

The Investment State

How a UK Development Bank Drives Growth, Productivity, and regional renewal

By Noah Lees

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Solving the UK investment and growth crisis with a development bank

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About the Author

Noah Lees is a postgraduate student at King's College London and a Fellow of the Fabian Society's Young Fabian Fellowship Programme. This paper was produced as part of that fellowship project and reflects his independent research and analysis.

His academic background includes undergraduate study at the University of Kent and postgraduate study at King's College London, which have provided the analytical and methodological foundations for this work. His research interests focus on UK economic policy, long-term growth challenges, and the role of institutions in addressing structural weaknesses in investment and productivity.

This report is written in a policy-facing context and is intended to contribute to ongoing debates around growth, public investment, and institutional reform in the UK. The views expressed are those of the author alone and do not represent the official positions of the Fabian Society or any affiliated institution.

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Executive summary

The United Kingdom faces a persistent growth crisis rooted in chronically low levels of investment. Since 2007, GDP growth has averaged around 1 per cent per year, falling to approximately 0.7 per cent on a per-capita basis. This weak performance has left the UK increasingly behind international peers and has translated directly into stagnant productivity and wages. Investment, a central driver of long-run growth, has been consistently inadequate: the UK ranks near the bottom of the G7 and OECD for both public and private investment, while public sector net investment is projected to decline further in the coming years.

The economic consequences are severe. UK productivity growth is among the weakest in the G7, and wage growth has effectively flatlined since the financial crisis. Real pay for many workers, particularly in the public sector, remains below pre-2008 levels, contributing to labour shortages, declining public service capacity, and the emigration of skilled professionals. Historical and international evidence demonstrates a clear relationship between sustained high levels of investment and strong economic performance; no country has achieved prolonged periods of rapid growth without investment rates significantly above those currently observed in the UK.

The government has correctly identified growth as its central economic mission and has introduced a range of policies aimed at improving investment outcomes, including the National Wealth Fund, efforts to attract foreign direct investment, planning reform, devolution initiatives, and renewed fiscal stability. While welcome, these measures are insufficient in scale to address the depth of the UK's investment gap. The National Wealth Fund is too small and narrowly focused to deliver a systemic shift, while reliance on private and foreign capital risks misalignment with national priorities.

This report argues that a step change in public investment capacity is required through the creation of a United Kingdom Development Bank (UKDB). Operating at scale and with institutional independence, a UKDB would mobilise long-term capital, crowd in private investment by absorbing risk, and direct funding toward strategically important sectors and underinvested regions. Without such an institution, the UK risks continued economic stagnation; with it, the country has a credible route to restoring growth, productivity, and living standards.

Introduction

The problem

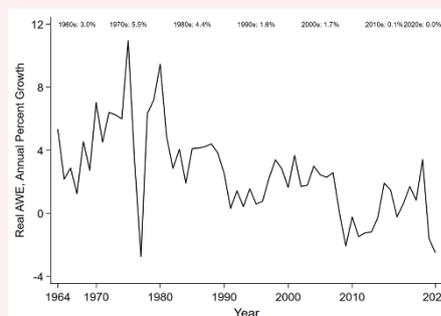
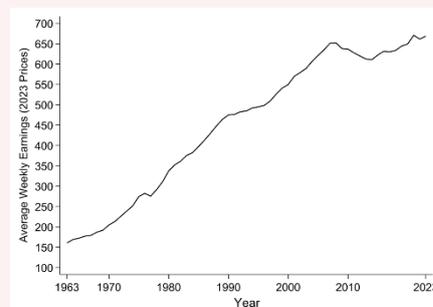
The UK currently faces a catastrophic growth problem. While the headline figure of GDP growth has increased slowly, averaging 1% per year between 2007 and 2024, this falls to around 0.7% when GDP per capita is accounted for¹. This growth is minimal and represents a widening gap between Britain and its peers. As a result, wage growth has been subdued and, in some cases, absent for decades². Average nursing wages are lower than they were two decades ago³. In the traditional GDP formula, investment is a key component, and in this paper, investment is treated as the primary vehicle for economic growth.

Investment in the UK has also been catastrophically low, representing a significant structural problem, particularly in comparison with international peers. Among the G7, the UK has consistently ranked lowest in investment for 24 of the past 30 years⁴. When compared with the 31 OECD nations, the UK ranks 28th for business investment⁴. This lack of investment constrains the government's ability to achieve its growth agenda and presents a considerable challenge for the Chancellor's attempts to build a stronger Britain⁵.

The UK's Public Sector Net Investment (PSNI) is expected to fall from £66.6 billion in 2024 to £53.1 billion in 2028⁶. This is significantly less than the £111 billion the UK expects to spend on paying interest on the national debt next year⁷.

Why is this a problem?

Investment is central to a healthy economy and is particularly important for GDP and productivity growth⁸. Both are key determinants of people's living standards. A strong, fair economy requires robust economic and productivity growth. Productivity is closely linked to wages⁹, and with productivity growth stalling in the UK—the lowest in the G7, excluding Italy¹⁰—wages have stagnated. Since the 1960s, the UK experienced an average annual wage growth of 4.3%, which steadily fell to 1.6% in the 1990s, remaining at that level until the 2008 financial crisis, after which wage growth has effectively flatlined¹¹.



This stagnation has had severe consequences, particularly for the lowest earners. Real public sector pay at the end of 2023 remained 1% lower than in 2007, while real private sector pay increased by just 4%¹². Both figures are low by historical standards, and in the context of inflation and the ongoing cost-of-living crisis, this decline is detrimental to public services—especially as key professionals, such as doctors, leave the UK for higher wages abroad in countries like Australia and Canada¹³. Wages must grow, productivity must rise, and the economy must expand. The current investment shortfall presents the government with an opportunity to address these issues at relatively low cost.

Investment has historically been central to global economic success. Ha-Joon Chang, in *Economics: The User's Guide*, notes that “No economy has achieved ‘miracle’ rates of growth (that is, over 6 per cent per year in per capita terms) over a period of time without investing at least 25 per cent of GDP. At the heights of such growth, countries invest at least 30 per cent of GDP. The investment ratio went above 35 per cent in Japan in the late 1960s and early 1970s. During its ‘miracle’ growth period since the 1980s, China’s investment rate has been 30 per cent and above, going above 40 per cent in the last decade”¹⁴. This demonstrates a clear relationship between investment and growth. With UK investment declining, it is evident that rising investment is essential to building a more prosperous Britain.

Although growth in the 2000s was not as strong as historical averages, it was still higher than current levels. Research from Torsten Bell, formerly of the Resolution Foundation and now a government minister, highlights that if productivity had remained at pre-2008 financial crisis levels, the average UK wage would be £11,000 higher today and continuing to grow¹⁵. In such a scenario, the government would not need to pursue tax hikes or spending cuts and could maintain a balanced budget with properly funded public services. Bell emphasizes that productivity and wages are closely linked and boosting one is critical to boosting the other¹⁶.

In summary, why is low investment a problem? Because investment drives GDP and wage growth. High levels of both enable citizens to earn and spend more, while simultaneously increasing government revenues, which can be reinvested in vital services such as the NHS.

This paper will argue that the UK’s weak growth and productivity performance stems from chronically low levels of public and private investment. It will first examine the structural causes of the UK’s investment gap, assess the shortcomings of the current institutional framework—particularly the UK Infrastructure Bank—and then propose a reformed national investment institution designed to restore long-term growth and competitiveness.

What is the government doing about it?

Rachel Reeves, Darren Jones, Torsten Bell, and Keir Starmer have correctly identified a growth mission and are moving to boost investment in the economy. The government has undertaken a variety of measures aimed at improving growth and investment¹⁷. These measures will be detailed below, with a particular focus on fiscal investment rather than more abstract forms of economic intervention.

The National Wealth Fund

The centrepiece of the government's growth mission is the National Wealth Fund. The fund, announced prior to the election, initially held £7.3 billion and was designed to leverage private investment as well¹⁸. Its focus is on green energy, gigafactories, and other vital elements necessary to boost UK development and growth.

This is an important move by the government and forms a central theme of this paper. While the National Wealth Fund is functional, it is too small and insufficiently equipped to tackle the challenges that a proposed United Kingdom Development Bank (UKDB) could address. Although £7.3 billion may appear substantial, it is minimal compared with the over €150 billion lent by the German KfW in 2022¹⁹. Germany is similar to the UK in size and resources but maintains a significantly larger development bank. The UK, however, has the context and capability to establish a development bank that could not only rival international counterparts but deliver far greater benefits for the domestic economy. Additionally, the NWF has a narrow remit, primarily focused on decarbonisation and manufacturing. While these areas are important, they represent only a fraction of the broader investment strategy required.

Attracting International Capital

The government has also sought to address the UK's historic shortfall in foreign direct investment (FDI). At the International Investment Summit in 2024, the UK secured £63 billion in investment and pursued further deals, including jet and ship agreements with Turkey and Norway to strengthen British military manufacturing, as well as agreements with the United States resulting in \$150 billion in FDI^{20, 21, 22, 23}. These developments reflect a clear shift in government strategy, aimed at promoting the UK brand internationally to attract investment, create jobs, and build industrial capacity for the future.

While necessary and beneficial, this FDI disproportionately flows to London and the Southeast and cannot substitute for robust domestic investment. Without increased domestic investment, the UK risks an economy increasingly owned by foreign actors, with industrial and GDP outcomes dependent on external nations²⁴. This also heightens exposure to international shocks and crises over which the UK has limited control.

Planning Reform

The government has initiated an ambitious programme of planning reform, a key policy likely to yield significant economic benefits. Facilitating development in major

cities, such as London, will strengthen economic centres and benefit the wider nation. These reforms make the UK a more attractive location for investment; however, they facilitate investment rather than create it. Investment itself must still be mobilised.

Devolution and Local Growth Plans

Devolution and local growth plans have the potential to further stimulate economic growth. The government has taken steps to empower local authorities, introducing new combined authorities, local growth plans, and investment zones, all of which are expected to increase local investment. However, local authorities currently lack adequate incentives and resources to prioritise and implement growth effectively. To remedy this, local governments should have greater capacity to raise capital, ideally linked to local economic performance through mechanisms such as business rates or salaries, creating a system where investment and growth directly enhance local budgets²⁵.

Human Capital

Although this report focuses primarily on physical and financial capital, human capital remains a critical element of growth²⁶. Investment in human capital can sometimes yield greater returns than investment in physical or digital assets. Much of the UK's economic growth and prosperity over the past century has been underpinned by education. The government has committed to landmark investments in skills, adult education, and employment support, aiming to place more people in the right jobs and upskill the workforce. The UK benefits from world-leading educational institutions such as Oxford, Cambridge, and the University of London. Its primary limitation lies in physical capital, rather than human capital.

Stability

Over the past decade, policy missteps have undermined UK economic stability. The current government, led by Rachael Reeves' commitment to fiscal rules and a series of legislative measures, aims to prevent repeats of crises such as the 2022 mini-budget disaster. These steps enhance the UK's attractiveness to international investors, particularly as other major economies, such as the United States and France, face increasing instability²⁷. In this context, the UK stands out as a relatively stable and secure investment environment²⁸.

The UK government has fundamentally reshaped the direction of travel of investment and growth in the UK making growth the central mission of the government. However, this has not transformed investment in the UK whilst all the changes above will boost investment and all that comes from it, and some will facilitate better investment it does not meet the challenge of the day, and more is necessary. And a lack of focus on public investment puts too many requirements on a private sector or international investors who have their own means over the benefit of the UK which a

public investment body would be focusing on. So, the next logical step for the UK is to really boost public investment in a meaningful way and crowd in private investment.

The UK Infrastructure Bank

The UK government has significantly reshaped its investment and growth strategy, making growth a central policy mission. However, these measures have not yet transformed investment levels. While the National Wealth Fund is a positive first step, its narrow scope and limited resources cannot meet the scale of the challenge. Overreliance on private and foreign investment risks misalignment with national priorities; a public investment body focused on the UK's long-term interests is necessary to complement private and international capital.

A UK Development Bank would serve as this vehicle, mobilising public and private investment to leverage the nation's strengths and direct funding to underinvested areas. The bank would be modelled on the German KfW and designed specifically for this purpose.

The UK previously established the UK Infrastructure Bank (UKIB) in 2021 to address the nation's investment gap, replacing access to the European development bank lost due to Brexit. The UKIB has two primary objectives: tackling climate change and supporting regional and local economic growth, forming part of the levelling-up agenda introduced by the Boris Johnson government²⁹. From its launch to March 2024, the bank committed over £3 billion and mobilised a further £16 billion in private funds—a fraction of the €150 billion mobilised by the German KfW in 2022³⁰.

The UKIB faced several challenges:

- Limited starting capital and slow deployment, with only £3 billion committed initially, hampered its ability to address pressing issues.
- Concerns were raised over the bank's rushed creation, with insufficient organisational capacity for rapid fund mobilisation.
- The bank adopted a conservative approach, prioritising low-risk projects with existing private funding rather than riskier, high-growth initiatives.
- In 2024, the bank reported a loss of £82 million. While this is not unexpected given the long-term nature of its investments, it raised concerns about the bank's sustainability³¹.

Lessons Learned

A development bank capable of rivalling the German KfW must operate at a significantly larger scale and with greater speed. The UK has suffered from decades of underinvestment, which cannot be remedied by deploying only £3 billion over a few years. Far larger investments are necessary, and while scaling up will take time, the UK must act with far greater vigour and efficiency.

The Case for the UK Development Bank (UKDB)

There are numerous benefits that a UK Development Bank would bring to the nation, with the central advantage being increased investment. A development bank would hold substantial capital and deploy it in nationally important projects, providing the funding required for essential infrastructure, including bridges, airports, and data centres.

However, the role of a development bank goes beyond simply providing capital. It would combine a deep pool of funds with a management structure designed to allocate resources to the most economically beneficial areas of the country, promoting strategic, fair development rather than being solely profit-driven. The UKDB would operate on a long-term basis, capable of delivering investment over decades to strategically strengthen key industries.

Delivering Investment: The most immediate benefit of the UKDB would be ready access to capital and the ability to inject funds into the economy over the long term. With the German KfW delivering over €150 billion annually, a UK equivalent could channel hundreds of billions of pounds per year into strategic areas, including the riskiest but most vital sectors.

Crowding in Private Sector Capital: By funding riskier projects, the UKDB would derisk investment for the private sector, enabling businesses to invest in the UK with reduced risk. The current National Wealth Fund is estimated to mobilise a 3:1 ratio of private to public investment, whereas a KfW-scale UKDB could generate over £450 billion in additional private investment, targeting the most critical areas of the economy.

Closing the Investment Gap: Through coordinated public and private investment, the UKDB would help close the investment gap between the UK and other OECD and G7 nations, restoring investment levels to more historically normal levels.

Building a Cleaner, Greener Britain: With a targeted approach, the UKDB would prioritise key industries, including the green energy sector and other environmentally significant areas, enabling the UK to grow while transitioning to a cleaner economy.

Boosting Innovation and Advanced Industry: The UK already hosts some of the world's most innovative companies. With the highest number of unicorns outside the US and China, the country possesses the tools for global success, but these companies often lack sufficient capital to innovate^{32,33}. For example, the Whittle Lab, an aerospace research facility, is highly productive and innovative but constrained by limited funding³⁴. The UKDB could invest in projects like Whittle, supporting advanced manufacturing and productivity. Other initiatives, such as the Oxford-Cambridge corridor, would also benefit from additional investment³⁵. With 17 of the

world's top 100 universities located in the UK, the nation has a strong foundation for innovation; it simply requires the capital to realise its potential³⁶.

Boosting Jobs: Investment through the UKDB would lead to increased construction, infrastructure, research, and development, generating more high-quality jobs across multiple sectors.

Investing in the Future of Britain and Productivity: A UKDB would help close the UK's estimated £2 trillion capital gap, providing more capital per worker and enhancing productivity³⁷. Increased productivity would support higher wages, creating a more prosperous and secure future for the UK.

Making Britain Richer and More Equal: These investments would raise wages, productivity, and tax revenues, benefiting both citizens and government. Crucially, investment could be directed to regions outside London, promoting regional equality and inclusive growth.

Bringing Long-Term Strategy to British Investment: An independent UKDB with a clear mandate would be able to invest strategically over decades, insulated from short-term political changes. Over the past ten years, the UK has experienced six prime ministers, each with differing priorities; a UKDB would provide stability and continuity in national investment strategy.

A Stabiliser for Britain: The UKDB would also enhance national financial stability, providing clarity and confidence for investors and making the UK a safer, more trusted destination for investment.

In summary, a UKDB would deliver substantial economic benefits, creating wealth and opportunity across all regions of the country.

How this differs from the National Wealth Fund

The main differentiator between the organisations is around scale and thus impact. The UKDB operating like the German KfW in scale would have a larger capacity to fund and thus lead to far more impact, where the UKDB can invest in entire industries. Alongside this because of the scale the UKDB will be able to close a multi decade investment gap of trillions, something the NWF is structurally incapable of doing. Alongside this the UKDB has an economy wide mandate and is enabled to invest far wider than the NWF. And because of the size the UKDB has more independence and capacity to act as a driver where it can absorb risk where markets fail to invest, and fund long term, capital intensive and risky projects that are necessary for long term national growth but unattractive to private investors, so the UKDB can crowd in private capital by derisking entire projects. And finally, the NWF primarily supports specific government priorities whereas the UKDB would be an anchor for national investment policy giving continuity and credibility to long term

projects allowing the bank to coordinate across regions and sectors creating a real driver of growth and investment.

All of this gives it the capacity and strength needed to address the investment and growth challenges of the day where the NWF whilst addressing some of these falls short.

Recommendation

The UK government should establish a UK Development Bank, integrating the National Wealth Fund into this new institution. The UKDB should have greater capital, independence, and a clear mandate to:

- Invest in future industries currently lacking sufficient funding.
- Promote regional equality.
- Support the government's green agenda.
- Most importantly, drive economic growth across the UK.

Considerations for a Policy Maker

The most central considerations in establishing a UKDB are financial capacity and institutional independence. The bank must be financially stable and sufficiently large to make meaningful investments, while maintaining independence to preserve public and investor trust. With adequate financial resources and the autonomy to pursue long-term strategies that are insulated from short-term political changes, the UKDB is more likely to succeed.

The Question of Funding

Funding a project of this scale represents the biggest challenge, particularly in the context of current government fiscal constraints. For comparison, the German KfW holds approximately €500 billion³⁸. Several potential funding strategies could be employed:

- **A Pension-Based Scheme**
Private pensions in the UK currently total around £3 trillion. These could potentially be consolidated into fewer schemes, each with roughly £500 billion in assets. If six such schemes were established and each invested 10% in the UKDB, this would provide an initial £300 billion in capital. If successful, this pilot could be expanded over time³⁹.

- **Crowdfunding**
Funds could be raised from private investors, companies, and citizens through targeted crowdfunding initiatives.
- **Utilising the City of London**
The City of London is home to the world's largest venture capital market and one of the largest global financial sectors. Banks hold approximately £470 billion in regulatory capital, with total assets of £14 trillion and total financial assets of £27 trillion^{40, 41}. This capital could be mobilised to support the UKDB, similar to the pension-based approach.
- **Direct Government Funding**
The simplest, though most politically challenging, approach is direct funding from the Treasury, potentially raised through taxation.
- **The Example of the KfW**
The German KfW does not provide a direct model for UKDB funding, as its initial capital came from the post-war Marshall Plan, part of the US effort to rebuild Germany after World War II⁴². However, now it works with private investors to compound its own funds which it has built up since the second world war.

The Reality

In practice, funding the UKDB will likely require a combination of the above approaches to maximise resources while minimising disruption to existing markets.

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