# Supplementary written evidence to the Business and Trade Committee's Call for Evidence on *Financing the real economy*

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## 1. Introduction

This document presents The Productivity Institute's (TPI) supplementary written evidence to the Business and Trade Committee's Call for Evidence on *Financing the real economy*, submitted on 21 November 2025. It follows on from initial written evidence submitted to the Committee on 12 September 2025[i] and oral evidence provided to the Committee by Professor Tera Allas on 14 October 2025[ii].

The written evidence was produced by Professor Tera Allas on behalf of The Productivity Institute. Both the initial and supplementary submissions draw on contributions from Professor Bart van Ark (The Productivity Institute, University of Manchester) and Dr Dimitri Zenghelis (University of Cambridge).

Note: Figure 1 in this document has been updated since submission to the Committee, to reflect the government's policy changes announced at Budget 2025 and the Office for Budget Responsibility's (OBR) latest projections in November 2025. The substantive conclusions are unchanged.

This document is structured as follows: 1. Introduction, 2. Executive summary, 3. Growth-enhancing public sector capital expenditure, 4. The quantum of public sector capital expenditure, 5. The nature of public sector capital expenditure, 6. The need for granular appraisal and evaluation, 7. Characteristics of growth-enhancing investments, and 8. Conclusions.

## 2. Executive summary

The UK's total public sector gross investment (including AME) is small, at 11% of total managed expenditure. Over the OBR's forecast horizon, between 2024/25 and 2030/31, total public sector gross investment is expected to remain flat at 11% and capital DEL is expected to increase only slightly, from 8.5% to 8.6% of total managed expenditure.

Moreover, based on a high-level classification, only around a third of capital DEL is allocated to spending that is directly growth-focused, such as R&D, transport infrastructure, or business support. The government's narrative of "record investment"

therefore overstates the scale of currently planned growth-enhancing activity. The implication is that the UK needs both a larger and a more sharply targeted public investment programme to boost productive capacity and growth.

However, growth is not the only legitimate objective of public spending, and neither growth potential nor social value can be robustly assessed at the level of broad spending categories. To maximise the value of every pound spent, a systematic, rigorous, granular, and transparent appraisal and evaluation system is needed. Crucially, its scope must cover both resource and capital expenditure.

One of the Committee's priorities should therefore be to explore how such a system could be implemented and sustained in practice. In the meantime, the Committee may find it helpful to scrutinise government programmes and projects using a set of practical tests proposed in this paper. These tests should help to distinguish investments that are growth-enhancing from those that are less likely to result in medium- to long-term economic gains.

## 3. Growth-enhancing public sector capital expenditure

Nearly all government expenditure *can* be growth-enhancing. Welfare transfers enable poorer households to spend more, creating demand for goods and services. Student loans help individuals gain human capital which can help them be more productive in the future. Preventative health measures that avoid sickness absences improve workforce participation. Low levels of crime are beneficial to the business environment. Access to clean, affordable, and reliable energy fuels the rest of the economy. An effective defence capability can deter destructive wars or geopolitical turmoil. Investment in intelligence research and development is likely to generate innovations that have positive spill-over benefits for the rest of the economy. And so on.

As we describe in more detail in section *6 (The need for granular appraisal and evaluation)*, genuinely assessing the impact of government spending would require a much more granular, item-by-item exercise, which is beyond the scope of this paper. To nevertheless help the Committee in its current enquiry, sections 4 *(The quantum of public sector capital expenditure)* and 5 *(The nature of public sector capital expenditure)* provide higher-level analysis of broad categories of investment, which necessarily makes the focus of this paper somewhat narrow. The following caveats are worth spelling out explicitly:

- We focus most of our commentary on money allocated in the Spending Review 2025 capital departmental expenditure limits (CDEL). This leaves out capital annual managed expenditure (AME).[iii] It also leaves out elements of expenditure that, while classified as resource, most economists would argue create an asset and enhance the nation's productive capacity (e.g., some health and education spending).[iv]

- We focus mainly on whether the government's investment is likely to generate GDP growth in the medium and long term. Although most capital expenditure boosts GDP mechanically in the short term[v], the primary concern here is the lasting impact on productive capacity. We also do not comment further on short-term macro-level crowding-out effects.[vi] Finally, we acknowledge that focusing on growth overlooks other legitimate government objectives—notably social welfare (also known as social value or public value), even though we discuss this further in section 6 *(The need for granular appraisal and evaluation)*.[vii]
- We have not attempted a quantitative assessment of the impact of different types of capital expenditure on GDP growth — whether at the macro or micro level — nor a review of the extensive academic literature on this topic. Instead, we take a pragmatic approach: classifying investment by its primary purpose and identifying a set of practical tests to assess the potential of specific government investments to support growth.

It is therefore important to recognize that the distinction between growth-focused and other capital expenditure used in this paper is necessarily coarse: in practice, many forms of public spending—capital and resource—can enhance productive capacity depending on their design, context, and complementary conditions. An in-depth assessment of detailed expenditure items would be required to draw more definitive conclusions.

Broadly speaking, then, for the purposes of this note, we define growth-enhancing capital expenditure as CDEL spending that enhances GDP growth in the medium and long term, relative to a counterfactual without the spending. Typical features of such spending are that it is complementary to existing assets, it relieves growth bottlenecks, it crowds in (or de-risks) private investment, and/or it generates positive spill-overs. It is worth emphasising that such features can apply to all types of government expenditure—both capital and resource, and regardless of functional categorisation.

## 4. The quantum of public sector capital expenditure

The overall level of the UK's historical, current, and projected public sector capital expenditure is low. As such, it is unlikely to deliver a sufficient boost to get the UK out of its low-investment, low-productivity equilibrium.

On an internationally comparable basis, the UK's general government gross fixed capital formation averaged just over 2.5% of GDP between 2000 and 2019, while the OECD average was around 50 per cent higher, at 3.7%. Cross-country assessments suggest that an effective level would be 4.5% of GDP. (Resolution Foundation, 2023) More recent Resolution Foundation research shows that the UK's general government investment as

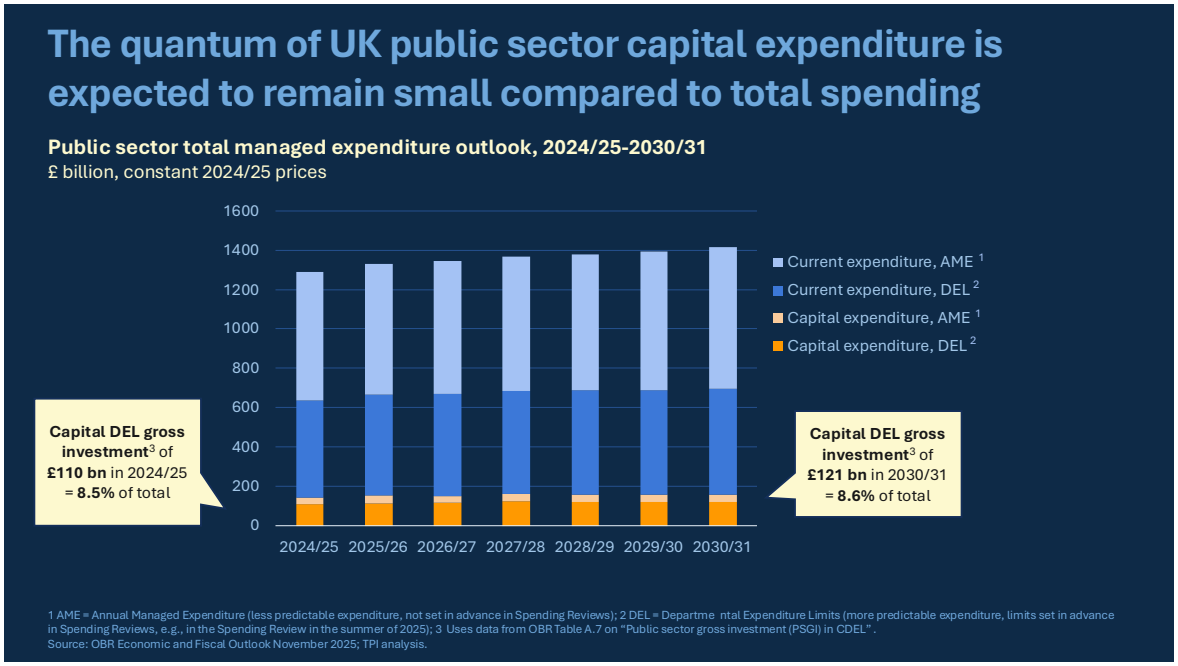
a share of GDP has increased somewhat, to around 3.9% in 2022, but was still well below the OECD average of around 5.5% (Resolution Foundation, 2025).

The UK's public sector capital expenditure is also low compared to the government's total spending. In 2024/25, capital DEL and capital AME together made up just 11% of the government's total managed expenditure outturn of £1.3 trillion. Capital DEL (excluding depreciation), the focus of sections 4 and 5 of this paper, totalled £110 billion, or 8.5% of total managed expenditure. (OBR, 2025) In an international comparison, which uses slightly different definitions, UK's government investment as a share of total government expenditure in 2023 was 6.7%, below the OECD average of 8.2% (OECD, 2025).

And, despite the current narrative, the amount of capital DEL is also not expected to grow much into the future, based on the government's 2025 Spending Review and Budget 2025. By 2030/31, in constant 2024/25 prices, capital DEL will still only be £121 billion, or 8.6% of total managed expenditure—an increase in capital DEL as a share of total managed expenditure of 0.1 percentage points from 2024/5 (Figure 1). (OBR, 2025)

These figures include the government's announced £120 billion additional capital investment (HM Treasury, 2025). The reason why, when put into context, the totals still seem small is twofold. First, the £120 billion figure is additional to the plans of the previous government, which had expected to reduce capital spending significantly (Resolution Foundation, 2025). Second, even a figure as large as £120 billion, when spread over the course of the Parliament, is only a few tens of billions per year. Such increases, while welcome, pale in comparison with the UK's capital gap of around £2 trillion (Allas and Zenghelis, 2025).

**Figure 1**



## 5. The nature of public sector capital expenditure

In addition to being small, the UK's public sector capital expenditure is not obviously dominated by growth-enhancing investments. Building on the IFS's classification of capital investment in its Spending Review 2025 analysis (IFS, 2025), only about a third of the government's cumulative total capital DEL from 2025/26 to 2029/30 is expected to be directly growth-focused[viii] (middle panel in Figure 2). Around a fifth is expected to be invested in defence and intelligence, a tenth in energy and the environment, and nearly a third in public services, such as health and social care, and education[ix].

**Figure 2**


Nor is the growth-focused capital DEL the category that is expected to increase the most. In absolute terms, growth-focused investments are expected to increase by £3.1 billion (in constant 2024/25 prices) between 2023/24 and 2029/30, compared to £10.2 billion for defence and intelligence, £7.8 billion for energy and environment, and £5.3 billion for public services related capital DEL (left-most panel in Figure 2).

The right-hand panel in Figure 2 further shows that, from 2023/24 to 2029/30, growth-focused investments are expected to increase by 1.2% per annum in real terms, with only devolved governments increasing by less than this, at 0.3% p.a. Energy and environment investments are expected to increase by 12.7%, defence and intelligence investments by 6.7% and public service related investments by 2.8% per year.

## 6. The need for granular appraisal and evaluation

The categorisations used in the previous section are necessarily simple. They are provided to aid the Committee in getting a sense of the quantum and nature of the UK government's capital expenditure. However, as mentioned in endnotes *iv* and *vii*, focusing just on capital DEL and focusing just on the growth objective is likely to miss significant parts of the bigger picture.

Moreover, even within broad categories, some projects deliver a far bigger boost to long-term growth than others. For example, while transport investments are generally considered growth-enhancing, the Eddington Transport Study showed that the impact of a scheme depends heavily on its mode, scale, location, and the wider conditions in which it sits. It found that the economic returns from transport investment range from very modest or negative in poorly targeted or low-demand schemes to several-times-cost in projects that relieve acute congestion or improve access to dense economic hubs. (Eddington, 2006)

Crucially, the Eddington Study also stressed that transport infrastructure on its own does not generate economic growth. Its benefits depend on the presence of complementary conditions — a skilled workforce, dynamic businesses, dense urban agglomerations, and local market conditions (e.g., low barriers to competition) amenable to benefiting from better connectivity. The same principle applies to all investment: housing where there are no good connections to jobs or amenities, grid connections where no-one wants to use extra electricity, or broadband where everyone already has an ultra-fast connection, are unlikely to unblock growth bottlenecks.

Therefore, for scrutinising the effectiveness of the government's planned capital expenditure, it is not enough to look at broad categories. There needs to be a more comprehensive, granular, and transparent appraisal system—followed by robust ex-post evaluation—that covers all of the government's £1.3 trillion of expenditure (some of which creates assets, such as human capital), not just the £100+ billion of capital DEL. Such a system also needs to be capable of recognising dynamic effects, network spill-overs, and non-marginal structural changes—for example where investment supports transformational shifts rather than incremental improvements.

In theory, the HM Treasury Green Book, and other appraisal and evaluation guidance, provide a framework for this (HM Treasury, 2024). In practice, the framework is not comprehensively applied in decision making or its assumptions and outputs transparently published. Developing such a system will require additional analytical capacity—some of which will need to come from collaboration with academia, think tanks and other centres of expertise—creating an opportunity for the UK to lead internationally in a more rigorous, evidence-based approach to strategic investment.

In 2019, only 8% of government spend on major projects had robust evaluations in place (NAO, 2021). While evaluation of major projects has improved, in 2023/24 only a third (34%) of the Government Major Projects Portfolio, representing £378 billion—or 45%—in total cost, had good quality evaluation plans in place (Evaluation Task Force, 2025). Major projects accounted for an estimated 4.8% of annual total managed expenditure, implying that only around 2.1% of all government expenditure had good quality evaluation plans in place (let alone actual evaluations)[x].

## 7. Characteristics of growth-enhancing investments

While a fully granular appraisal system, covering both capital and resource spending, is the first-best solution, such a system will take time to build. The practical tests below therefore provide the Committee with an interim way to assess whether individual investments are likely to be growth-enhancing. The following questions are not exhaustive, but they highlight key characteristics of growth-enhancing investments. If a project cannot demonstrate a credible rationale or evidence for meeting these tests, it is unlikely to deliver significant medium- to long-term economic gains.

| Test | Illustrative examples | Rationale |
|---|---|---|
| Does the investment relieve a binding growth bottleneck? | Increasing transport capacity or smoothing demand where congestion is high | Removing a growth bottleneck unleashes latent potential that already exists, making returns more likely |
| Is the utilisation of the asset created or demand for its outputs likely to be high? | Building housing in areas of elevated house prices and job vacancies | Building capital intensive assets that are poorly utilised is unlikely to deliver value-for-money |
| If there were a market for the output, would users likely be willing to pay a high price? | Upgrading the electricity network in areas where firms are queuing for connections and wait times are long | High willingness to pay implies high value to users, beneficiaries, and society |
| Is the investment complementary to existing assets (in the same locality)? | Upgrading a suburban rail station that feeds into an employment hub, improving capacity where connecting services already exist | The more the asset can benefit from investments already made, the higher its benefits relative to costs |
| Does the investment crowd in private capital investment? | Building a high-capacity fibre backbone which unlocks private investment in local data centres | The public sector accounts for only a small share of total investment, so significant private investment needs to be unleashed |
| Does the asset generate significant positive spill-overs? | Creating an open-access university–industry research centre that expands the local talent pool and absorptive capacity of local firms | If the benefits go beyond the direct users, e.g. by diffusing innovation, the growth returns can be higher |
| Is the procurement or construction of the asset likely to be efficient? | Using tested, standardised, modular school or hospital designs instead of bespoke one-off builds | A project that is over-designed, over-priced, or delayed ties up money that could be better used elsewhere |
| Are there clear mechanisms in place to mitigate any delivery barriers? | Upgrading the electricity grid for an industrial zone with land access, planning consent, and skilled contractor capacity secured | Even good projects can fail to deliver benefits if obstacles — planning, skills, supply chains, local opposition — are not actively managed |
| Are there clear plans for driving and monitoring benefits realisation? | Training and reorganising hospital staff to make the most of electronic patient record systems | For many assets, complementary changes to processes are required to realise the intended benefits |

## 8. Conclusions

The UK's public investment is both insufficient in scale and not obviously focused on growth. Without more investment that directly relieves growth bottlenecks, complements existing assets, and unlocks private capital, the UK is unlikely to escape its low-investment, low-productivity equilibrium.

For the Committee's scrutiny role, this means looking beyond headline totals and broad spending categories. What matters is the quality of individual projects: whether they are well targeted, whether they support existing strengths, whether the assets created are effectively used, and whether they create the conditions for private investment and wider spill-overs. Existing appraisal frameworks—including the Green Book—provide a foundation for this kind of assessment, but in practice they are not applied consistently or transparently enough to ensure that public spending systematically maximises social value or supports growth.

A fully granular, rigorous appraisal and evaluation system—covering both capital and resource spending on a comparable basis—is therefore the first-best route to ensuring that public money delivers the greatest possible impact. Implementing such a system will take time. In the interim, the practical tests set out in this paper can help the Committee identify which investments are most likely to enhance productive capacity and which are less likely to deliver lasting economic gains.

Ultimately, improving the quality—not just the quantity—of public investment is essential if the government's growth mission is to be credible.

## References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## ANNEX A: Classification of capital DEL into categories in Figure 2

| Department or area | Classification | Cumulative capital DEL, 2025/26 to 2029/30, £ billion** |
|---|---|---|
| Transport (excl. High Speed 2) | Growth focused | 81.5 |
| Science, Innovation and Technology | Growth focused | 72.7 |
| Transport - High Speed 2 | Growth focused | 30.5 |
| MHCLG Housing, Communities and Local Government* | Growth focused | 21.9 |
| Business and Trade | Growth focused | 8.7 |
| Culture, Media and Sport | Growth focused | 3.5 |
| Growth Mission Fund | Growth focused | 0.2 |
| Defence | Defence and intelligence | 134.6 |
| Single Intelligence Account | Defence and intelligence | 7.9 |
| Energy Security and Net Zero (excl. Sizewell C) | Energy and environment | 45.6 |
| Energy Security and Net Zero - Sizewell C | Energy and environment | 13.3 |
| Environment, Food and Rural Affairs | Energy and environment | 12.9 |
| Health and Social Care | Public services related | 66.2 |
| Education | Public services related | 35.8 |
| MHCLG Housing, Communities and Local Government* | Public services related | 21.9 |
| Foreign, Commonwealth and Development Office | Public services related | 14.1 |
| Justice | Public services related | 10.4 |
| Reserves | Public services related | 9.8 |
| Home Office | Public services related | 7.8 |
| Provision for intra-governmental leases | Public services related | 3.8 |
| Work and Pensions | Public services related | 3.4 |
| HM Revenue and Customs | Public services related | 3.0 |
| Small and Independent Bodies | Public services related | 2.1 |
| Cabinet Office | Public services related | 1.9 |
| HM Treasury | Public services related | 1.8 |
| Law Officers' Departments | Public services related | 0.4 |
| Scottish Government | Devolved governments | 32.6 |
| Welsh Government | Devolved governments | 16.3 |
| Northern Ireland Executive | Devolved governments | 11.2 |
| | | |
| **Total Capital DEL** | | 675.8 |

* Half of MHCLG capital DEL classified as Growth focused, half classified as Public services related.

** Constant 2024/25 prices.

[i] The initial written evidence is available on the Business and Trade Committee website at https://committees.parliament.uk/writtenevidence/148552/pdf/.
[ii] A transcript of the oral evidence session is available on the Business and Trade Committee website at https://committees.parliament.uk/oralevidence/16491/pdf/.
[iii] In 2024/25, capital AME made up around 2.5% of the government's total managed expenditure and around 23% of total (AME+DEL) capital expenditure. (Table A.7, OBR, 2025) Capital AME includes expenditure on, for example, student loans, financial sector interventions, and public corporations' capital expenditure.
[iv] Most economists agree that parts of health and education spending are investments in human capital — they build the nation's future productive capacity. However, the resulting asset is embodied in individuals rather than owned or controlled by the state. Under the national accounting framework (ESA 2010 / SNA 2008), only assets that accrue to the public sector can be recorded as government capital formation. As a result, expenditure that enhances people's skills or health is treated as current (resource) spending in fiscal accounts, even though it represents long-term investment in economic potential. In an ideal world, we would have included the relevant parts of health and education spending in our analysis of growth-focused investments. However, in the context of this paper's focus, there is inadequate data to reliably identify which parts of health and education expenditure are materially growth-enhancing.
[v] In national accounts, under the output (production) measure of GDP, when the government commissions a capital project, firms supply labour and materials to build it, and that production raises GDP, regardless of whether the asset boosts productive capacity. For example, an imaginary "bridge to nowhere", or a "white elephant" project, would increase economic output in the short term, but not in the medium to long term. The main exception is when the capital goods for the project are wholly or largely imported: if most of the equipment or construction value is produced abroad, then little domestic value added is created, and even the short-term effect on GDP is minimal.
[vi] In the short term, if an economy is operating near its capacity, higher government investment (and borrowing) can crowd out private investment because it adds to demand, pushing up wages, input costs, or interest rates — so firms face tighter financing conditions or resource constraints (OBR, 2024). This in turn will, at the margin, discourage private sector investment.
[vii] In theory, government should seek to maximise social welfare (also referred to as social value or public value), rather than GDP growth or GDP per capita (HM Treasury, 2024). GDP measures the total market value of goods and services produced each year but not overall wellbeing over time. It omits many dimensions of quality of life—such as health, relationships, safety, equality, and environmental sustainability. Nonetheless, since the BTC inquiry focuses on the government's growth mission, and the government has identified economic growth as its number-one priority (Prime Minister's Office, 2024), this paper concentrates on assessing capital expenditure plans in terms of their likely impact on medium-term and long-term economic growth (GDP). For a further discussion, see the section in this paper on *The need for granular appraisal and evaluation*.
[viii] For a detailed explanation of which capital DEL areas have been classified into each of the categories shown in Figure 2, see Annex A.
[ix] Please see endnote ii above.
[x] Based on the Infrastructure and Projects Authority's Annual Report for 2023/24, the cost-weighted average length of major projects in the Government Major Project Portfolio (GMPP) was 14.2 years (author's calculations based on Figure 1a and Figure 3 in Infrastructure and Projects Authority, 2025). Both this report, and the Evaluation Task Force report (Evaluation Task Force, 2025) show the total lifetime costs of the 227 projects in the major project portfolio at £834 billion. This implies an approximate annual cost of £58.7 billion. The government's total managed expenditure in 2023/24 was £1,229 billion (HM Treasury, 2025a). Hence, major projects accounted for approximately 4.8% of all expenditure. The Evaluation Task Force indicates that 34% of all GMPP projects, representing 45% of the total lifetime costs of the portfolio, had good quality evaluation plans in place. This implies that approximately 2.1% of all government expenditure in 2023/24 had good quality evaluation plans in place. Systematic data on evaluation coverage outside of the Government Major Project Portfolio Based is not available.