

The question all UK pensions funds should be asking themselves: Does the case for investing in the UK stack up?

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The UK government's number one priority is to get wilting economic growth back on track. In fact, it's become somewhat of a fixation – almost akin to Tony Blair's 1996 mantra of education, education, education. And for good reason - kickstarting growth is the key to bolstering employment, raising living standards and generating much-needed tax revenue to pay for under resourced public services, notably the NHS, education, defence and social care.

A key focus of this dash for growth is to entice UK pension funds, with their vast resources, to invest in Britain. Along with measures to accelerate scheme consolidation and minimum fund sizes to create scale and enhanced governance, the premise is that this investment will improve saver outcomes via robust growth. So, this Britain-first policy, in effect, seeks to reverse the long-term decline in UK pension funds investing domestically, outside of UK government debt - a decline, in part, hastened by much more attractive investment opportunities available elsewhere.

But here's the thing – for anaemic growth to revert to its long-run trend means revitalising its two key components - labour force growth and productivity growth. Whereas post-war trend UK growth of around 2.25% per annum typically comprised 1% labour force growth and 1.25% productivity growth, for some time these numbers have almost come to a standstill. Then, of course, comes the double-edged question of sustainability. That is, keeping rejuvenated growth on track with environmental and social considerations front of mind. Indeed, generating sustainable growth that doesn't negatively impact people and planet is key if pension funds are to willingly subscribe to this Britain-first policy. More on that shortly.

The labour force challenge

Although in the short to medium-term, finessing monetary and fiscal policy can play its part in stimulating growth, in the long-run it's all about fixing and sustaining the fundamentals. However, the enormity of the task is brought home by a plethora of sobering statistics. For instance, over one fifth (9.34m/22.5%) of the UK's 43.2m working age (16 to 64) population – the principal income and wealth generators and taxpayers – are economically inactive.¹ Of these, over one quarter (26.8%) are aged 50 to 64 - a cohort whose vast knowledge, experience and skills are in danger of being permanently lost to the economy. Then there's the whopping 2.5m, one in 16 of the working population, classified as long-term sick, and almost one fifth (19%) of the UK's 67.6m population comprising those aged 65+ - a percentage forecast to steadily rise for decades to come.²

Granted, economic inactivity can largely be explained by those adults in full-time education, on parental leave, caring for others and those who've opted for early retirement, but it also includes those who may be involuntarily inactive - those wanting to work but failing to secure employment and, as noted, those suffering ill health. To further compound matters, the nation is experiencing

¹ See: [Economic inactivity](#) - Office for National Statistics. Also see: [Employment in the UK](#) - Office for National Statistics.

² [Estimates of the population for the UK, England, Wales, Scotland, and Northern Ireland](#) - Office for National Statistics.

rising morbidity, or falling healthy life expectancy, principally as a consequence of poor diet and lack of exercise. Indeed, the average English female can only expect to live a healthy life until she's just into her 60s (61.9 years) – though this average disguises significant regional differences.³

In addition, although the UK's labour force participation rate and employment rate exceeds that of its two main comparators, the US and eurozone (though not Germany), post-covid both rates have been almost static in the UK, in contrast to the steady growth seen in the US and eurozone.⁴ Furthermore, the UK labour force's replacement rate continues to be compromised by the UK's long-standing sub-par birth rate - this difference no longer being plugged by net international migration – with the latter now adding less than 200,000 workers to the annual total.⁵ That said, the ONS is projecting net migration to be the only source of population growth in the UK over the next 25 years, with a projected net increase of 4.9m by 2032. Of these, 4.1m will be of working age, so will potentially add to the UK's labour force total, albeit with growth initially expected to decline, before accelerating from 2028.⁶

So, as things currently stand, less than half the population is supporting the needs of a population which is increasingly ageing and not as productive or healthy as it could be. Moreover, with an ever-narrowing tax base, seemingly inventive approaches are being employed to tax the same pool of people in many different ways. That in itself is unsustainable and particularly unattractive to the young, many of whom are free to seek employment opportunities elsewhere.

In other words, much needs to be done on a number of fronts if labour force growth is to be restored to its long-run potential, and the nation's public finances are to be put on a more even keel. No easy task and certainly not one that can be fixed in the short term. So far, not so good. Pension funds take note.

Productivity growth to the rescue?

Given the challenging headwinds facing the labour market, enhancing productivity, or growth in output per hour worked, might seem to be the more feasible way of boosting economic growth, at least in the medium term.

The key to robust productivity growth is manifold, comprising a healthy flow of investment in infrastructure, R&D, new technology, innovation and human capital. However, it's also predicated on

³ See:

<https://www.ons.gov.uk/peoplepopulationandcommunity/healthandsocialcare/healthandlifeexpectancies/bulletins/healthstatelifeexpectanciesuk/between2011to2013and2021to2023>

⁴ Indeed, this is most evident in the eurozone where, according to the European Central Bank (ECB) "sustained labour force growth in the post-pandemic period has incentivised firms to get new workers on board to address actual or expected labour shortages. The labour force participation rate has risen above pre-pandemic levels, driven primarily by transitions from inactivity to employment. Women, older workers, persons with a higher education and foreign workers have contributed the most to this increase. Faced with the possibility of labour shortages, firms hired these additionally available workers by way of precaution, despite subdued economic activity." See: Explaining the resilience of the euro area labour market between 2022 and 2024. [ECB Economic Bulletin, Issue 8/2024](#). Also see: [Labour Market Situation, Q" 2024 - OECD News Release, January 2025](#)

⁵ See: [Long-term international migration, provisional - Office for National Statistics](#)

⁶ See: [National population projections - Office for National Statistics, 28 January 2025](#). Births and deaths to 2029 are expected to cancel each other out, at which point deaths will start to exceed births, with this gap projected to accelerate to 1.1m by 2047. Also see: Cumulative fiscal impact of representative migrants. OBR. September 2024. Chart 4.13 p.4. This shows that attracting average and high wage migrants is projected by the Office for Budgetary Responsibility (OBR) to be strongly fiscal positive.

business confidence which, in turn, is a function of consumer demand, entrepreneurial spirit and a willingness to disrupt.

Alas, the short-termism and resulting inadequate investment in many of these areas in recent decades has culminated in a multi-faceted problem, effectively condemning swathes of the UK economy to an unenviable doom loop of low skills, low wages and low productivity. Indeed, while lower productivity growth has pervaded globally, most notably post the 2008 global financial crisis and the 2020/21 covid pandemic, many refer to the UK's lacklustre productivity, certainly in comparison to the US, Germany and France, as the productivity puzzle. But it really isn't. Indeed, six factors really stand out, all of which need to be reversed, if UK productivity growth is to get back on track:

1. The most obvious, and the government's principal target for pension fund money, is to fix the chronic underinvestment in infrastructure and to support the energy transition – measures that could potentially and dramatically transform the UK. Highly visible in many aspects of British life, the result of this underinvestment is a crumbling, antiquated infrastructure, operating inefficiently at sub-scale, unable to cope with the demands of modern living and a rapidly growing, ageing and increasingly unhealthy population. A failure by successive governments to properly forecast the demand for, plan and cost infrastructure projects, many potentially transformative projects have been the casualty of unwarranted lengthy delays to implementation, while others have been cut short given overly complex contracts and significant cost overruns. In short, as a country, we haven't been good at building the things that really matter. The energy transition, better transport links, refurbishing and building hospitals and dramatically improving water security and the treatment of sewage are but a few of the areas which require substantial cash injections if living standards *and* the quality of life – the two not being synonymous - are to benefit.
2. Two is a failure, by both successive governments and business, to enable human capital to really flourish. Indeed, the quality of state primary and secondary education and the rising cost of tertiary education have long been political hot potatoes, as has ensuring that education translates into transferable skills for the workplace and adult life more generally. Moreover, the subrogation of apprenticeships, since the targeting of 50% of 18-year-olds to attend university, has not only culminated in a shortage of essential skills, since exacerbated by Brexit, but has also resulted in the dilution in the worth of many university degrees. Redressing the balance in favour of apprenticeships, by incentivising employers to make more apprenticeships available, must surely be the way forward. However, the real blocker to unlocking the full potential of human capital in the workplace remains the sheer number of unmeritocratic and dysfunctional organisational structures and poorly led organisations that populate the UK.⁷

So, not only do education and vocational skills need to be continually honed, made more accessible and more relevant to the workplace for organisations to function more efficiently and effectively, but genuinely meritocratic and empowering organisational structures also need to be

⁷ A moot point, that warrants further investigation, is the phenomenon of "job blocking" by those having to work longer owing to inadequate defined contribution pension pot sizes. Currently, only 10.5% of those aged 65+ in the UK are employed, in contrast to the 18.9% of those aged 65+ in the US. See: OECD (2023), OECD Labour Force Statistics 2022, OECD Publishing, Paris, <https://doi.org/10.1787/dc0c92f0-en>.

adopted, along with better thought through organisational values, hybrid working policies and higher quality leadership. Change must come from and at the top. Seemingly compounding the unmeritocratic nature, and therefore the productivity, of numerous organisations is the contention that many diversity, equality and inclusion (DEI) policies have been ill thought through, half-baked, and treated as a tick box exercise. While initially well intentioned, to improve equality of opportunity and cognitive diversity, it is increasingly suggested that many DEI policies have lost their way. Moreover, by becoming loaded with bias, many have compromised how countless organisations function.

3. Three, closely linked to having a stable educated population, is acknowledging and addressing the, relatively poorly documented, extent to which the breakdown of the family unit sows the seeds of destruction for future growth by undermining the life chances of those children and young adults at the centre of family breakups. Stable family units really are the bedrock of a productive society.⁸
4. Four, and closely linked to two, is a reluctance to properly embrace the enormous potential of artificial intelligence (AI) to better absorb and exploit knowledge, innovate and develop more efficient processes. Being at the forefront of harnessing the full potential of AI, in acting as a complement to, not as a replacement for, human capital is crucial in securing the long-term health of the economy. Indeed, the ever-widening gap in US versus UK productivity can be attributed in large part to the differences in R&D and advanced technologies spending.⁹
5. Five, the UK seems to have lost its mojo, with business investment growth having stalled since 2016.¹⁰ Restoring flagging business confidence, while rekindling an entrepreneurial spirit and a passion for disrupting, akin to that seemingly normalised in the US, is much needed.
6. Finally, six, is addressing overly burdensome regulation. While much regulation is in place for good reason - to protect the populous from harmful and often dangerous practice - much regulation is outdated, unduly cumbersome, inadequately enforced and productivity-sapping. Some has resulted from poorly executed initiatives, such as Brexit and the stultifying productivity-sapping processes that have ensued. Financial regulation has already come under the microscope for this very reason.

Meeting pension fund thresholds

As previously stated, the UK government has suggested that UK pension funds, both public and private, when operating at scale, could invest meaningful sums principally in infrastructure but also in productive capital, such as potentially high growth start-ups. However, there are a number of points for pension schemes to consider.

Firstly, successfully managing a pension scheme is a complex integrated risk management exercise with myriad moving parts which, against the backdrop of heightened geopolitical tensions and

⁸ See: [Economic Growth - Hansard - UK Parliament](#). See columns 1832 and 1833.

⁹ See: [Analysis of Productivity and Growth Disparities between the United States and Europe \(2010 – 2023\)](#). Economics Online. 9 December 2024.

¹⁰ See: [Can Rachel Reeves boost the UK's weak economic growth?](#) Financial Times. 29 January 2025.

increased systemic and macro risks, is about building and maintaining resilience through diligent diversification. This means assuming the right risks, at the right size and at the right price over an appropriate timeframe. While timeframe isn't a major constraint for most defined contribution (DC) schemes, for defined benefit (DB) schemes it increasingly is, especially for those better funded schemes targeting buyout over run on.

Then there's an ever-increasing emphasis and regulatory focus on pension schemes managing and reporting on myriad and impactful scheme Environmental, Social and Governance (ESG) risk factors, many of which, such as climate change and nature and biodiversity loss, are systemic, and therefore pose material financial risks. As such, these risks cannot be underestimated by government, in its pursuit of growth, if pension funds are to help finance a Britain-first growth strategy.

Ultimately, however, prospective risk-adjusted returns must be commensurate with the risks assumed and measure up against the many investment opportunities available elsewhere, while diversification considerations mean each asset must seek to do something differently to other assets in the portfolio to avoid a concentration of risks.

Although a glaringly obvious impediment to investing in the UK are the manifold risk factors that are constraining economic growth, two things should be acknowledged. Firstly, that investment opportunities, such as social infrastructure, are not wholly contingent on robust growth, and secondly, that while investment returns, more generally, are not wholly driven by economic growth in the short to medium-term, there is a strong long-term correlation. Hence why the US, with its perennially strong labour force and productivity growth, continually trumps the UK in this regard and increasingly dominates world equity market capitalisation.

Also, fiduciary duty, as currently defined, means that UK pension scheme fiduciaries are compelled to act in beneficiaries' best financial interest. This is narrowly interpreted as seeking out the best expected short-term risk-adjusted returns and only taking account of financially material factors in investment decision making. This doesn't include investing for the warm glow of patriotism or even doing social good unless this obviates a material financial risk factor. That is, one which could materially impact risk-adjusted returns - such as addressing the systemic nature of climate change, nature and biodiversity loss and income inequality - albeit none of these themes are likely to maximise short-term risk-adjusted returns. And therein lies the paradox of fiduciary duty as currently defined.¹¹

So, the answer to the question is?

While it is easier for the government to compel public sector pension funds to increase their exposure to specific UK assets, by contrast, and in the absence of a statutory override to scheme rules, private sector funds are free to evaluate the merits of investing in the future of the UK.¹²

¹¹ See: <https://www.pensions-institute.org/wp-content/uploads/Reforming-Fiduciary-Duty-Wagstaff.pdf>

¹² That said, it's perfectly conceivable for the UK Treasury to pose a quid pro quo to private sector pension funds, along the lines of invest an extra [x]% p.a. into specific UK assets over [y] years and we'll continue to pay tax relief on member contributions. If you don't, then tax relief will cease.

However, all pension funds need to ask themselves the question whether the case for the UK as a viable long-term investment medium stacks up, especially given the lengthy timeframe over which any monies will need to be committed and the ever-increasing need to identify and manage ESG risk factors.

In addition, pension fiduciaries need to weigh up whether the UK offers better relative value than competing opportunities elsewhere. It's certainly the case that UK publicly quoted equities stand on lower valuations than many peers, not least the US - not that investing in liquid securities is what the government has in mind for pension funds. However, this is helpful in thinking about relative value, as is weighing up whether all of the structural headwinds faced by the UK, relative to its peers, and the likelihood of each being addressed, is fully priced into valuations.

Of course, for pension fiduciaries to invest meaningful amounts in UK infrastructure in particular, will not only require the government to make sufficient investable opportunities available but to also demonstrate the ability, or perhaps even guarantee, to deliver projects on time and on budget. As to investability, for DC schemes in particular, there's the practicalities of plugging platform-based, life wrapped and daily dealt structures into these projects. This is where active asset managers may well have a fundamental role to play in aggregating funds and making projects investable.

So, perhaps predictably, with so much to consider, given the sheer number of ifs, buts and maybes, the answer to the question all pension fiduciaries should be asking themselves is far from clear cut. As such, it's unlikely to be a quick and easy win for the UK government and one that will, perhaps inevitably, require more thought to be given to the potentially transformative financing of the nation's infrastructure and seedbeds of growth.

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