

Opinion | Michael Tory, Columnist

# A Novel Fiscal Fix for What Ails the UK Economy

Allocating some of the additional tax revenue raised by the budget to the state-owned pension fund could generate future economic growth.

20 January 2025

**By Michael Tory**

Michael Tory is a founder of Ondra LLP, a financial advisory firm in London and Paris.



Chancellor of the Exchequer, Rachel Reeves faces a growth challenge rather than a fiscal emergency. *Photographer: Leon Neal/Getty Images Europe*

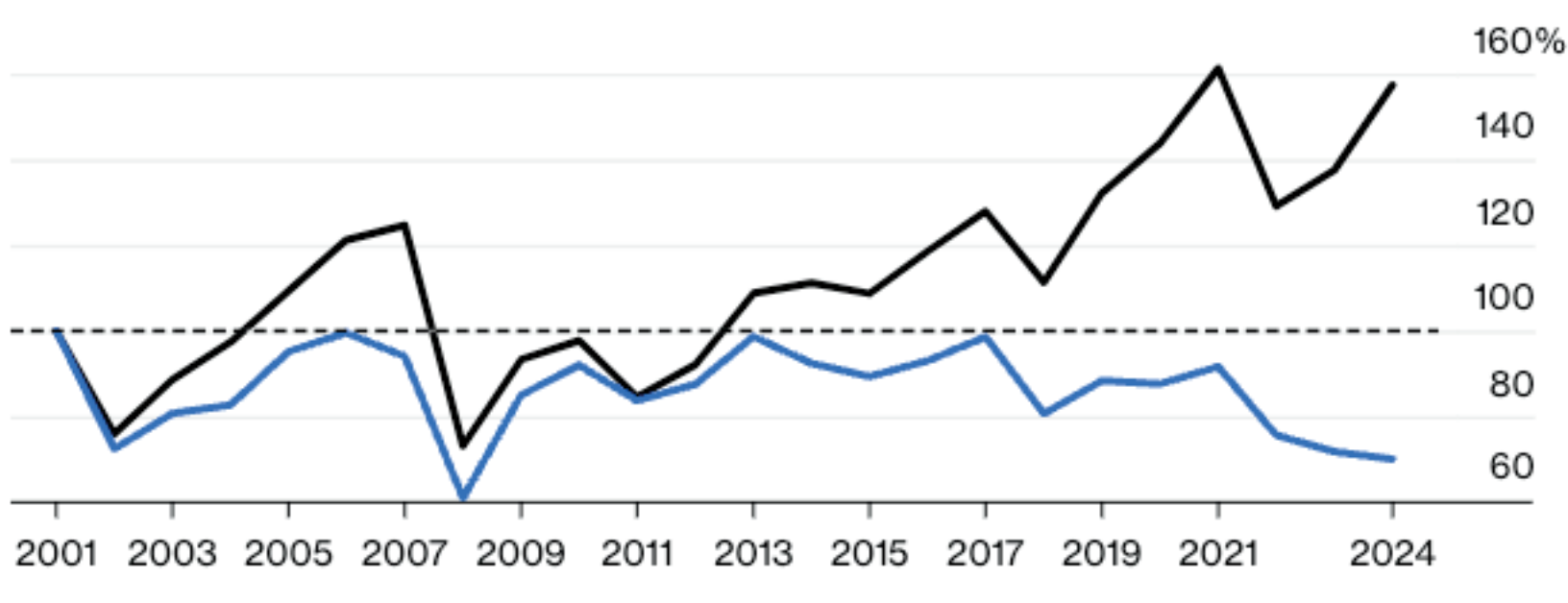
A single chart captures much of what has been wrong with British economic policy over the past two decades and is, sadly, a perfect illustration of this country’s seemingly inexorable economic decline, of which the latest market crisis is merely a further symptom. But there’s a way to begin breaking the cycle.

The chart shows the steady downward trend – some 30% since 2001 – in the UK stock market’s value relative to its gross domestic product; the same measure for its global peers over the same period increased by more than 50%. Had the UK merely kept pace with the average, the UK stock market’s value today would be more than double its current level – £5.5 trillion (\$6.7 trillion) versus £2.5 trillion – and today we’d be in the top five globally rather than outside the top 10.

### UK Stock Market Has Shrunk Compared With the Economy

British equities have fared much worse than their global peers

Market value of UK FTSE All Share as % of GDP Peer average



Source: Bloomberg, Office for National Statistics, World Bank via Ondra LLP  
 Note: Peers are US, Canada, Australia, Germany, France. Rebased to 100 from 2001.

This decline – unmatched in a Group of Seven economy – has two main components, which are in turn derived from the UK’s chronic lack of domestic savings and investment.

First, triggered by policy mistakes in the early 2000s, UK pension funds and insurers steadily liquidated their holdings in listed UK companies. This prompted an unprecedented yard sale of great UK companies, investments that had been built over generations being abandoned by their natural long-term owners. The remaining listed companies are, with limited exceptions, now in “harvest” mode. Starved of fresh growth capital, they rationally prioritize dividends, with yields usually double their US peers and correspondingly curtailed investment, leading to lower growth and depressed valuations - now at record discounts to peers. This is why so many fine British firms are easy pickings for foreign buyers; not a free-market outcome, but rather a direct result of decades of policy negligence regarding the deployment of the nation’s savings.

The second component is even more profound and unjust as its effect is infinite: The missing accumulation of value that should naturally accrue to domestic investors and savers from the UK’s bountiful new business formation, which spans a wide spectrum of dynamic sectors such as life sciences, artificial intelligence, robotics, materials science, aerospace and defense and the creative industries.

However, virtually all new wealth creation from this country’s innovations and startups is now captured by foreign capital. Take two examples: ARM Holdings Plc, which departed these shores in 2016 valued at around \$32 billion, and pioneering AI startup DeepMind. ARM is today listed on the US Nasdaq exchange with a market value of \$155 billion. DeepMind was acquired by Alphabet Inc. a decade ago to form the core of its AI division; AI has in turn helped drive Alphabet’s valuation to \$2 trillion. Even if only, say, 10% is attributable to AI, this \$200 billion compares with the \$400 million Alphabet is reported to have paid for DeepMind in 2014. So just two companies have effectively cost British savers and investors more than \$300 billion in lost value.

This has repercussions for the current malaise afflicting gilts and the pound. Britain’s dismal growth record and outlook matter more than its current fiscal position. UK per capita income has been more or less stagnant since 2007. Since economic growth is the most important variable for future tax revenue, according to the Office for Budget Responsibility, confidence in the outlook drives expectations for the fiscal position, and hence the government’s borrowing requirement and the clearing rate of interest to fund it.

So it’s no surprise that a budget that both increased taxes on business and reduced after-tax returns on new investment would reduce expectations for GDP – with a corresponding downgrade of future tax income that swamped the amounts raised by the budget measures. The UK is trapped in a recursive loop: A gloomy growth outlook diminishes expectations for fiscal revenue, driving up borrowing costs and prompting speculation about ... future tax increases.

There’s a partial solution available. Having decided to increase levies on business by increasing National Insurance contributions, half of that additional revenue – £12 billion, say – should be allocated for investment and management by the Pension Protection Fund (PPF).

The PPF is a state-owned asset pool with an infinite time horizon that’s generated average annual returns since 2006 of around 8%. The mandate would be clear: 75% of the fund’s assets would be allocated to domestic equity investment to begin restoring lost risk capital for infrastructure, mid-sized companies seeking global scale, investment in smaller listed companies and emerging technologies firms. By initially raiding the fiscal purse, the government could generate future economic expansion that would in turn bolster long-term tax revenue.

This bold, course-correcting change would deliver lasting benefits: a sustainable, investment-led improvement in GDP; an instant transformation of fiscal revenue into capital, breaking the confidence-sapping tax/spend cycle; and more efficient capital deployment through best-in-class professional fund management and monitoring. Most importantly, it would allow the public to once again begin to share in the wealth creation that springs from Britain’s extraordinary innovation capacity and entrepreneurial energy.

*This column does not necessarily reflect the opinion of the editorial board or Bloomberg LP and its owners.*

**Michael Tory** is a founder of Ondra LLP, a financial advisory firm in London and Paris.