Institute for Public Policy Research

ROCK BOTTOM

LOW INVESTMENT IN THE UK ECONOMY

George Dibb and
Carsten Jung

June 2024

ABOUT IPPR

IPPR, the Institute for Public Policy Research, is an independent charity working towards a fairer, greener, and more prosperous society. We are researchers, communicators, and policy experts creating tangible progressive change, and turning bold ideas into common sense realities. Working across the UK, IPPR, IPPR North, and IPPR Scotland are deeply connected to the people of our nations and regions, and the issues our communities face.

We have helped shape national conversations and progressive policy change for more than 30 years. From making the early case for the minimum wage and tackling regional inequality, to proposing a windfall tax on energy companies, IPPR's research and policy work has put forward practical solutions for the crises facing society.

IPPR
4th floor,
8 Storey's Gate
London
SW1P 3AY

E: info@ippr.org
www.ippr.org
Registered charity no: 800065 (England and Wales),
SC046557 (Scotland)

The progressive policy think tank

ABOUT THE AUTHORS

George Dibb is associate director for economic policy and head of the Centre for Economic Justice at IPPR.

Carsten Jung is a senior economist at IPPR.

ABOUT THIS PAPER

The purpose of this paper is to compare levels of capital investment in the UK to other advanced economies in the G7 and OECD, and to consider forecasts of different political parties post-2024-election plans.

ACKNOWLEDGEMENTS

The authors would like to thank Pranesh Narayanan, David Wastell, Liam Evans, and Richard Maclean.

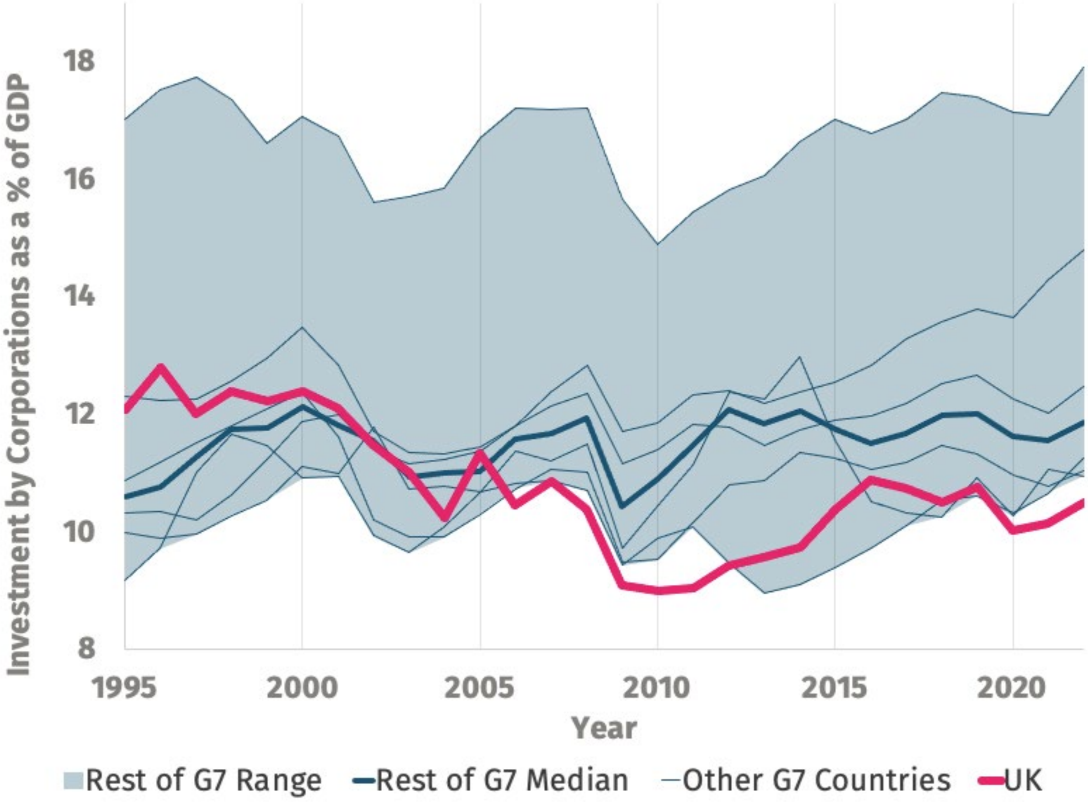
Download
This document is available to download as a free PDF and in other formats at:
http://www.ippr.org/articles/rock-bottom

Citation
If you are using this document in your own writing, our preferred citation is:
Dibb G and Jung C (2024) *Rock bottom: Low investment in the UK economy*, IPPR. http://www.ippr.org/articles/rock-bottom

1.
The UK is bottom of the G7 investment league

The UK's investment performance is still worse than every other G7 country, new data shows. The latest OECD investment data for 2022, which is the most recent year for which a full G7 comparison is possible, shows that **the UK still has the lowest business investment in the G7 (figure 1.1) ranking a lowly 28th among 31 OECD countries**. Only Greece, Luxembourg, and Poland have lower levels than the UK. Countries like Mexico, Slovenia, Latvia, and Hungary all attract higher levels of private sector capital investment as a per cent of GDP.[1]

Figure 1.1: The UK has had the lowest business investment in the G7 for three years running
Gross fixed capital formation by corporations for the UK and the G7



Source: Authors analysis of OECD 2024

[1] For the purposes of this analysis, by investment, we mean gross fixed capital formation (GFCF) by sector as reported in the OECD National Accounts.

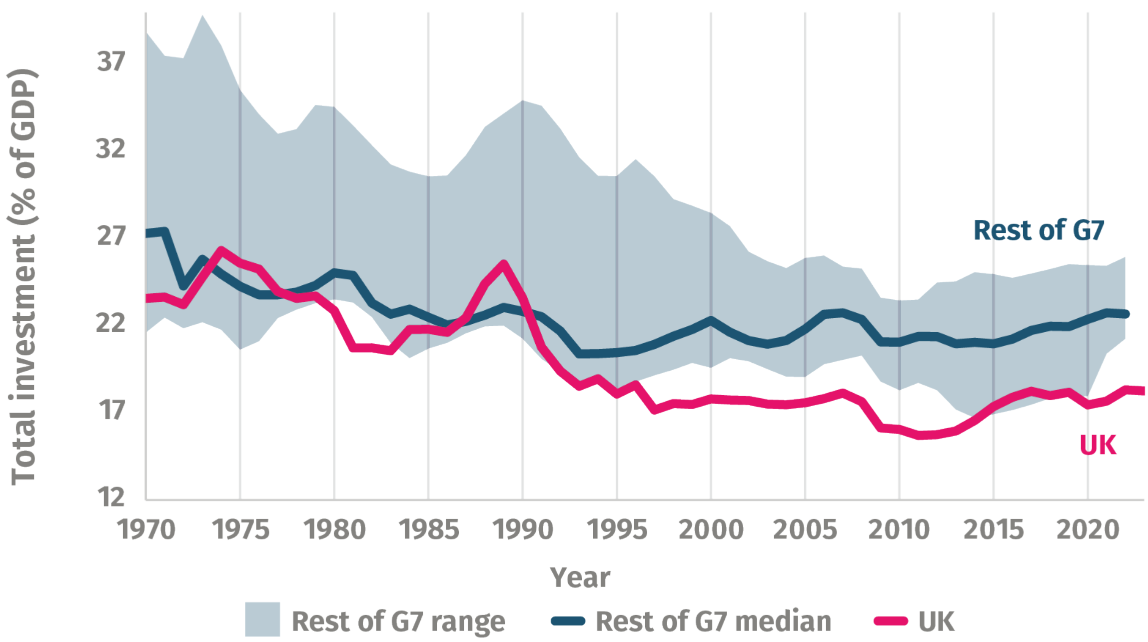
Compared to Japan, the USA, Germany, France, Italy and Canada, the UK languished in last place in 2022, a spot we have now held for three years in a row. It should however be noted that incomplete data for 2023 (figure A1 in appendix) shows that Canadian private investment fell below the UK last year ending our last-place streak. The different trajectories of France (second highest in the G7) and the UK show that our poor performance was far from inevitable. In 2005 the two countries had the same level of business investment (about 11.35 per cent of GDP). In the most recent data (2022) France has increased its level by 3.4 percentage points, whilst the UK's now stands almost 1 percentage point lower.

The government has accepted this issue as a problem and has put in place policies to increase investments, such as 'full expensing' which allows capital investment to be deducted from corporation tax. While UK business investment did tick up in response (ONS 2023) this has not led to the UK catching up with the rest of the G7, as Figure 1.1 shows. Figure A1 shows that a much larger increase would be needed to significantly raise the UK's G7 ranking.

Figure 1.2 shows total investment across the whole economy (ie the rates of investment across government, corporations, households and others) the picture is no better. On total investment the UK is not just bottom of the G7 (with investment at 18.3 per cent of GDP), we are *significantly* behind our nearest competitor (the USA at 21.2 per cent). **The UK has had the lowest level of investment in the G7 for 24 of the last 30 years.**[2]

Figure 1.2: The UK has had the lowest level of total investment in the G7 for 24 of the last 30 years

Gross fixed capital formation (total economy) for the UK and G7



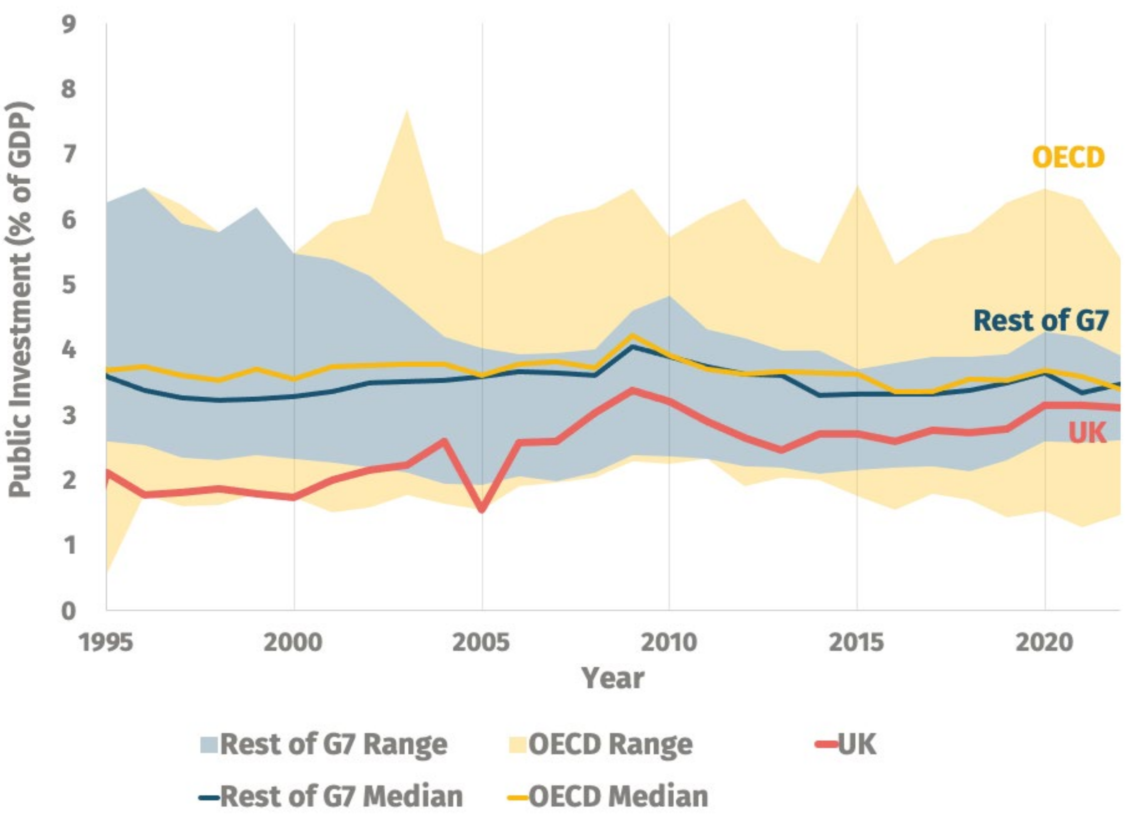
Source: Authors' analysis of OECD 2024

[2] Figure A2 in the appendix includes incomplete 2023 data showing the UK maintaining its poor performance.

Investment, or to be more specific capital formation, matters because it's the expenditure on new facilities, factories, buildings, equipment, innovation, and productivity improvements that fuel economic production and, consequently, economic activity, wages, and household incomes. If the economy is an engine, then investment is its fuel. The UK's dire productivity performance since the great financial crisis of 2008 is, to a large extent, the single biggest driver of our dire living standards. Without resources flowing into new investment, it's hard to see how UK economic performance can improve.

The last time the UK was 'average' in the G7 for total investment was in 1990. The difference between the median and the UK's position has waxed and waned over that time, but on average the UK has fallen 3.2 per cent of GDP behind the median over the last 32 years. But over time that gap adds up. In terms of total investment, **the UK has underinvested over the past 32 years (1990-2022) by £1.9 trillion in real terms relative to the counterfactual in which the UK maintained its median position over that period**. This is foregone investment could have boosted productivity, advanced the green transition, and brought about better, cheaper products and services.

Figure 1.3: Public investment in the UK has risen but never been above average in the OECD
Public investment in the UK, G7 and OECD



Source: Authors' analysis of OECD 2024

Besides business investment, the other major part of the capital picture in the UK is investment by the government, shown in figure 1.3.[3] This includes building new schools, buying new NHS equipment, procuring software for more efficient use of the police force, and spending on building new roads and railways. Compared to other economies, the UK remains below average within the G7 and the OECD but not at such low levels as business and gross investment. That said, within the dataset that we studied, the UK has never been at or above the G7 median for public investment. Not only is our government investment low, it is also volatile and short-termist (Odamtten and Smith 2023).

[3] Here we use gross fixed capital formation by general government (GFCF-GG) as a measure of public investment which differs from the frequently used measure of public sector net investment. The latter measure is net of depreciation and capital transfers, which can be confused by inclusion of non-investment policy decisions such as student loans (OBR 2020). GFCF-GG is the best measure for international comparison given it is part of standard national accounting reporting.

2.

The consensus on investment is shifting – public investment can crowd in business investment

Well-designed, high-quality public investment can crowd in private sector investment and act as a foundation for equitable growth (IMF, 2020). There is a large body of literature highlighting that public investment can boost economic potential of the economy (see Ramey 2020 for an overview), by making the private sector more productive and by crowding in private investment. Moreover, public investment can act as a coordinating device and unlock network effects – for instance, when helping an electric vehicle charging network take off (Li et al 2017).

This is echoed in the views of practitioners. The Financial Times recently asked 85 economists in its annual survey (Romei and Strauss 2024) the question: 'Which single policy change after the next election would do most to boost the UK's long-term growth?'. Of those 85 economists, 52 (two-thirds) recommended increasing investment overall, with 35 infrastructure investment, climate investment, or education and healthcare investment.

Stephen Millard, deputy director for macroeconomic modelling and forecasting at the National Institute of Economic and Social Research, said "a marked increase in public investment would be the key policy change that could do most to boost long-run UK growth" whilst Jumana Saleheen, chief economist and head of investment strategy, Europe at Vanguard Asset Management said: "A consensus has built in recent years that the way to boost UK productivity is through public and private sector investment … bouts of famine and feast into public sector projects and services, create uncertainty about the future. That uncertainty deters the private sector from their own investment."

Yet despite the wide ranging acceptance of its economic benefits, and notwithstanding the UK's position at the bottom of the G7 league table, both **Conservative and Labour parties plan to *further reduce* public investment over the next parliamentary term**.

Current OBR forecasts based on the government's plans, last updated at the March 2024 budget, see public investment *falling,* not increasing, after the election. The Labour party has pledged to invest a further £4.74 billion per annum (raised through tax changes and borrowing) (Labour 2024) as part of its revised Green Prosperity Plan[4] but the forthcoming cuts pencilled in by the government are so severe that even if Labour's plans are added on, public investment would still be declining over the next parliament.

[4] For the purposes of this analysis, we have assumed that Labour will serve a five-year term, with the £23.7 billion of green investment all added directly into general government public investment and spread evenly over the term with £4.74 billion of investment per annum. We have not considered the effects of this increased investment upon GDP.

3.

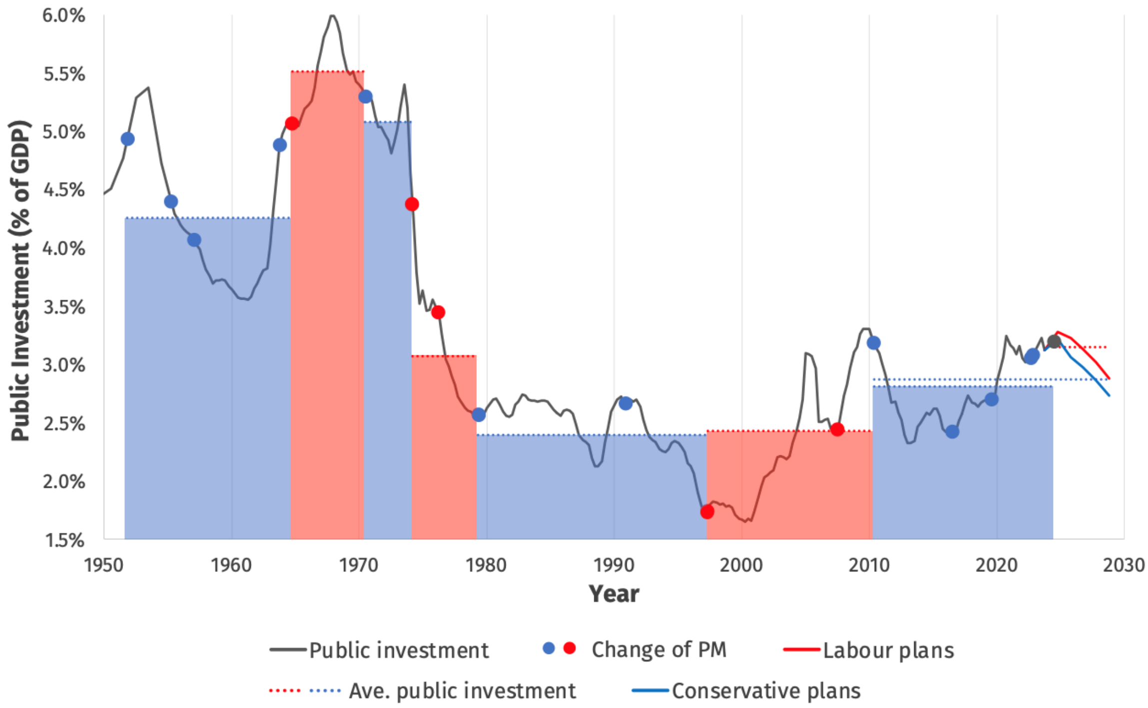
Both major parties plan to cut public investment putting future growth at risk

Figure 3.1 puts the UK's levels of public investment into a longer-term perspective.[5] The significant fall in government investment following the 1973 oil crisis and recession of 1973-75 which has never been reversed has led some commentators to state that all the UK's economic performance today is built on an increasingly crumbling foundation of 1960s and 70s capital investment.

Levels of public investment have increased significantly since their post-second world war nadir in 2000, after the period during which the incoming New Labour administration pledged to stick to John Major's spending plans. As the UK goes to the polls in 2024, public investment will be roughly where it was during the 2010 election, having been cut sharply during austerity and then increased since roughly 2015. Figure 3.2 shows the difference in levels between the beginning and end of different prime ministerial terms (a positive number showing a government finishing its term investing more than when they started as a per cent of GDP). Considering these figures together yields two interesting observations. First, no administration has increased investment as much as 'New Labour' between 1997 and 2010, despite them investing on average almost as little as the Thatcher/Major administration they succeeded.

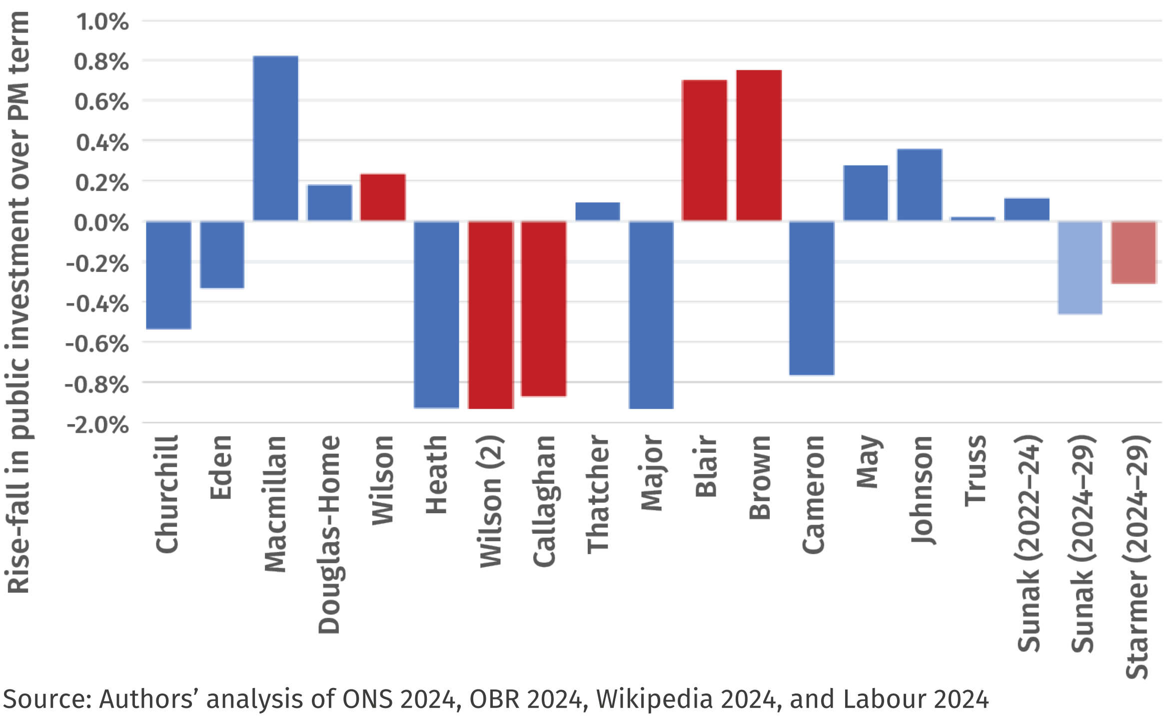
[5] The data presented in both figure 1.3 and figure 3.1 is gross fixed capital formation by general government. Figure 1.3 shows the internationally comparable OECD dataset, whilst Figure 3.1 is analysis of an Office for National Statistics time series that extends pre-1995 to allow a longer historical comparison.

Figure 3.1: A Starmer-led government would oversee the highest average public investment of any administration for half a century
Public investment as a per cent of GDP since 1950 with projections of future investment (line) and average public investment for each government administration (bars)



Source: Authors' analysis of ONS 2024, OBR 2024, Wikipedia 2024, and Labour 2024

Figure 3.2: Comparing the beginning and end of the term, a Starmer-led government would cut public investment more than the 2010-24 Conservative administration
Rise or fall in public investment over post-WW2 prime ministerial terms



Source: Authors' analysis of ONS 2024, OBR 2024, Wikipedia 2024, and Labour 2024

Figure 3.1 also shows the post-election plans of both the Conservative government and Labour opposition.[6] Labour plans take their proposals of an additional £23.7 billion of investment in a flat investment profile on top of existing government capital investment plans as announced at the '24 spring budget. The blue dashed lines show the average investment over the period 2010-2029, assuming another five-year parliament, whereas the red dashed line shows the average investment of a single five-year-term Labour government. This shows that **a Starmer-led government would be, on average, the highest investing administration since Ted Heath's government of 1970-74**. That said, **a Starmer-led government would end its first term having cut investment more than the entire Conservative 2010-24 administration, and about half as much as the Thatcher/Major governments of 1979-97**.

[6] Conservative spending plans are taken from the March 2024 OBR forecasts. We have not identified any new, clearly costed policies that would add to forecasts of general government GFCF used here in the Conservative or Labour manifestos, beyond Labour's Green Prosperity Plan.

4.
What can we do about it?

What can be done to turn this ship around? The causes of the UK's long-term underinvestment across public and private sectors are numerous and it is beyond the scope of this paper to set out a detailed programme to address these challenges here. However, we identify the policy areas that we believe parties should adopt in government to aim to raise levels of economy-wide investment.

Government priorities for private investment

1. **Commit to an industrial strategy.** To significantly increase private investment government must commit to a comprehensive, wide-ranging industrial strategy (Alvis et al 2023) that seeks to remove barriers to growth, creates business and regulatory certainty, and solves coordination problems across the economy. Such an approach should seek to improve investment both at the technological frontier and also in lower-productivity sectors (Jacobs et al 2017), such as care (Jung and Srinivasa Desikan 2024). Tools to achieve this range from planning regulations to skills policies to direct fiscal incentives. These should be put to use supporting the sectors and technologies the UK is best placed to specialise in (IPPR's recommendations are set out in Narayanan et al 2024).

2. **Adopt a whole-government, mission-oriented approach to growth.** The UK should take inspiration from the Biden administration's efforts and set out a 'whole-government' approach to industrial strategy. It is not just the role of economy-wide tax policy and the Treasury to support growth, it will require the right policies to be in place across different policy areas as diverse as housing, energy, transport infrastructure, skills policy, and childcare. In practice, this will require close coordination between government departments to unlock synergies between policy areas.

3. **Ensure investment certainty.** Government should clearly define the direction of travel and in order to give investors more certainty. When governments do so through clear missions, businesses have a better idea of future growth opportunities (UCL IIPP 2019). Such an approach, if well-designed, can 'crowd-in' private sector investment with catalytic government investment and policy (Deleidi 2019).

4. **Align the tax and subsidy system with industrial strategy.** The corporate tax system should incentivise investment and innovation and discourage unproductive activities. The government's plans for 'full expensing' capital allowances are a step in the right direction. A further step would be to introduce a share buyback tax (Evans, Hayes and Dibb 2021) which discourages investor payouts over reinvestment. Another would be replacing business tax rates with a land value tax, which also encourages productive use of land (Roberts et al 2018). In turn,

conditional subsidies could be considered in order to steer investment towards industrial strategy objectives.

5. **End policy chop-and-change.** Since 2010 the government have had 11 industrial strategies or plans for growth: from the coalition's 'eight great technologies', or Sajid Javid's austerity tenure as business secretary, to Greg Clark and Theresa May's industrial strategy (Alvis et al 2023). This chop-and-change of policy and objectives is confusing for businesses and undermines UK economic credibility and stability, damaging investment (Wilkes 2022).

Policy priorities for public investment

6. **Change the process via which the envelope of public investment is decided.** Rather than the Treasury making decisions about the investment enveloped each financial year, essentially treating investment as the residual of other tax and spend decisions, we should consider a long-term envelope being set by parliament on a multi-year basis (Odamtten and Smith 2023). This would ensure that public investment is stable and gives both government and the private sector a basis for planning.

7. **Establish a 'public investment quality guarantee'** which ensures public investment processes in government prioritise projects that are aligned with missions and undergo a strict quality control process. Alongside this, establish **a public investment watchdog** that monitors public investment quality and provides a high level of transparency about the types of projects that are funded.

8. **Establish public investment benchmarks,** which set out **how much and what kind of investment (public and private) is needed** to achieve government's ambitions, or missions. Government should put in place an institutional process for devising how much public investment is needed to deliver key industrial strategy targets. Currently, bodies like the Committee on Climate Change and the National Infrastructure Commission conduct assessments on how much, and what kind of, investment is needed to deliver key targets. But these are not integrated sufficiently with actual government investment decision making. Moreover, such a process should be broadened to include other strategic policy areas and streamlined in order to establish what investment needs there are. The public investment watchdog could then **monitor investment performance against benchmarks.**

9. **Review whether fiscal rules are set right for ensuring fiscal sustainability and future growth.** With inflation receding, the key constraint on public spending, including capital investment, is the design of self-imposed fiscal rules (Jung and Roberts 2022). There have been many criticisms of fiscal rules recently. For instance, the Bank of England's former chief economist Andy Haldane in 2023 argued out that the UK's fiscal rules "rather than exerting useful discipline (…) are constraining government investment." Proposals to address this range from tweaking anchor metrics (eg moving from net debt to GDP to net worth) to fully exempting investment from rules, while introducing institutional safeguards to mark the government's homework. A careful review of these proposals is needed to ensure the UK's fiscal framework delivers fiscal sustainability, while allowing for the benefits of higher public investment.

References

Alvis S, Dibb G, Gasperin S and Murphy L (2023) *Market making in practice*, IPPR. http://www.ippr.org/articles/making-markets-in-practice

Deleidi M, De Lipsis V, Mazzucato M, Ryan-Collins J and Agnolucci P (2019) *The macroeconomic impact of government innovation policies: A quantitative assessment*, UCL Institute for Innovation and Public Purpose,. https://www.ucl.ac.uk/bartlett/public-purpose/wp2019-06

Evans J, Hayes C and Dibb G (2021) *Buy back better: The case for raising taxes on dividends and buybacks*, IPPR and Common Wealth. https://www.ippr.org/articles/buy-back-better-the-case-for-raising-taxes-on-dividends-and-buybacks

Haldane A (2023) 'The case for rethinking fiscal rules is overwhelming' *Financial Times*. https://www.ft.com/content/d57567c3-cd97-4cbe-be00-6cf50886b308

International Monetary Fund [IMF] (2020). Fiscal monitor October 2020 – Policies for the recovery, report. https://www.imf.org/-/media/Files/Publications/fiscal-monitor/2020/October/English/text.ashx

Jacobs M, Hatfield I, King L, Raikes L and Stirling A (2017) *Industrial Strategy: Steering structural change in the UK economy*, IPPR. http://www.ippr.org/articles/industrial-strategy-steering-structural-change-in-the-uk-economy

Jung C and Roberts C (2022) *Spending and stability: How much fiscal space does the UK have?*, IPPR. http://www.ippr.org/articles/spending-and-stability

Jung C and Srinivasa Desikan B (2024) *Transformed by AI: How generative artificial intelligence could affect work in the UK – and how to manage it*, IPPR. http://www.ippr.org/articles/transformed-by-ai

Labour (2024) *Change: Labour Party Manifesto 2024*, The Labour Party. https://labour.org.uk/change/

Li S, Tong L, Xing J, and Zhou Y (2017) 'The Market for Electric Vehicles: Indirect Network Effects and Policy Design', *Journal of the Association of Environmental and Resource Economists*, 4:1, 89-133

Narayanan P, Dibb G, Vanino E and Gasperin S (2024) *Manufacturing matters: The cornerstone of a competitive green economy*, IPPR. http://www.ippr.org/articles/manufacturing-matters

Odamtten F and Smith J (2023) *Cutting the cuts: How the public sector can play its part in ending the UK's low-investment rut*, Resolution Foundation. https://economy2030.resolutionfoundation.org/reports/cutting-the-cuts/

OECD (2024) 'Annual investment by asset and institutional sector', dataset. https://data-explorer.oecd.org/vis?df%5bds%5d=dsDisseminateFinalDMZ&df%5bid%5d=DSD_NASEC10%40DF_TABLE14_GFCF&df%5bag%5d=OECD.SDD.NAD&df%5bvs%5d=1.1&pd=2019%2C2023&dq=A.CHE%2BSWE%2BESP%2BSVN%2BSVK%2BPRT%2BPOL%2BNOR%2BNZL%2BNLD%2BMEX%2BLUX%2BLTU%2BLVA%2BKOR%2BISR%2BIRL%2BHUN%2BGRC%2BFIN%2BEST%2BDNK%2BCZE%2BCRI%2BCHL%2BCOL%2BBEL%2BAUT%2BAUS%2BCAN%2BDEU%2BFRA%2BJPN%2BITA%2BUSA%2BGBR.S12%2BS13%2BS11%2BS1...P51G.N11G....V..&ly%5bcl%5d=TIME_PERIOD&ly%5brs%5d=REF_AREA&to%5bTIME_PERIOD%5d=false&vw=tb

Office for Budget Responsibility [OBR] (2020) 'Box – Public Sector Net Investment, Economic and fiscal outlook – March 2020', dataset. https://obr.uk/box/public-sector-net-investment/

Office for Budget Responsibility [OBR] (2024) *Economic and fiscal outlook – March 2024*. https://obr.uk/efo/economic-and-fiscal-outlook-march-2024/

Office for National Statistics [ONS] (2024) 'Public sector finances time series Gross fixed capital formation', dataset. https://www.ons.gov.uk/economy/governmentpublicsectorandtaxes/publicsectorfinance/timeseries/anse/pusf

Ramey V (2020) The Macroeconomic Consequence of Infrastructure Investment, NBER Working Paper 27625. http://www.nber.org/papers/w27625

Romei V and Strauss D (2024) ‘FT economists survey: ‘anaemic’ economy needs ‘investment, investment, investment’’, news article, Financial Times. https://www.ft.com/content/0b0802b2-aa4a-4d74-91ea-a97fb7f9fafb

Roberts C, Blakeley G, Murphy L (2019). A wealth of difference – Reforming the taxation of wealth. IPPR discussion paper. https://ippr-org.files.svdcdn.com/production/Downloads/cej-a-wealth-of-difference-sept18.pdf

UCL Commission for Mission-Oriented Innovation and Industrial Strategy (MOIIS) co-chaired by Mazzucato M and Willetts D [UCL IIPP] (2019). A Mission-Oriented UK Industrial Strategy. UCL Institute for Innovation and Public Purpose. https://www.ucl.ac.uk/bartlett/public-purpose/wp2019-04

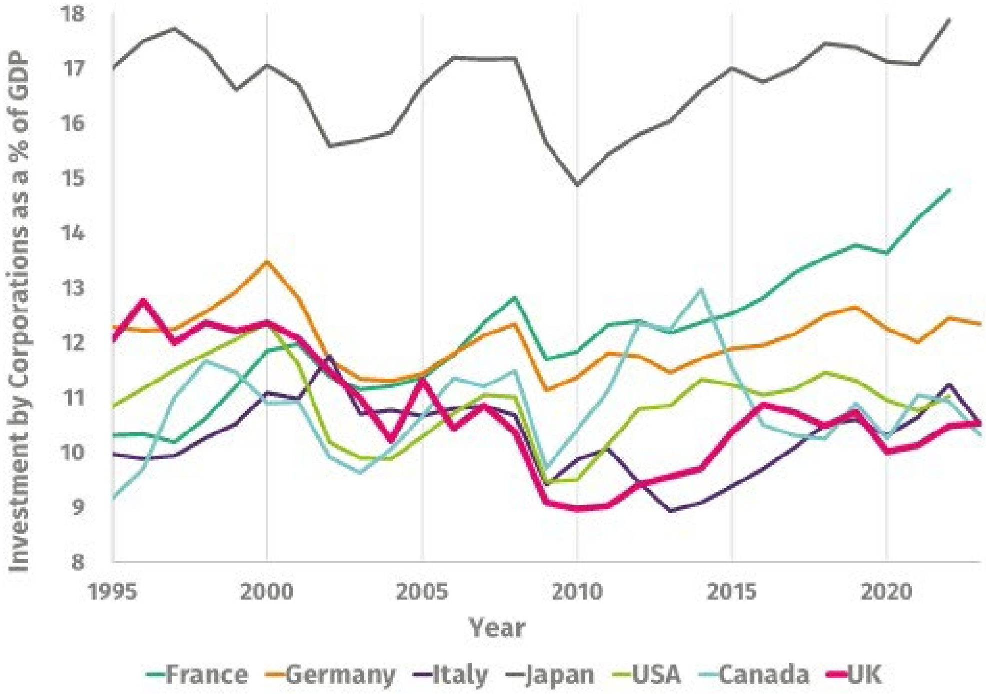
Wikipedia (2024) ‘List of prime ministers of the United Kingdom’, webpage, accessed 6 June 2024. https://en.wikipedia.org/wiki/List_of_prime_ministers_of_the_United_Kingdom

Wilkes (2022) *Business investment: Not just one big problem*, Institute for Government. https://www.instituteforgovernment.org.uk/publication/report/business-investment

Appendix

Figure A1

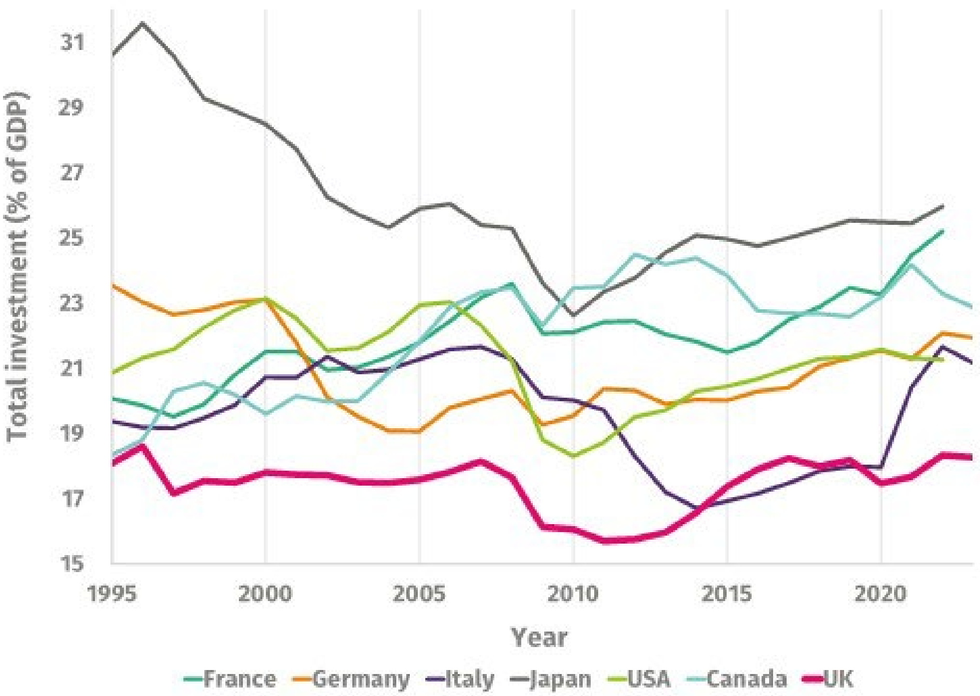
Gross fixed capital formation by corporations, G7 countries



Source: OECD 2024

Figure A2

Gross fixed capital formation, total economy, G7 countries



Source: OECD 2024

Institute for Public Policy Research

GET IN TOUCH

For more information about the Institute for Public Policy Research, please go to www.ippr.org, e-mail info@ippr.org or find us on X @ippr

Institute for Public Policy Research
Registered Charity no. 800065 (England & Wales),
SC046557 (Scotland), Company no, 2292601 (England & Wales)

The progressive policy think tank