorb external monetary inflows depends not only on its political backing but on the institutional structure of the markets in which it is traded. Foreign exchange markets are among the largest and most liquid financial markets in the world, with daily turnover measured in trillions of dollars (Bank for International Settlements, 2025). Within these markets, currencies differ markedly in depth, turnover, and the diversity of agents willing to hold and transact in them.

Sterling occupies a privileged position in this hierarchy. It is continuously traded across multiple time zones, used in a wide range of derivative and funding markets, and supported by a dense network of clearing, settlement, and custody institutions. These features mean that very large volumes of sterling can be bought and sold without large or persistent movements in the exchange rate. Exchange rates respond primarily to net order flow relative to market depth, not to the gross volume of transactions, and deep currencies can absorb substantial external inflows or outflows without destabilisation.

This institutional reality underpins the argument developed in this paper. A currency that is thinly traded or subject to capital controls will react very differently to foreign inflows than a currency embedded in global financial markets. Sterling's role as a major trading and funding currency gives it a capacity to absorb foreign-held balances that is qualitatively different from that of most developing-country currencies.

The empirical relevance of this difference is explored in Appendix C, which uses international turnover data to derive indicative envelopes for currency-denominated aid flows that can be accommodated without significant exchange-rate pressure.

4 Aid, Exchange Rates, and the Real Constraint

The macroeconomic relevance of foreign aid therefore depends not on its nominal size but on how it interacts with the sterling system. When aid is paid in sterling and absorbed into global sterling holdings, it does not generate additional demand for UK goods, labour, or energy. Nor does it require compensating taxation or borrowing. It expands the stock of sterling circulating abroad, increasing the scale and scope of the currency's international use.

Only when aid payments lead to a rapid conversion of sterling into foreign currencies,

or when they are tied to purchases of UK output that strain domestic capacity, do they generate inflationary or exchange rate pressures. These are not inherent properties of aid, but consequences of its institutional design and the structure of currency markets.

For a country like the United Kingdom, whose currency is deeply embedded in global finance, these design conditions are not trivial. They imply that the volume of aid that can be disbursed without macroeconomic stress is far larger than is commonly assumed. The true constraint is not fiscal but real: the availability of domestic resources and the stability of the external monetary system in which sterling circulates.

5 External Monetary Circulation and the Nature of Aid

When sterling is transferred abroad through aid payments, it does not leave the British economy in the same sense that goods, energy, or labour leave when exported. What is exported is a set of monetary claims denominated in pounds. These claims are held by foreign governments, firms, and financial institutions and can be exercised only through subsequent purchases of UK goods, services, or assets. Until that moment, they remain as offshore sterling balances, circulating within global financial networks that are largely centred on London and other sterling-using markets.

This creates what may be described as an external sterling circulation loop. Aid payments increase the stock of sterling held outside the UK. Those holdings, in turn, facilitate trade invoicing, credit creation, and financial intermediation denominated in sterling. Over time, they generate demand for UK exports and UK financial assets, but this demand is deferred, distributed, and contingent. It does not translate into an immediate draw on domestic capacity.

The historical experience of the dollar system illustrates the same mechanism, even though the institutional channels have changed. For much of the post-war period, US military spending, development finance, and multilateral lending exported dollars abroad, creating vast offshore dollar holdings. Those holdings then underpinned the dollar's role as the dominant trade and reserve currency, allowing the United States to import real resources on favourable terms. While institutions such as USAID have been significantly curtailed under the current US administration, the global dollar system continues to operate through offshore dollar markets, trade invoicing, and Treasury securities. The mechanism is not the aid agency itself, but the monetary circulation it helped establish.

Sterling operates in a similar, if smaller, system. The UK's role as a global financial

centre, the depth of sterling markets, and the widespread use of pounds in international transactions mean that sterling exported through aid does not have to be immediately repatriated. It can be held, used, and intermediated abroad, sustaining a wider sterling zone that ultimately feeds back into UK economic activity.

6 Foreign Aid, Inflation, and Real Constraints

From a constraint-driven macroeconomic perspective, inflation is not caused by government spending as such, but by spending that encounters binding real constraints. These constraints may take the form of labour shortages, energy bottlenecks, material scarcities, or fragile supply chains. In an open economy such as the UK, many of the most important constraints are external: imported energy, food, industrial inputs, and geopolitical stability.

Sterling-denominated foreign aid does not, in itself, add to domestic demand for these constrained resources. On the contrary, when it is directed toward enhancing productive capacity, infrastructure, and resilience in vulnerable regions, it can reduce the very bottlenecks that drive UK inflation. Investments in renewable energy, climate adaptation, agricultural productivity, and political stability abroad all act to stabilise the global supply conditions on which the UK economy depends.

This implies a reversal of the usual narrative. Rather than competing with domestic anti-inflation policy, international assistance can form part of it. By expanding global capacity and reducing exposure to external shocks, foreign aid can ease the real constraints that ultimately limit domestic fiscal space.

7 Re-thinking UK Aid Policy Under Monetary Sovereignty

If foreign aid is understood as an external monetary circulation rather than a fiscal outlay, the criteria for UK aid policy change fundamentally. The relevant questions are no longer how much tax revenue can be spared, but how much sterling the global system can absorb, and how aid can be structured to minimise pressure on domestic bottlenecks.

A sterling-based aid regime would be designed to encourage the retention and use of pounds abroad, integrating aid flows into trade, finance, and payment systems that already operate in sterling. At the same time, it would prioritise projects that expand global productive capacity in areas critical to UK price stability and supply security. Under such a regime, the volume of aid would be governed by the depth of sterling markets and the state of domestic real resources, not by arbitrary budgetary limits.

Sterling, Trust, and Soft Power

The ability of sterling to absorb large external monetary flows depends not only on market liquidity but also on institutional trust. Foreign governments, banks, and firms hold and transact in pounds because they have confidence in the stability of the UK's legal, financial, and political systems. This confidence is shaped in part by long-term relationships, diplomatic engagement, and development partnerships.

Foreign aid contributes directly to this trust. By funding public goods, infrastructure, and institutional capacity in recipient countries, the UK strengthens the legal and financial environments within which sterling is used. Development partnerships often lead to the adoption of British legal standards, banking practices, and regulatory frameworks, all of which reduce transaction costs and encourage the use of sterling in trade and finance.

In this way, soft power is not an adjunct to the monetary mechanism described in this paper but one of its transmission channels. Aid increases the willingness of foreign actors to hold sterling, raising the absorption parameter that determines whether aid flows remain within the sterling system or are converted into other currencies.

8 Conclusion

The widespread belief that Britain cannot afford to support large-scale international development rests on a misunderstanding of how a sovereign currency operates. The UK does not need to acquire pounds before it can spend them abroad. What matters is whether the spending mobilises or strains real resources.

When foreign aid is paid in sterling and absorbed into global currency networks, it does not reduce the UK's capacity to provide for its own citizens. Instead, it expands the monetary and real infrastructure through which British prosperity is sustained. Under these conditions, helping others and helping ourselves are not competing objectives but mutually reinforcing ones.

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Appendices

9 Appendix A: Monetary Logic

This appendix formalises the sterling-aid mechanism developed in the main text. It defines the absorption parameter and specifies analytically the conditions under which sterling-denominated aid is neutral, inflationary, or expansionary for the UK. The purpose is not to replace the institutional argument with a purely technical one, but to provide a concise representation of the monetary logic that the main paper describes in prose.

A.1 The External Sterling Balance

Let the United Kingdom be a monetarily sovereign issuer of a floating currency, sterling (£). Let:

- A_t denote sterling-denominated foreign aid outflow at time t,
- H_t denote total foreign holdings of sterling,
- X_t denote UK real exports,
- M_t denote UK real imports,
- B_t denote foreign holdings of UK financial assets (gilts, equities, property, etc.).

Foreign holdings of sterling evolve according to:

$$\Delta H_t = A_t + (X_t - M_t) - \Delta B_t$$

Aid increases offshore sterling holdings directly. Trade and asset flows redistribute them.

A.2 The Absorption Parameter

Define $\lambda \in [0, 1]$ as the fraction of aid sterling that is retained within the sterling system (held as balances, used for settlement, or reinvested in sterling assets) rather than converted into foreign currency. Then the FX-market-impacting component of aid is:

$$F_t = (1 - \lambda)A_t$$

This is the net selling pressure on sterling. High λ corresponds to strong foreign confidence, reserve usage, trade invoicing, and financial integration. Low λ corresponds to rapid conversion, FX pressure, and potential depreciation. Aid design and financial architecture determine λ.

A.3 Exchange Rate Impact

Let exchange rate pressure be a function of net order flow relative to market depth:

$$\Delta e_t = \phi\left(\frac{F_t}{D}\right)$$

where D denotes sterling FX market depth and $\phi' > 0$. For sufficiently large D and λ near 1, $\Delta e_t \approx 0$. Sterling's large D is the empirical basis for Appendix C.

A.4 Real-Resource Cost

Let s be the share of aid that requires UK-based real resources (UK labour, UK-made goods, UK energy). Then domestic resource draw is:

$$R_t = sA_t$$

Inflation risk arises if R_t collides with domestic capacity C_t:

$$\pi_t = f(R_t - C_t)$$

If s is small or capacity is slack, aid is non-inflationary.

A.5 Aid Neutrality Condition

Sterling-denominated aid is macroeconomically neutral for the UK if:

$$(1 - \lambda)A_t \ll D$$

and

$$sA_t \leq C_t$$

That is, FX pressure is absorbed by market depth and real resources are not constrained. Under these conditions there is no depreciation, no inflation, and no crowding-out. Aid functions purely as an external monetary circulation.

A.6 Aid as External Demand Creation

Foreign sterling holdings are deferred claims on UK output:

$$E[X_{t+k}] = g(H_t)$$

Aid increases H_t, raising expected future exports and asset demand. Aid is therefore not a cost but a temporal reallocation of demand.

10 Appendix B: Monetarily Sovereign Nation States

The analysis developed in the main text and Appendix A rests on two distinct but related properties of a state's monetary system: monetary sovereignty and currency tradability. Both are necessary for foreign aid to be delivered without imposing a macroeconomic cost on the donor.

B.1 Monetary Sovereignty

A state is monetarily sovereign if it: (i) issues its own currency, (ii) allows that currency to float on foreign exchange markets, and (iii) does not have large binding obligations denominated in foreign currency. Under these conditions, the state cannot be forced to obtain foreign currency in order to meet domestic or external spending commitments. Its spending is constrained only by real resources and inflation, not by financial solvency.

This excludes eurozone member states (which do not issue the euro individually), dollarised economies, and countries with large foreign-currency public debt. It includes the United Kingdom, the United States, Japan, Canada, Australia, Switzerland, and (conditionally) China.

B.2 Currency Tradability

Monetary sovereignty alone is not sufficient. A currency must also be widely traded and willingly held by non-residents. Tradability refers to participation in global FX markets, use in trade invoicing and settlement, presence in international banking and derivatives markets, and holding by foreign central banks and financial institutions. A sovereign currency that is not traded internationally will be quickly sold when it enters foreign hands, producing exchange-rate pressure and inflation. A traded currency can be absorbed into global financial networks.

Sterling, the US dollar, the yen, the Swiss franc, and the Australian dollar all possess this property. Most developing-country currencies do not.

B.3 The Eligible Set

Combining these two criteria yields a sharply defined group of states for which aid-neutrality is feasible:

Country	Monetary sovereign	Currency traded	Aid-neutral possible
United States	Yes	Yes (dominant)	Yes
United Kingdom	Yes	Yes	Yes
Japan	Yes	Yes	Yes
Canada	Yes	Yes	Yes
Australia	Yes	Yes	Yes
Switzerland	Yes	Yes	Yes
Eurozone states	No	Yes (euro)	No
China	Partial	Partial	Conditional
India	Yes	Limited	Limited
Nigeria	Yes	Weak	No

This clarifies that the results of this paper do not apply to all aid donors. They apply to a specific class of currency issuers whose money already circulates internationally.

B.4 Implications

This classification resolves a long-standing confusion in development economics. Rich countries are not rich because they can "afford" aid; they can provide large-scale, non-inflationary aid because their currencies are widely used. The causality runs from currency status to fiscal capacity, not the reverse. It also explains why attempts to emulate US-style aid programmes by countries without reserve-class currencies often end in currency crises, inflation, or external indebtedness.

11 Appendix C: Feasible Aid Levels

This appendix derives a first-order empirical benchmark for the scale of sterling-denominated foreign aid that can be absorbed by currency markets without material exchange-rate pressure. The purpose is not to provide a precise operational limit, but to demonstrate that the feasible volume of aid is orders of magnitude larger than is typically assumed in fiscal debates.

C.1 Market Depth and Exchange-Rate Absorption

Exchange rates are determined not by the gross volume of currency trading, but by net order flow relative to market depth. Highly traded currencies can absorb very large inflows

and outflows with little price movement because buy and sell orders are continuously matched by a wide range of market participants, including banks, funds, corporations, and central banks.

Sterling is one of the world's most actively traded currencies. According to the latest triennial survey of the Bank for International Settlements (BIS) (Bank for International Settlements, 2025), global foreign exchange turnover now exceeds USD 9 trillion per day, with sterling appearing on one side of roughly ten per cent of all trades. This implies that hundreds of billions of dollars' worth of sterling are exchanged daily across spot, forward, and swap markets.

Not all of this turnover is relevant for absorbing aid flows. Immediate exchange-rate pressure arises primarily in the spot market, which accounts for approximately one-third of total turnover. Nevertheless, spot trading alone provides a conservative proxy for the minimum depth available to absorb net currency flows.

C.2 A Conservative Liquidity-Based Envelope

Let D_{GBP} denote average daily sterling spot turnover. BIS data imply a figure on the order of USD 300 billion per day. Suppose that net selling of sterling equivalent to a small fraction f of this turnover can be absorbed without material price impact under normal market conditions. Taking f in the range 0.05–0.2 per cent, which is conservative by standards of market microstructure, yields a net flow envelope of roughly USD 150–600 million per day.

Annualised over 250 trading days, this corresponds to a range of approximately USD 40–150 billion per year of net sterling conversion that could be accommodated without destabilising the exchange rate.

This figure refers only to the portion of aid that is actually converted out of sterling. If a share λ of aid is retained within the sterling system—as deposits, reserves, trade balances, or investments—the gross aid flow can be substantially larger. For example, if half of sterling aid is retained ($\lambda = 0.5$), the corresponding gross aid envelope doubles.

C.3 Interpretation

These magnitudes place current UK foreign aid spending, which is measured in the tens of billions of pounds, well within the absorption capacity of global sterling markets. Even a dramatic expansion of aid—by an order of magnitude—would remain small relative to the liquidity of sterling markets if structured to maximise offshore retention and minimise forced conversion.

This quantitative result reinforces the theoretical argument of the main paper. The UK's ability to provide large-scale international assistance is constrained not by fiscal solvency, but by the depth and structure of sterling markets and by domestic real-resource limits.

C.4 Limitations

These estimates are intended as conservative benchmarks rather than precise operational rules. Market depth varies with global risk conditions, and exchange-rate responses are nonlinear in periods of stress. Nevertheless, the orders of magnitude involved make clear that the notion of aid as a binding financial burden for a currency-issuing, highly traded economy is misplaced.

12 Appendix D: Climate Finance and COP

International climate negotiations are increasingly paralysed by the problem of finance. Developing and climate-vulnerable countries face mounting costs from mitigation, adaptation, and loss-and-damage, while advanced economies resist the scale of transfers implied by scientific assessments of what is required. These disagreements are commonly framed as disputes over burden sharing: who should pay, how much, and through what fiscal channels.

The framework developed in this paper dissolves much of this impasse. For countries that issue internationally traded sovereign currencies, climate finance is not a fiscal burden in the conventional sense. It is a monetary and real-resource allocation problem, not a question of taxpayer affordability.

When climate finance is paid in the donor's own currency, what is transferred is not domestic purchasing power but offshore monetary balances. These balances can circulate, be saved, and be used in global payment systems without any immediate claim on the donor's productive capacity. Provided that a significant share of the currency is retained within global financial networks rather than sold for other currencies, such payments do not exert destabilising pressure on exchange rates.

This observation has profound implications for the design of climate finance. Large-scale funding for mitigation and adaptation in the Global South can be delivered by sovereign-currency issuers without requiring domestic austerity, tax increases, or borrowing in foreign currency. The relevant constraints are the depth of the donor's currency markets

and the availability of real resources in the sectors supplying climate projects, not the size of public deficits.

From a constraint-driven macroeconomic perspective (Mitchell, Wray and Watts, 2019; Wray, 2023), climate finance should be understood as an investment in global capacity. Climate change acts as a systemic bottleneck, amplifying risks to food production, energy systems, migration, and geopolitical stability. These risks feed back into advanced economies through supply disruptions, commodity price volatility, and financial instability. Funding adaptation and mitigation in vulnerable regions therefore reduces the real constraints facing donor economies themselves.

This creates a direct alignment between climate solidarity and domestic macroeconomic stability. A sterling-denominated climate finance programme that supports renewable energy, climate-resilient agriculture, and infrastructure in vulnerable regions reduces the likelihood of future supply shocks that would otherwise raise UK inflation and undermine fiscal space.

The persistent framing of climate finance as a transfer from rich to poor obscures this feedback. For a country like the UK, large-scale climate finance is better understood as the export of currency in order to import stability. It expands global productive capacity, reduces the probability of disruptive shocks, and supports the international use of sterling. In this sense, climate finance is not charity, but a rational extension of monetary sovereignty into the realm of global risk management.

Appendix E: Soft Power, Currency Networks, and Development Finance

The economic argument of this paper rests on the ability of a traded sovereign currency to circulate beyond its national borders. That circulation, however, is not sustained by markets alone. It depends on a dense web of legal, institutional, and political relationships that give foreign actors confidence in holding another state's money.

Historically, international currencies have been embedded in systems of influence as much as in systems of trade. The post-war dollar system was supported not only by US economic size but by security alliances, development finance, and the global reach of American legal and financial institutions. Offshore dollar markets, Treasury securities, and dollar-denominated trade all developed within this wider geopolitical architecture.

Sterling operates within a similar, though smaller, network. The UK's global financial role, the international use of English law, and the presence of British banks and

professional services in developing economies all encourage the use of sterling. Foreign aid amplifies these effects by deepening institutional ties and embedding UK standards in recipient countries' financial and administrative systems.

Development projects financed in sterling often require local banking systems to interface with London-based correspondent banks, adopt British accounting and procurement standards, and hold working balances in pounds. Over time, these practices create a durable sterling zone in which economic activity is denominated, settled, and financed in UK currency.

This institutional dimension reinforces the monetary logic described in the main text. By increasing trust, legal compatibility, and financial integration, aid raises the fraction of sterling that is retained within global currency networks rather than sold on foreign exchange markets. Soft power thus directly increases the capacity of the sterling system to absorb external monetary injections.

Seen in this light, development finance is not merely a moral or diplomatic instrument. It is a structural component of the international monetary system. For a country such as the United Kingdom, whose prosperity depends on the stability and reach of its currency, foreign aid helps to sustain the very networks through which sterling circulates and returns as demand for UK goods, services, and assets.