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Fiscal Rules Should Serve Britain's Future

BY MARIANA MAZZUCATO · MISSION ECONOMICS BY MARIANA MAZZUCATO · 23
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Earlier this month, in his first major speech as the UK's new Chancellor, John Healey stood in Coventry and reiterated his commitment to "fiscal discipline". It is not hard to understand why: the UK faces high borrowing costs and weak growth alongside the intense pressure to fund defence, infrastructure and public services. This month, ten-year gilt yields hit their highest level since 2008 and thirty-year yields touched levels not seen since 1998, reflecting changing expectations around medium-term borrowing costs and longer-term fiscal credibility, respectively.

Much of the rise in gilt yields since the summer reflects a global repricing of long-term debt, not a UK-specific problem, as bond markets reassess debt sustainability and fiscal trajectories across every major advanced economy. Within that broader move, renewed conflict in the Middle East and the resulting oil-price surge are one thread further pushing up expectations around inflation and BoE rate rises, thereby making every pound the UK borrows more expensive.

The temptation with borrowing costs like that is to treat the fiscal rules as the central problem to be solved: find enough headroom, stay within the numbers and hope that growth eventually follows. I would argue for the opposite starting point. Fiscal rules matter. But they should be designed to serve an economic strategy, not substitute for one.

It would be a mistake to let this global background cloud a bigger domestic story: the scale of the UK's underinvestment problem. For most of the last three decades, the UK has had the lowest level of total investment — public and private combined — in the G7 (CITE IPPR, 2024). Business investment by private companies is lower than any other country

in the G7, and the UK ranks 28th out of 31 OECD countries on business investment. The last time the UK was the median country in the G7 for private investment was 2005; had it stayed there, UK businesses would have invested an additional £354 billion between 2006 and 2021. Public investment has fared little better. UK public sector investment has averaged 2.6% of GDP over the past 25 years, against a G7 average of 3.5% and an OECD average of 3.7%. Had the UK invested at OECD-average levels over the past two decades, it would have deployed an additional £500 billion of public money.

The UK is not a country that has borrowed and spent too freely. It is a country that has underinvested for a generation and is now paying the price – ironically, by generating precisely the fiscal vulnerabilities like weak productivity growth that make investors in gilts nervous in the first place.

The most important question for a government is not simply whether debt is falling as a percentage of GDP. It is whether the economy is becoming more productive, more resilient and better able to generate the revenues that make public finances sustainable in the first place. A government can balance its current budget while starving the economy of investment it needs to create an inclusive, sustainable and resilient economy over the long term. That is not fiscal prudence but deferred failure.

The UK's move from public sector net debt (PSND) to public sector net financial liabilities (PSNFL) was therefore a step in the right direction, and created roughly £50 billion of additional headroom. PSNFL recognises a wider range of financial assets and liabilities; if government borrows to make a loan or acquire an equity stake, the resulting financial asset can be set against the liability. This creates more space for public investment than the old debt measure did, and the Treasury itself argues that this allows investment which supports growth while generating a return for the Exchequer.

That logic points directly to a greater role for public banks. Our new report, "Coordinating and Scaling the UK's Public Finance Bodies," asks whether the wider public finance ecosystem - fiscal rules included - is fit for purpose. In the same vein, this month, a coalition of trade unions, environmental groups and think tanks called on the Government to scale up the National Wealth Fund (NWF) into a fully fledged national development bank. The gap is significant: the NWF can currently invest up to £5.5 billion a year, while Germany's KfW lent €62 billion in 2025 alone. Because public bank lending and equity stakes create financial assets, a larger NWF with the independence to raise its own finance and invest over the long term would be consistent with the fiscal rules, and could steer far more private capital than public spending alone.

But Healey should not stop there. PSNFL remains a financial measure. It does not fully capture the productive value of a railway, a stronger electricity grid, a healthier population, a skilled workforce or a research ecosystem. These capabilities may not appear on the public balance sheet the way a financial asset does, yet they can determine the future size and resilience of the economy.

There is a clear implication for the government's public-control agenda: because PSNFL only nets off financial assets like loans and equity stakes, taking physical assets directly onto the balance sheet – like a nationalised steelworks, energy generation capacity built and owned outright, or social housing held directly – still counts as pure debt, with no credit for the asset itself. That makes the case for adopting public sector net worth (PSNW), which does capture non-financial assets, more urgent. Otherwise, the accounting framework structurally penalises exactly the kind of direct public ownership that public control implies.

So, the test for public investment should be more demanding than “does this fit inside the fiscal rule?” Healey should be asking: What capability are we creating? What productivity gain could it generate? What private investment could it crowd in? What future public costs might it reduce? And, crucially, who captures the returns? This last question is essential. Public investment should not simply socialise risk while allowing private actors to capture all the upside.

That is why I would not advocate simply “borrowing more”, but instead borrowing differently. Britain should protect investment that expands productive capacity in areas such as housing, energy networks, transport, research and development, digital infrastructure, skills and preventative health. But public money should come with conditions where appropriate such as equity, royalties, intellectual-property arrangements, and domestic supply-chain commitments. Rather than simply de-risking private capital, conditionalities help shape the direction of investment and terms of investment, ensuring that the public shares in the value it helps create.

This is also why Britain needs missions rather than a shopping list of projects. Consider energy. A mission to build a clean, secure and affordable energy system can coordinate investment in grids, storage, renewables, nuclear, efficiency and industrial decarbonisation. The objective is not to spend a predetermined sum. It is to change an outcome. The same approach can be applied to housing, health, artificial intelligence and regional development – conditional on having a state with the right capacity and dynamic capabilities to deliver it.

There are global lessons here too. As I argue in *The Entrepreneurial State*, the United States did not become a technological powerhouse because government simply withdrew and let markets work. Public institutions financed and coordinated high-risk research and helped create technologies that private firms later commercialised. East Asian economies similarly used strategic public investment to build industrial and technological capabilities. The lesson is not that Britain should copy another country's institutions, but that successful economies have often treated the state as a market-shaping investor, not merely a passive purchaser of services.

Of course, there is a legitimate danger here. Once “investment” becomes a magic word, politicians can label almost any spending as investment and borrow without discipline. That is why the answer is not to abandon fiscal rules but to improve them. Britain needs a credible fiscal anchor, independent scrutiny, and much stronger evaluation of the quality of investment. Government should have to demonstrate that major investments are strategically coherent, deliverable, and capable of generat-

ing economic and social returns rather than simply fitting inside a spending envelope.

This is where the ‘mission approach’ comes in: without a mission, private investment is only commercialisation. With a mission, strategic public investment crowds in private investment to solve real world problems for people and planet – directing growth rather than generating growth for growth’s sake. Starmer adopted missions but got it wrong from the start: growth is not a mission; it is the result if missions succeed in catalysing cross sectoral investment towards achieving goals. Growth is a function of investment and innovation, so if missions can help catalyse investment to solve key problems such as fostering health and wellbeing for all, protecting the climate and biodiversity, reducing the digital divide, reducing hunger and poverty – then we succeed in fostering growth while solving key problems that matter to people and planet.

Healey should therefore resist the false choice between fiscal credibility and public investment. Credibility does not come only from cutting expenditure until a spreadsheet balances. It also comes from demonstrating that public money is building an economy capable of sustaining prosperity and – at a moment where bond markets are heavily influenced by geopolitical risk – from building an economy that is less exposed to that risk in the first place. The government’s own framework already recognises that well-directed investment can catalyse private investment and generate a return for the Exchequer. The next step is to make that principle the centre of fiscal policy, not a footnote to it.

Britain’s greatest fiscal risk may not be that it borrows too much today. It may be that it invests too little, grows too slowly, and discovers tomorrow that its tax base is too small to support the services and security its citizens expect. The answer is neither austerity nor unlimited borrowing. It is a different definition of fiscal responsibility: one that distinguishes consumption from investment, measures the creation of productive capacity, demands a public return when the state takes risk, and uses government to shape markets – including energy markets – towards clear national missions.

If Healey thinks that it is politically expedient to meet the fiscal rules, he should. But he should also ask a more fundamental question: what kind of economy are those rules helping Britain to build? The purpose of fiscal policy is not to win a quarterly argument with the bond market. It is to create the conditions for long-term prosperity. Fiscal rules should be the guardrails. They should not be the destination.

Will you be at Labour Party Conference 2026?

I’ll be discussing these ideas to Labour Party Conference in Liverpool on 28 and 29 September, where I’ll present our new report on the UK’s public finance eco-system, Coordinating and Scaling the UK’s Public Finance Bodies to Support Mission-Oriented Industrial Strategy, at Positive Money’s New Economy Fringe panel on the opportunity for public financial institutions in the UK.



Mariana Mazzucato at Labour Party Conference
27-28 September 2026

Mariana Mazzucato | Professor, Economics of Innovation and Public Value, University College London;
 Founding Director, UCL Institute for Innovation and Public Purpose

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Mon 28th Sept

EVENT | Powering prosperity: Driving growth, energy security and affordability through industrial strategy, in Partnership with the National Grid
 10:30–11:30 (BST) | Open | Good Growth Foundation Pod, Dee Room, Lower ACC Hall (inside secure zone), Liverpool L3 4FP

EVENT | Towards A New Economic Model: How can UK businesses deliver good growth that benefits people & planet?
 15:30–16:20 (BST) | Open | Auditorium 1b, LEX (formerly, ACC) (inside secure zone) Liverpool L3 4FP

EVENT | Investment in every postcode: The opportunity for public financial institutions
 17:00–18:00 (BST) | Open | Quaker Meeting House, 22 School Lane, Liverpool L1 3BT

Tues 29th Sept

EVENT | The Extreme Wealth Challenge (Oxfam / War on Want)
 09:00–10:00 (BST) | Open | The Hilton, opposite LEX (formerly, ACC), Liverpool, L1 8LW

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Coordinating and Scaling the
 UK's Public Finance Bodies
 to Support Mission-Oriented
 Industrial Strategy

UCL IIPP REPORT September 2022

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Across the two days I'll also be joining the Good Growth Foundation and National Grid to discuss how industrial strategy can drive growth, energy security and affordability; the New Statesman and B Lab UK on how businesses can deliver good growth for people and planet; and Oxfam and War on Want on the growing concentration of extreme wealth and the policy responses it demands.

Across conference, I'll be sharing research, findings, and recommendations from our research project at UCL IIPP, Reimagining the state for the green transition: theory and practice, which is rethinking how government can align fiscal, industrial and financial policy, and redesign tools such as public procurement and public finance, to deliver the UK's net zero missions while creating good jobs and sustainable growth. If you're at conference, do come and say hello.



Coordinating and Scaling the UK's Public Finance Bodies to Support Mission-Oriented Industrial Strategy

IIPP POLICY REPORT September 2026

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Mazzucato, M., Pick, A. and Emerson, A.H. (2026). *Coordinating and Scaling the UK's Public Finance Bodies to Support Mission-Oriented Industrial Strategy*. UCL Institute for Innovation and Public Purpose, Policy Report Series (Policy Report 2026/06). ISSN 2635-0122.

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How to mitigate AI's systemic risk

BY CHRIS HUGHES · MARKETCRAFT · 23 SEPTEMBER 2026

I have an article in today's *Financial Times* arguing that the best model for overseeing frontier AI is something we already do with banks: supervision. Both are critically important industries where we have to weigh systemic risks against gains from innovation.

As in banking, AI supervisors would embed inside the firms to ensure the humans and agents building these systems to focus on preventing bad behavior. They would run stress tests to check that a system can be reined in if it ever threatens social stability. And they would have the power to discipline non-compliant firms should that be necessary.

The full piece is below — would love your thoughts.

What AI should learn from the banks

Both industries change rapidly and reach throughout the economy, requiring officials to weigh the benefits of innovation against risks

Dario Amodei wants independent evaluators to have desks inside AI companies. In his essay on the need to pace the frontier, Anthropic's chief executive promises outsiders key cards, laptops and nearly full access so that they can monitor how the company's systems are working in real time rather than simply testing them before release. He makes the case for governments to formalise this arrangement, pointing to bank supervision as a precedent.

It is a good comparison. Like AI, banking changes rapidly and reaches across the economy, forcing public officials and private firms to continually weigh the benefits of innovation against its risks. The Federal Reserve, FDIC and the Office of the Comptroller of the Currency (OCC) all embed teams inside the commercial banks they supervise to learn how the businesses operate and where their weaknesses lie. These supervisors meet with staff and management, review internal documentation and keep up with day-to-day operations. Their job is to assess whether leadership is adequately managing risk in accordance with regulation — not just whether paperwork is in order. If they are not, supervisors can require the bank to fix the problem.

The need to adopt a similar approach to AI has never felt more urgent. This summer, AI agents showed they have become increasingly clever, coordinating with one another to meet their goals. Hacks illustrate how a lapse in oversight can spill into systems entirely outside a lab's realm of operation.

Under a supervisory approach modelled on bank supervision, each frontier AI lab would work with a team of supervisors who understand its

technology. Embedded from the start in model design and review, supervisors would ensure the humans and agents building these systems are adequately focused on preventing bad behaviour.

Supervisors would also oversee stress tests for the models. Each year the largest banks must show how they would fare in a severe downturn, against scenarios the Federal Reserve updates and (until recently) has kept confidential so banks cannot train for the test. AI systems will pose their own systemic risk if they manage to gain control of electricity, payment or transportation systems. A stress test would require each company to show that its staff could still override or shut down a model under those conditions, against scenarios the company has not seen in advance.

We need to learn lessons from the success or failure to regulate other sectors. Policymakers failed to regulate social media because they were overwhelmed by the range of problems, ranging from teen mental health to privacy and misinformation. The challenges of AI can be similarly intimidating, but Congress does not need one massive bill to deal with AI. Instead, it should start with the most pressing concern today — model safety — and go from there. The work will require a regulatory agency, perhaps called the Office of AI Supervision, to translate requirements into rules.

Bank supervision is far from perfect. Officials have sometimes identified dangers and then failed to act. In other cases, leadership has attempted to strip discretion out of supervision altogether, reducing it to the completion of narrowly configured checklists. Supervisors can become compromised or “captured”, causing them to inaccurately assess the nature of risk.



The FDIC supervises the nation's banks in conjunction with the Federal Reserve and the OCC.

To mitigate these challenges, an AI agency would need staff who understand the technological paradigm and are unafraid to bring their power to bear. Senior examiners should rotate between companies, just as they do in banking. The OCC caps an examiner-in-charge's tenure at a single bank at five years. Given how fast AI moves, three would work better.

Congress has already started to consider these ideas. The bipartisan Frontier Act, which OpenAI has partially endorsed, would require the largest AI companies to retain federally licensed assessors for ongoing safety reviews. But this stops short of public supervision. Companies could hire their own assessors, risking the conflicts that compromised credit rating agencies before 2008. No independent supervisory agency would be charged with overseeing the labs, and there would be no embedded supervisors as in banking.

AI holds enormous promise, and like any other technology it brings risks that have to be managed. A bank supervision model for AI regulation creates a way for public officials and private experts to assess those trade-offs together, while ensuring that the companies profiting from a decision are not its only judges.