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Official Monetary and Financial Institutions Forum
6-9 Snow Hill, London, EC1A 2AY
T: +44 (0)20 700 27898
enquiries@omfif.org
omfif.org

ABOUT OMFIF

With a presence in London, Washington and New York, OMFIF is an independent forum for central banking, economic policy and public investment – a neutral platform for best practice in worldwide public-private sector exchanges.

EY TEAM

Mark MacDonald, Global Public Finance Management Leader

Caroline Vasques, Global Senior Analyst, Government and Infrastructure

Richard Hall, Global Communications Lead, Government and Infrastructure

Sedat Ersoy, Senior Economist, Valuation, Modelling and Economics

AUTHOR

Andrea Correa, Senior Economist, OMFIF

With support from Conor Perry, Economist, OMFIF

In collaboration with Udaibir Das, Distinguished Fellow, formerly International Monetary Fund and Member of OMFIF's Advisory Council

OMFIF TEAM

Sarah Moloney, Editorial Director

Simon Hadley, Director of Production and Development Planning

Janan Jama, Content Editor

Prerna Kala, Editorial and Marketing Assistant

Ophelia Mather, Marketing Coordinator

Avnish Patel, Senior Programmes Manager

Ben Rands, Managing Director of Operations and Marketing

CONTENTS

A NEW FRAMEWORK FOR FISCAL EFFECTIVENESS

Accelerating the shift from a spending mindset to an investment mindset.

By Mark MacDonald, Global Public Finance Management Leader, EY

It's not news to anybody that many governments in charge of large economies around the world are in a fiscal fix. We all know the underlying problems – demographic change driving demand for spending, the necessity to invest more in defence and the climate transition, higher debts and borrowing costs – and the world doesn't need another report setting out the risks and challenges.

Policy-makers must consider fresh thinking and new solutions. And this is what OMFIF and EY have sought to offer through our joint programme of research and inquiry over the past year, which culminates in this report. 'Investing for a productive state' is the fourth instalment of 'The future of public money' project by OMFIF and EY.

Here, we present evidence, based on EY economic modelling, that supports a powerful new strategy: as demographic shifts bring attrition in the public-sector workforce, policy-makers should divert funding to investment in digital and technological capital. We have established a business case forecast that this redirection of resources will lead to productivity gains in the public sector, growth in the wider economy, increases in government revenue and improvements to fiscal competitiveness.

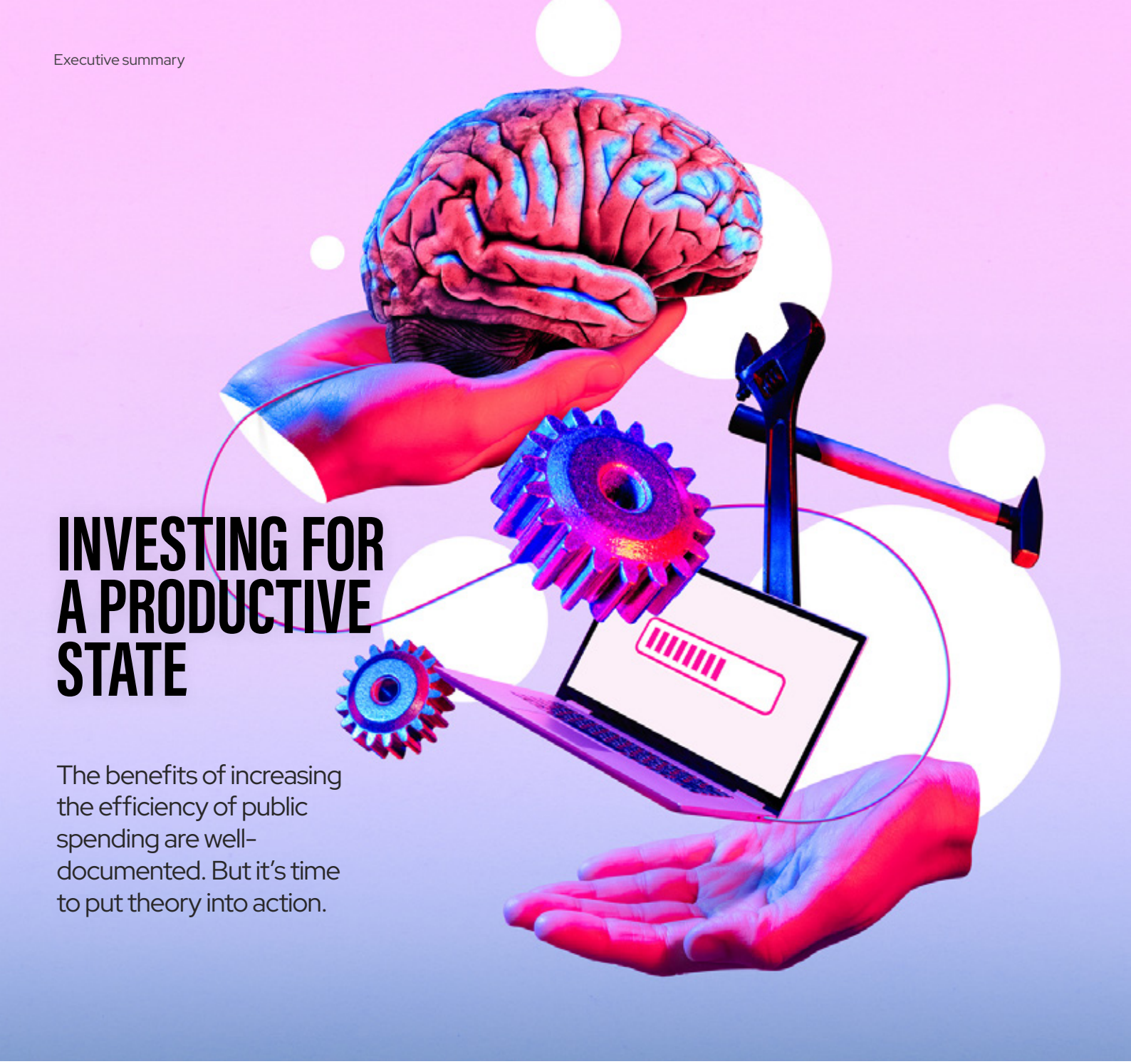
We hope this report can help reframe public finance by accelerating a shift from a spending mindset to an investment mindset – so the debate moves beyond budgeting cycles towards a new model for how governments invest for prosperity.

We would like to extend our warmest thanks to OMFIF and members of its network, public finance experts and practitioners, and colleagues across the EY organisation who have generously contributed their ideas and perspectives to this report.

How well governments invest public money to improve public outcomes matters greatly to citizens and communities around the world. This is a vitally important debate, and it is one we are determined to help advance. ■

The views reflected in this foreword are the views of the author and do not necessarily reflect the views of the global EY organisation or its member firms.

'How well governments invest public money to improve public outcomes matters greatly to citizens and communities around the world.'



INVESTING FOR A PRODUCTIVE STATE

The benefits of increasing the efficiency of public spending are well-documented. But it's time to put theory into action.

Governments across advanced economies face a fiscal trilemma: ageing populations demand more services, climate and security needs require massive investment, yet increasing debt levels limit action. In an era of fiscal constraint, creating lasting public value becomes a fundamental challenge.

Traditional measures of fiscal sustainability, focused on budgets, deficits and debt ratios, fail to capture whether government spending actually delivers impact for citizens and the broader economy. Traditional responses, such as austerity or expansion, fail because they ignore the quality of the public expenditure.

This report presents a new framework for fiscal effectiveness. Public money serves multiple purposes, ranging from income redistribution to the provision of direct services. For the purposes of this report, we focus on public administration and direct service provision as the production function of the state; we do not examine alternative conceptions of income redistribution.

Governments must measure value by linking expenditures to real-world outcomes, not just compliance. Modelling scenarios of alternative public funds

allocation reveals where investments yield the highest returns. Mobilising capital through credible, accountable institutions enables both public and private resources to be directed towards investments that fuel growth, fiscal resilience and social progress.

Institutions like the International Monetary Fund have documented the benefits of closing public spending efficiency gaps and the gains to be made in redirecting resources to productive investments. This report aims to take that further. Through empirical modelling, the report illustrates that the strategic allocation of public resources towards productive investments can simultaneously enhance growth, reduce debt and improve competitiveness.

Empirical analysis of 10 western European countries demonstrates the magnitude of this opportunity. Redirecting, on average, 2.5% of gross domestic product to digital and technological capital over the next 30 years can generate a multiplier effect of around three times over the same time horizon, indicating that every dollar invested generates $3 in GDP over time. Strategic allocation towards digital and technology investment can reduce debt-to-GDP ratios by 5% by 2036 and 8.6% by 2055, while also boosting productivity and fiscal competitiveness.

Leveraging the advantages of demographic change and natural retirement attrition of the public-sector workforce can account for all required investment resources from labour to productive capital, ensuring a smooth transition without disruptive workforce cuts. Repurposing existing borrowing can support productive capital investment while maintaining fiscal discipline.

A new fiscal paradigm is within reach. By adopting an investment mindset, measuring outcomes rather than outputs, modelling alternative allocations of public funds and mobilising capital through strong institutions, governments can transform fiscal systems from instruments of control into engines of sustainable prosperity. ■

QUOTES

'We spend so much time around the discourse of public budgeting, of public finance management, around the administrative components of that. But perhaps incomplete in that discourse is whether we are actually achieving the intended results.'

Mark MacDonald, Global Public Finance Management Leader, EY

'The engagement with the private sector and the local community is absolutely vital. The first thing is to accept the fact that, without the private sector, long-term, durable change will not happen.'

Udaibir Das, Distinguished Fellow, IMF

'What we are really looking for now is what those dollars are achieving, and some of those things are actually achievable very quickly; it's not all about the longer term.'

Dean Yates, Regional Market Segment Leader in Government and Health Sciences, Oceania, EY

'Outcomes should not be seen as narrow or for specific departments or ministries, but actually much more cross-cutting. Governments are trying to move away from the relatively short-term cost benefits analysis and more into systems thinking.'

Rainer Kattel, Deputy Director and Professor of Innovation and Public Governance at the University College London Institute for Innovation and Public Purpose

'Thinking about the labour capital trade-off in terms of technology adoption and innovation, it's going to be critical moving forward.'

Mauricio Zelaya, Partner and National Economics Leader, EY Canada

'Generally, the frameworks that have been well received provide transparency on what the objectives are, clarity in the mode of investment and monitoring to make sure that, over the lifetime of the investments, things have been going as planned.'

Marie Diron, Managing Director, Sovereign Risk, Moody's Ratings

'Rather than focus on process, you focus on outcomes and all of a sudden, a lot of other possibilities open up.'

Andrew Kleine, Managing Director, Government and Public Sector, EY

'You have to hardwire fiscal discipline into the institutions as you manage a fiscal crisis. So that's looking at building a multi-year financial plan to see how you can be financially viable and stable as an entity, and doing it transparently and inclusively.'

Adam Chepenik, Principal, Government and Public Sector, EY

THE SEARCH FOR REAL-WORLD IMPACT

Fiscal sustainability depends not only on how much governments spend, but also on how effectively they turn spending into lasting public value.

KEY FINDINGS:

1. Effective, transparent and accountable institutions enable better prioritisation and greater returns from public investment.
2. Sustainable public finances require a focus on both spending efficiency and growth and productivity.
3. Shifting fiscal policy towards value creation redefines the state's role as an impact generator, not just a budget controller.

ACROSS advanced economies, governments spend roughly the same share of gross domestic product on health, yet outcomes diverge sharply. Countries with comparable levels of spending can see life expectancy differ by as much as a decade. This efficiency gap highlights a broader challenge in public finance: how effectively public funds translate into real-world value for citizens.

Last year's report, 'From fiscal fantasy to reality', began this conversation by challenging conventional thinking about public money, discussing the limitations of budget-centred fiscal frameworks. Focusing solely on annual budgets cannot reveal whether public spending is effective or creates long-term value for citizens.

Three core lessons emerged from last year's work. First, institutional strength remains essential: without effective, transparent and accountable institutions, no fiscal framework can deliver public value. Second, fiscal sustainability is not just about balancing the books but about linking spending to measurable impact. Third, both sides of the debt-to-GDP ratio matter, not only the amount borrowed and spent but

‘Governments, like firms, must make strategic choices about investing in labour and capital to drive productivity and fiscal competitiveness.’

the quantity and quality of growth.

This year’s work builds on these lessons by introducing the concept of the state’s production function. Governments, like firms, must make strategic choices about investing in labour and capital to drive productivity and fiscal competitiveness. This calls for a discussion about the effective allocation of public money. By reframing public finance in these terms, the discussion moves beyond annual budgeting cycles towards a model of government as a purposeful, long-term investor in national prosperity.

From institutional strength to measurable impact

In today’s fiscal environment, it is no longer sufficient to account for how much is spent; there must be a clear link to what those expenditures can achieve in terms of impact and value creation. This transition highlights the core aim of public money allocation: transforming financial inputs into measurable outcomes that enhance societal wellbeing, strengthen the economy's productive base and improve fiscal sustainability.

This principle applies not only to traditional budgetary spending but to the entire public balance sheet, which represents the state’s assets, liabilities and risk exposures. Public money refers to the full set of public financial resources, including budgetary expenditure, sovereign assets, state-owned enterprise holdings, public financial institutions and contingent liabilities, which reveal the full scale and nature of public assets and liabilities.

Measuring the public balance sheet directly reflects the asset-building nature of public investment. Adding an intertemporal dimension helps address limitations such as short-term political visibility, rigidity and reactiveness by accounting for future costs and revenues. The International Monetary Fund has recognised the importance of adopting a public-sector balance sheet approach, yet operational uptake remains limited.

Building institutions capable of auditing and managing these assets is central to the effectiveness of a modern fiscal state. Governance quality and institutional capacity influence not only the returns on investments in areas such as education, healthcare and infrastructure but also how effectively governments design their spending and investment strategies. Evidence shows similar levels of public spending can produce different outcomes, indicating that spending quality is often more important than quantity (Figure 1.1).

While this is partly attributable to

1.1. Similar spending levels can lead to divergent outcomes

Life expectancy (years) versus health expenditure (% of GDP)

Source: OMFIF analysis, Organisation for Economic Co-operation and Development Health Statistics 2023 and Society at a Glance 2024

‘The issue is not how much governments borrow, but how intelligently they use that borrowing to enhance productive capacity.’

differences in institutional capacity, it also reflects variation in the composition and design of spending. Countries that adopt more productive, investment-orientated approaches tend to achieve better long-term outcomes, suggesting that different investment strategies play a significant role in driving divergent outcomes.

According to Udaibir Das, distinguished fellow at the IMF, the Covid-19 pandemic is a stark example of this: ‘Countries that treated their response as an investment in health systems, technology and supply chains recovered more quickly. Research shows that the multipliers were 2.7, meaning every dollar invested generated $2.7 in output. But countries that spent without building future capacities struggled. So, it wasn't how much they spent, it was very much how they thought about it.’

Real-world fiscal experiments provide more evidence of this. Examples include the Centre for Global Development’s analysis of the debt relief initiatives launched in 1996 and 2006 under the Highly Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative. These initiatives failed to free up resources for health and education because governance and institutional capacity did not improve, and because allocations did not shift towards productivity-enhancing investments. Although the share of education spending in GDP initially increased, health spending remained constant and the combined budgetary allocation for education and health did not rise. Growth rates started to decline despite fiscal loosening and spending continued to rise, driven by further borrowing.

This experience underscores the importance of institutional capacity and highlights the need to foster sustained growth through effective allocation and productive investment. Strong institutions must pair fiscal space with well-designed, investment-orientated strategies to secure lasting gains. Fiscal space without transparent governance delivers consumption, not growth.

The production function of the state

Traditional fiscal discourse focuses on the deficit and debt-to-GDP ratios. These indicators matter, but they tell only part of the story. What truly makes a difference in fiscal health is how governments influence both sides of the ratio: debt and liabilities, and economic growth and productive capacity. Public money, properly used, is an instrument of production. By borrowing for productive investment, governments can simultaneously strengthen fiscal sustainability and economic growth.

Every government faces choices about where and how to allocate its resources. At the most basic level, these choices concern the mix between labour and capital. The productivity of the public sector depends on how effectively that mix is managed and on how well public capital is allocated towards high-return uses. Fiscal competitiveness, which captures the effective use of fiscal policies to attract investment and support growth, while maintaining public services delivery,

is not just about affordability; it is about the productivity of public investment. By investing in technology, as well as human and digital capital, governments can generate productivity growth that will free up fiscal capacity over time.

How governments fund their investments is a question of competitiveness. Fiscal policy should treat financing strategy as a lever to optimise cost, risk and long-term value. Responsible debt, when directed towards productive assets, strengthens rather than weakens fiscal sustainability. This reframes the conventional narrative: the issue is not how much governments borrow, but how intelligently they use that borrowing to enhance productive capacity.

A new fiscal paradigm

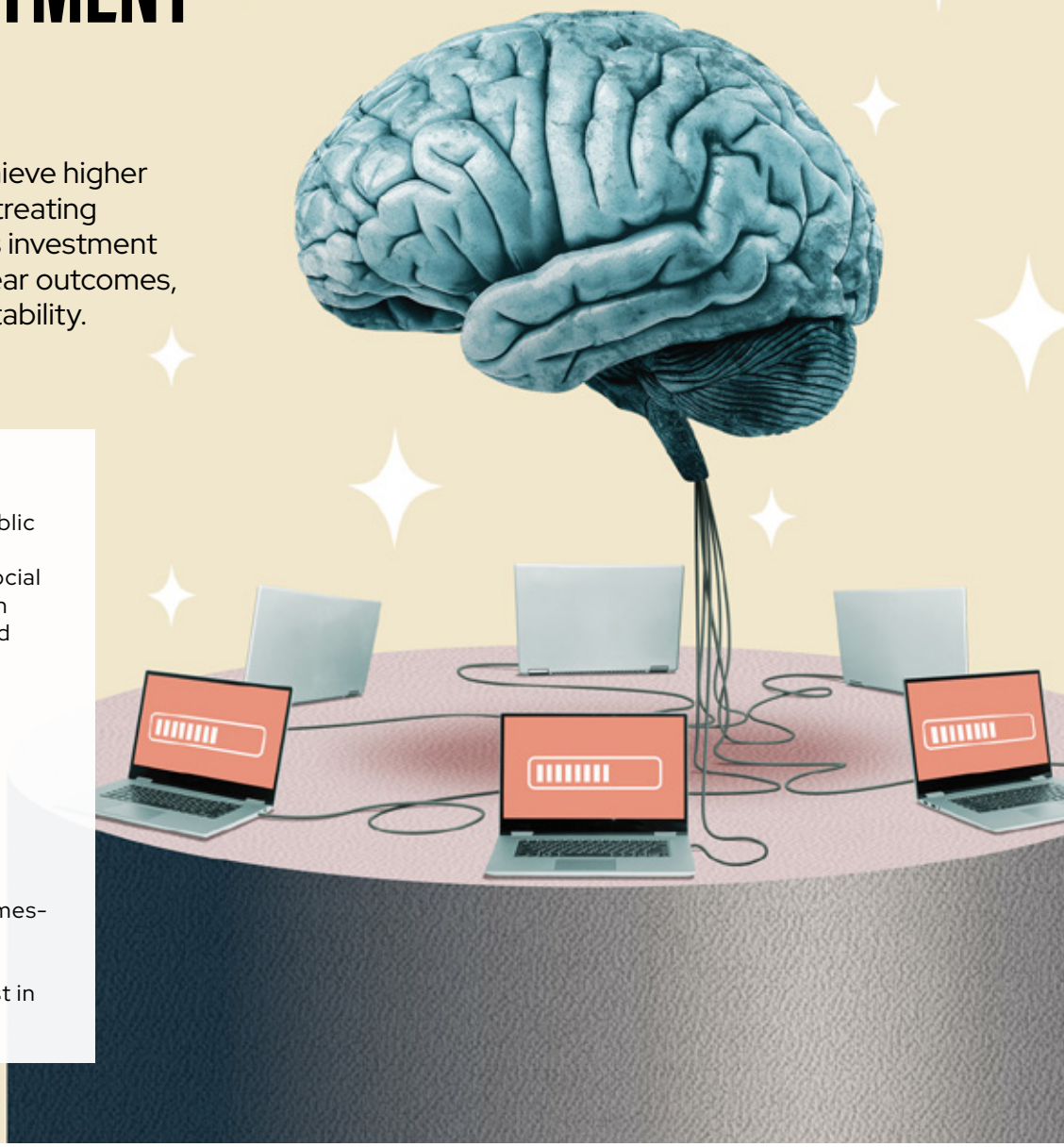
These ideas mark a shift from fiscal sustainability to fiscal effectiveness. In this new paradigm, a credible and modern fiscal system is no longer about balancing the books but about turning resources into enduring value. Institutional strength, fiscal competitiveness and productive investment become mutually reinforcing elements of a redefined fiscal paradigm, not separate goals.

Governments can enhance both fiscal stability and growth by rethinking the state's production function. Through targeted investment in labour and capital, governments can create the conditions for sustainable prosperity. Realigning fiscal systems around value creation requires a common language for measuring it. This measurement must link public money allocated, outputs generated and long-run outcomes delivered. The next step is to define public value in measurable, outcome-based terms. ■

'Countries with comparable levels of spending can see life expectancy differ by as much as a decade.'

THE INVESTMENT MINDSET

Governments can achieve higher long-term returns by treating spending decisions as investment choices, guided by clear outcomes, evidence and accountability.



KEY FINDINGS:

1. Every allocation of public money creates long-term economic and social returns, demanding an investment-orientated mindset.
2. Integrating strategic planning in fiscal frameworks ensures resources align with national priorities and measurable results.
3. Embedding data, evaluation and outcomes-based budgeting strengthens both transparency and trust in public finance.

WHEN a government launches a vaccination programme that achieves herd immunity, the true measure of success lies in the improved health of the population, not simply in the number of doses administered. Such examples illustrate the distinction between outcomes and outputs, highlighting the need for a clearer understanding of what constitutes value in the public sector.

'Public value' can be defined as the measurable return that societies gain from the resources entrusted to the state. Establishing this definition provides the necessary link between financial inputs and tangible outcomes in human capital, social and economic wellbeing, and productive growth. This clear definition is needed before governments can start allocating resources strategically.

The UK National Audit Office highlights that 'to deliver value for money over the medium to longer term, a government needs to turn its objectives into outcomes in a way that delivers the best value for every pound of public money while managing its fiscal position'. In the case of the UK, there have been positive developments in the approach to value for money. However, this has not

'Redirecting at least 1% of GDP to infrastructure or education from less-productive uses can raise output by 1.5% to 3.5% in advanced economies and up to 6% in emerging markets and developing economies.'

resulted in an enduring system of realistic short-, medium- and long-term planning to deliver value for money. As the NAO wrote in a 2024 report, 'achieving this might require different skills and a significant change in mind-set at the centre of government and in departments'.

Shifting this way of thinking demands a rigorous focus on outcomes, where every allocation of public money is measured and audited for real-world impact. This requires linking public money allocated to the outcomes generated and the long-term public value created. As institutional strength remains fundamental, technological and organisational transformation inside the state becomes equally essential. New mechanisms for accountability and transparent measurement further enable the transition from administrative, process-driven spending to investment with clear and measurable objectives, ensuring that public resources generate the greatest possible societal return.

The pursuit of value

This report argues that allocating resources to productive investment can boost productivity and growth, increase revenues and decrease debt over time (see Chapter 4). The International Monetary Fund's October 2025 Fiscal Monitor, 'Spending Smarter: How Efficient and Well-Allocated Public Spending Can Boost Economic Growth', supports these findings. It shows how governments facing tight fiscal constraints can increase economic growth by improving the efficiency and allocation of public spending. The analysis examines how adjusting the composition of public spending, without increasing total expenditure, can stimulate growth, which raises living standards and alleviates fiscal pressures by increasing revenues and making public debt more sustainable.

The IMF's results are clear: many countries can significantly reallocate spending towards growth-enhancing areas, as current allocations often do not support growth effectively. For example, public investment has decreased globally while wage bills remain high. Most countries can increase public spending efficiency: closing efficiency gaps could generate 30% to 40% more output and welfare per unit of public money spent, particularly through investment in research and development. The findings also show that stronger institutions are linked to more efficient and growth-friendly spending. Redirecting at least 1% of gross domestic product to infrastructure or education from less-productive uses can raise output by 1.5% to 3.5% in advanced economies and up to 6% in emerging markets and developing economies.

To deliver value, governments must treat public money as strategic capital and embrace an investment mindset. Every budgetary allocation, whether to health, education or digital infrastructure, represents a choice about future returns to the economy. Yet most fiscal systems still treat these decisions as short-term expenditures rather than long-term investments.

The investment mindset demands three shifts in thinking. First, from expenditures to investments: treating every outlay as a long-term investment in public value. For example, designing and equipping a new hospital determines decades of healthcare outcomes, not just construction costs.

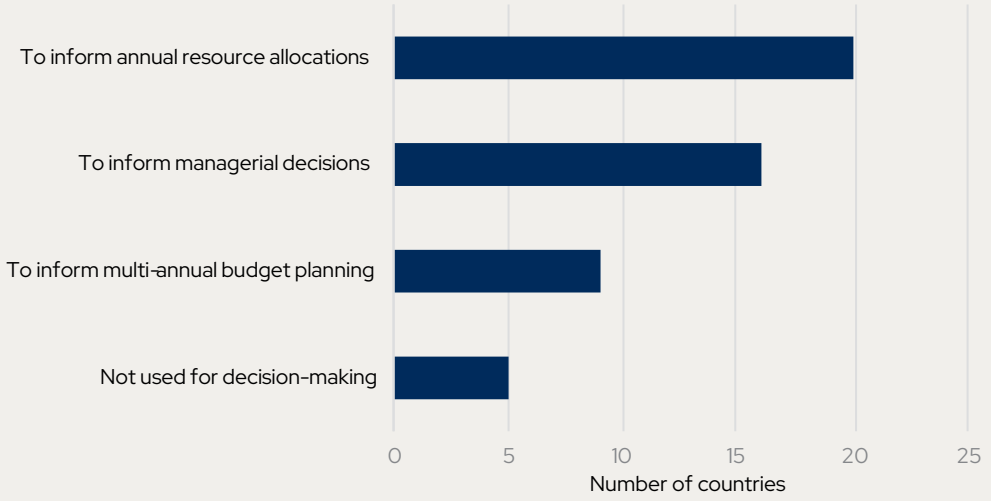
Second, moving from a fiscal year to multiannual perspective and evaluating investment over its full lifespan. This requires multi-year budgeting integrated with long-run investment planning. For instance, rail projects should be assessed over their entire lifespan, taking into account maintenance, usage and long-term economic benefits.

And third, from compliance to performance, embedding measurement, evaluation and learning into public investment planning. An example is evidence-based allocation of resources to inform decisions about patient care and prioritising the most effective interventions. When governments view decisions through an investment lens, the focus moves from cost control to value creation, and from limiting deficits to expanding capability.

The new rules of the game

This view changes the rules of the game for fiscal policy. Under the old paradigm, success meant meeting annual deficit targets. Under the new one, it means producing measurable public value. As Mark MacDonald, global public finance management leader at EY, mentioned in a podcast with OMFIF, 'Making sure that the public interest is still maintained and put up front is the number one thing we should be talking about when we talk about

2.1. Outcome-linked analysis is lagging in budget planning
Use of performance information in decision-making in the OECD countries



Source: OMFIF analysis, OECD Performance Budgeting Survey 2023

'Making sure that the public interest is still maintained and put up front is the number one thing we should be talking about when we talk about public investment, public goods and public utilities.'

Mark MacDonald, Global Public Finance Management Leader, EY

public investment, public goods and public utilities.'

Effective use of public money combines the rigour of traditional fiscal management (auditability, transparency and accountability) with an expanded capacity to measure and deliver impact. This dual requirement defines what credible fiscal reform looks like in the current environment: not abandoning the old disciplines but extending them. Governments must be able to say not only where the money went, but what it achieved. Crucially, this approach requires shifting the focus from measuring outputs (how much is done) to measuring outcomes (what difference it makes). It is not just about doing more or less, but about doing it better.

That impact dimension includes outcomes that are both tangible and enduring, as well as investments that build physical, digital and human capital, mitigate risk and enhance the state's productivity. It also encompasses institutional value, including the capacity to plan, deliver and learn systematically. Together, these outcomes define fiscal effectiveness.

Operationalising the investment mindset

Putting this mindset into practice requires aligning fiscal allocation with strategic planning. Historically, fiscal management and national planning have often been siloed: finance ministries focus on expenditure control, while line ministries pursue sectoral ambitions without coherent cross-sectoral priorities.

The result is fragmentation, short-termism and spending that is controlled but not optimised. Rainer Kattel, deputy director and professor of innovation and public governance at the University College London Institute for Innovation and Public Purpose, said in an OMFIF podcast that 'interlinking various areas of government gives much better long-term outcomes that you are trying to achieve.'

Better allocations depend on bridging this gap. Governments can achieve this by embedding long-term priorities and performance measures into their budget processes. One tool is outcomes-based budgeting, which ties resource allocation to measurable results. The Organisation for Economic Co-operation and Development finds that, while most member countries use performance information in some form, fewer than one-third integrate it into multi-year fiscal planning (Figure 2.1). This gap represents a missed opportunity to link fiscal decisions to their intended impact.

Andrew Kleine, managing director, government and public sector at EY, said:

‘What outcome budgeting does is shift from a backwards-looking to a forward-looking budgeting process. So instead of starting from last year's budget, we start from what goals and priorities we have for next year and beyond. This allows us to examine the base budget to find opportunities to repurpose funds towards programmes and services that demonstrate impacts on the goal.’

This budgeting approach also allows citizens to participate more in the budgeting process. As Kleine explained, ‘we want the unit of analysis in our budgeting to be those programmes and services that people actually interact with, and that would make the budget much more relatable to the ordinary resident’.

Outcome-based budgeting and performance data tools have been tested in local governments across various US cities, including Baltimore. The city has been using this tool for more than a decade, as a result of the economic impacts of the 2008 financial crisis. Policy leaders decided that, instead of allocating fewer resources into each department, they would pool available public money around specific city-wide outcomes and invite departments to compete and collaborate for funding.

The city was able to drive efficiency and cross-team collaboration by implementing targeted innovations that both improved service and reduced costs. These innovations included assigning nurses to frequent 911 callers, cutting repeat calls by 50%, and coordinating city mowing contracts to save $1.5m. Today, this has led to improved service delivery and strategic allocation, and the model serves as a reference for national best practice.

Data and digital tools now enable governments to track value creation, support measurement and auditability, and help identify priorities for public investment. For example, Lithuania’s State Data Agency developed a data-driven decision platform that, during the Covid-19 pandemic, provided updated information daily to help the public and policy-makers make informed decisions based on data, enabling more precise investment prioritisation.

The Policy Priority Inference programme is another prioritisation tool that uses computational methods to help governments measure the impact of public expenditure on development outcomes. This tool has been implemented in various countries, initially in Latin America, and has helped governments redirect resources effectively.

These innovations point to a broader institutional transformation. Fiscal accountability is no longer just about preventing misuse of funds; it is also about proving effectiveness. Governments that invest in data infrastructure build trust and legitimacy while improving resource efficiency. This kind of innovation is also welcome when talking about financial resilience.

As Adam Chepenik, principal, government and public sector at EY, said, governments also have to start ‘thinking around ways to innovate. There are new tools available for governments that never existed before, through the deployment of artificial intelligence, managing cost recovery and service delivery’.

The path to a more productive state

Ultimately, the pursuit of public value is about creating a more productive state, one that not only allocates public money into greater social and economic benefits but also invests in broader economic productivity and transforms its own capacity to deliver.

When governments place value at the centre of fiscal decision-making, they can enhance the quality of public spending while expanding growth. By investing rather than merely spending, governments can build resilience, stimulate productivity and expand fiscal space over time.

The transition to a productive state requires three ingredients: first, an intellectual framework to guide decisions; second, robust data and modelling tools to test alternatives; and third, governance mechanisms to ensure accountability and value creation.

The future of public money lies in this synthesis – a system that remains fully accountable and auditable, yet is explicitly designed to generate long-term, measurable value across the whole economy. Success depends on aligning decision-making, bringing together public and private actors, and allocating capital to ensure that investments are effective, scalable and measurable. ■

‘Instruments like outcomes-based budgeting tie resource allocation to measurable results, bridging the gap for better allocation.’

THE NEED FOR ALIGNMENT

Delivering public value at scale requires aligning political decisions, institutional capability and market capital around shared long-term outcomes.

KEY FINDINGS:

1. Lasting reforms depend on the alignment of decision-makers, institutions and investors around value creation.
2. Credible, transparent governance attracts investment, lowers borrowing costs and amplifies the impact of public spending.
3. Mobilising public and private capital through credible institutions is essential to scale investment and achieve lasting public value.

A productive state must examine the political economy of fiscal decisions, focusing on the incentives, capacities and narratives that influence how governments justify and implement spending decisions. For policy-makers, adopting an investment lens provides a narrative of optimism and productivity, reframing fiscal debates around value creation rather than austerity. For institutions, it demands improved data systems, medium-term planning and performance evaluation capacity, facilitating the prioritisation of investment decisions. For citizens, it promises a clearer link between public money and tangible improvements in services, economic prosperity and welfare.

The questions then become how well governments make allocative decisions, who shares the decision-making process with them, what capabilities they utilise and how they can align the state, markets and society around shared goals of long-term value creation.

A new decision space

Traditional fiscal systems were designed to control spending, keep it within limits, ensure

‘When borrowing is tied to measurable outcomes, such as digitalisation or the green transition, markets perceive it as value creation, not fiscal risk.’

debt sustainability and maintain credibility with creditors. Today’s fiscal systems not only need to do that, but also support investment, ensuring that scarce public resources generate the greatest possible economic, social and environmental returns. This shift opens a new fiscal decision space: one that integrates fiscal discipline with investment logic. It requires governments not only to balance budgets, but to shape markets, mobilise capital and manage risk in ways that sustain growth and public value.

This is particularly important as, even with improved resource allocations, the scale of today’s investment needs far exceeds what public budgets alone can sustain. Climate transition, defence and security modernisation, digital infrastructure and demographic adaptation require more capital than traditional fiscal systems can mobilise. A research paper published by University College London’s Institute for Innovation and Public Purpose highlights that ‘public value should be understood as a way of measuring progress towards the achievement of broad and widely accepted societal goals. Such goals can only be achieved through collaboration between both private and public sectors’. Therefore, it is essential to bring together various sectors of the economy when considering reforms to achieve public value.

Every reform of public finance is ultimately a political decision. Decisions about investment, risk and value are made by people and institutions, each with different incentives and time horizons. These incentive structures shape which projects get funded, how risks are allocated and the quality of long-term investment outcomes. To make public money work better, the political economy of fiscal decision-making must evolve.

Four groups shape that evolution (Figure 3.1). First, elected decision-makers, who set

3.1. Four groups that shape the future of decision-making

Source: OMFIF

the overall policy direction and authorise spending, should broaden their approach from short-term expenditure management to long-term value creation. They can redefine fiscal responsibility as the capacity to invest wisely, rather than merely spending less.

Second, public officials and institutions, who implement those policies, must build the analytical and organisational capability to allocate resources by impact. This involves understanding risk, measuring financial and non-financial returns, and managing portfolios of public investment as effectively as private investors manage their own.

Third, capital markets and investors, who finance a growing share of long-term public priorities, are not substitutes for government but partners in scaling public value. Their confidence depends on credible institutions, transparent rules and a consistent link between fiscal choices and economic outcomes.

Finally, broader stakeholders, such as media, experts and civil society, who interpret and influence fiscal debates, help shape the narrative of what responsible government looks like. When the public conversation recognises that better spending is as important as higher spending, it creates the political space for reform.

Together, these actors determine whether the state can evolve from a spender to an investor, one that uses its fiscal credibility to mobilise capital for productive investment and deliver measurable social outcomes.

Mobilising capital through credibility

Mobilising private capital is central to this transformation, but only credible states can do it effectively. Fiscal and institutional credibility act like a sovereign credit rating for policy. When markets trust that governments manage risk transparently, allocate resources effectively and maintain long-term discipline, they reward that trust with lower borrowing costs and stronger capital inflows. Market participants respond to policy analysis, looking beyond headlines when governments present budgets, and consider not only the amount of borrowing but also what it will be spent on.

As Marie Diron, managing director of sovereign risk at Moody's Ratings, explained: 'The credit implications come not only from the boost to economic activity that comes from the investment, but also from the wider objectives in terms of reforms or economic evolution that come from that. There are a number of loans and grants that are tied to digitalisation and a greener economy, which will have a wider impact.'

For example, in Germany, announcements of significant increases in investment, defence and infrastructure spending were viewed as credible and positive – even though borrowing was expected to increase – because they would help sustain future growth and support public finances.

This alignment creates a virtuous cycle: transparency, long-term fiscal discipline and robust governance attract capital; capital supports productive investment; and productive investment improves economic growth and strengthens fiscal sustainability (Figure 3.2). Capital markets can be powerful allies in scaling public investment, not by replacing fiscal spending, but by amplifying it.

This is why adopting an investor mindset within the state is crucial. Governments must recognise risk, measure return and send clear market signals about the quality of their fiscal decisions. Instruments such as performance-linked bonds, outcome-based contracts and blended finance work best when underpinned by accountable institutions and transparent governance. Mauricio Zelaya, partner and national economics leader at EY Canada, agrees that it is crucial 'to develop this investment governance, or a very transparent performance measurement framework for these investments, to understand whether we are actually going to achieve some of these outcomes'.

As Chile's sustainability-linked bonds and the European Union's Recovery and Resilience Facility demonstrate, credibility transforms borrowing into investment. Chile issued the first sovereign sustainability-linked bond in March 2022, totalling $2bn, with an oversubscription of $8.1bn, signalling strong investor demand. This initiative has helped achieve investment in renewable energy, which generated 40.5% of the total energy produced by the end of 2024, up from 33.5% in 2022. In the case of the EU's Recovery and Resilience Facility, the reforms and investments proposed by member states in climate and digital objectives have exceeded the initial targets: climate

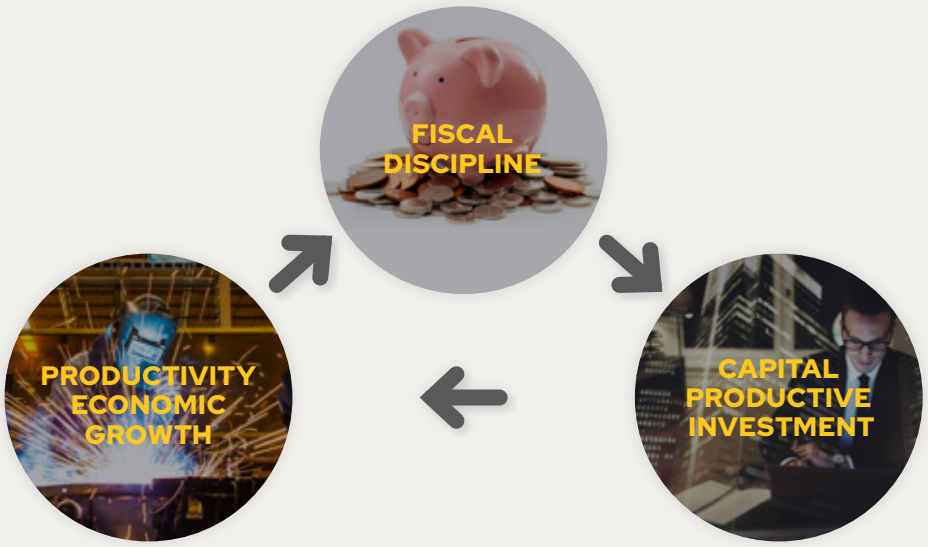
'The credit implications come not only from the boost to economic activity that comes from the investment, but also from the wider objectives in terms of reforms or economic evolution that come from that.'

Marie Diron, Managing Director, Sovereign Risk, Moody's Ratings

'The weakest part of the budget cycle is definitely the review and evaluation phase. We do not often review and evaluate its impact and then learn from it, so it is a cycle that is almost broken.'

Dean Yates, Regional Market Segment Leader in Government and Health Sciences, Oceania, EY

3.2. The virtuous cycle of credibility and investment



Source: OMFIF

expenditure amounts to 42% compared to the initial 37% target, and digital expenditure amounts to 25% compared to the initial 20% target.

When borrowing is tied to measurable outcomes, such as digitalisation or the green transition, markets perceive it as value creation, not fiscal risk. The distinction is both political and technical: it is the difference between spending money and deploying capital.

Ultimately, capital mobilisation depends on institutional readiness. Capital follows credibility and credibility depends on governance (Figure 3.2). Successful investment systems should share three features. First, clear accountability: decisions on public investment and risk allocation are made within transparent and legally grounded frameworks, with clear institutional responsibilities. Second, value orientation: spending choices are assessed by long-term value for money, not institutional bias or administrative inertia. And third, fiscal integrity: investments and partnerships are fully integrated into budget processes, with all liabilities disclosed and performance monitored.

All these steps are critical to delivering value through effective partnerships. As Dean Yates, regional market segment leader in government and health sciences, Oceania, at EY, observed: 'To get those really long-term outcomes, you have to learn from what happens within. The weakest part of the budget cycle is definitely the review and evaluation phase. We do not often review and evaluate its impact and then learn from it, so it is a cycle that is almost broken.'

Towards a new fiscal consensus

The political economy of better allocation decisions comes down to collaboration across levels of government, between public and private actors, and between political and technical communities. Fiscal sustainability will not be secured by austerity, nor by unbounded expansion, but by alignment: between what is affordable, what is investable and what creates value for citizens.

Elected leaders, officials, investors and institutions all have roles to play in this alignment. Governments must act as disciplined investors; markets must reward transparency and purpose; and citizens must hold both accountable for results. If the past fiscal consensus was about managing money, the new one must be about maximising value. Realising this potential requires analysis of alternative investment choices to understand how resources can be allocated to maximise productivity, fiscal sustainability and long-term public value.

FORGING A NEW PATH

Different public investment choices can significantly impact productivity, fiscal sustainability and competitiveness across advanced economies.

KEY FINDINGS:

1. Digital and technological capital investment generates the highest productivity and fiscal returns in a selection of advanced economies, improving both growth and debt sustainability.
2. Demographic transitions offer a natural, self-funding opportunity for reallocating resources towards productive investment.
3. Fiscal competitiveness depends not on spending more, but on investing strategically, targeting digital capital that multiplies long-term public value.

THE arguments presented in this report have been tested by EY's economic advisory team through empirical analysis and modelling. This exercise examines the impacts of different public investment strategies on productivity, growth and fiscal sustainability across 10 western European countries over a 30-year horizon. The results demonstrate that, for these advanced economies, although investing in any capital brings benefits, strategic allocation of digital and technological capital yields the highest long-term gains in both productivity and fiscal sustainability.

This analysis also examines the demographic headwinds posed by ageing populations. The evidence underscores a broader opportunity. Ageing populations mean smaller workforces and tax bases, as well as higher demand for services such as healthcare and pensions, resulting in greater fiscal pressures. However, demographic change also creates natural savings as greater numbers of public-sector workers retire from the labour force, resulting in cost savings that can be redirected into productive investments. By investing these savings in digital and technological capital,

This exercise examines the impacts of different public investment strategies on productivity, growth and fiscal sustainability across 10 western European countries over a 30-year horizon.

as well as in emerging technologies such as artificial intelligence, governments can address the twin challenges of affordability and effectiveness simultaneously.

The modelling analysis employs a scenario-based approach, with a baseline simulation based on Organisation for Economic Co-operation and Development growth projections for each country, as well as historical growth rates for capital, labour and total factor productivity. This sets the benchmark for analysing different public-sector allocation decisions (see the technical appendix on p.30 for more information).

Scenarios are defined by funding source and investment target. Investments can be funded through public-sector labour savings or capital market borrowing. In each case, the assumption is that the additional investment amount is equivalent to 1% of the total annual compensation of the public labour force. This is equivalent to, on average, 2.5% of gross domestic product over the 30-year horizon.

Two points of clarification on the funding sources are essential. First, every year, more than 1% of the public-sector workforce reaches retirement age. Therefore, allocating 1% to capital investment will be achieved through natural attrition, while still leaving a budget to hire new public-sector labour and upskill the existing workforce. Second, the assumption of borrowing from capital markets is used to analyse the impact of debt-funded allocations and to illustrate the potential impact of redirecting existing borrowing towards more productive investments.

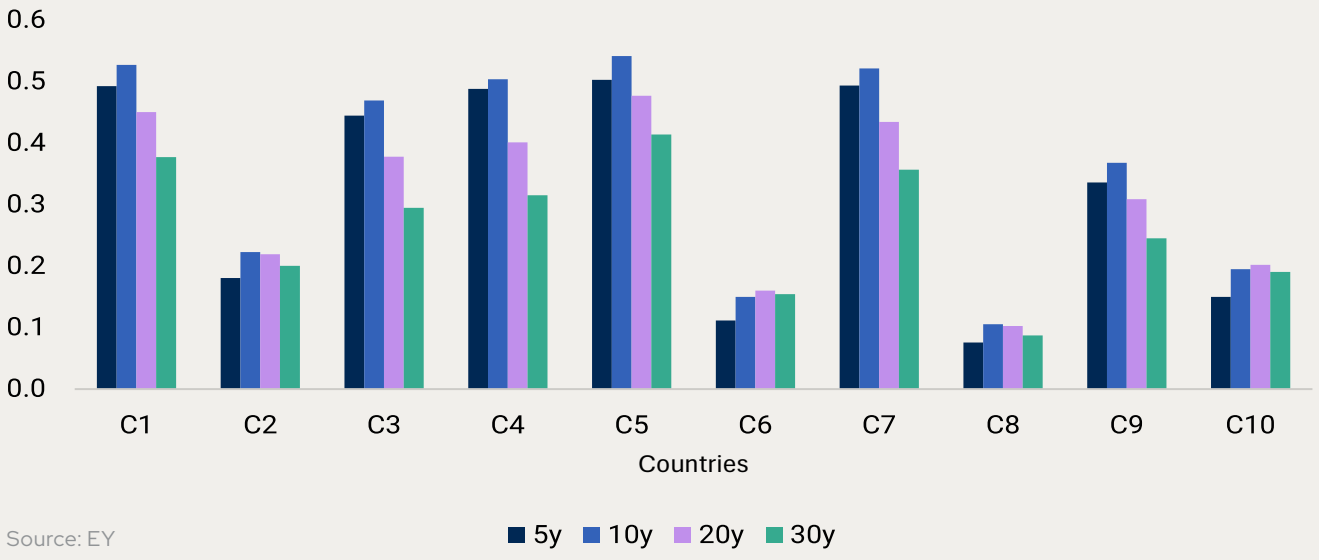
This funding can be allocated to digital and technological capital, encompassing computing and communications equipment, computer software and databases, or to general capital, defined as non-DTC. The scenarios can be summarised as: DTC funded by labour savings; DTC funded by capital market borrowing; GC funded by labour savings; and GC funded by capital market borrowing.

The productivity advantage of DTC

In the first scenario, funding DTC investment via labour savings creates a two-stage effect: first, productivity rises as technological adoption improves efficiency; second, the capital stock increases while labour input declines. Together, these improvements boost GDP, reaching a 0.5% increase around year 10 for the median country, though the effect is partially offset by lower labour input. Still, GDP growth remains above the benchmark over 30 years, highlighting sustained growth from the initial investment in DTC (Figure 4.1).

4.1. GDP growth improvements from TFP spillovers

Average annual increase in GDP growth relative to the benchmark, %, across 5-, 10-, 20- and 30-year horizons



Source: EY

This investment strategy yields GDP multipliers of approximately three times over 30 years for the median country, indicating that every dollar invested generates nearly $3 in GDP over time. Tax-revenue multipliers also improve, remaining at 1.1 times over 30 years. This signals that digital and technological investments strengthen government revenue alongside economic growth.

However, the benefits are uneven. This reflects two crucial differences across the country sample. First, the investment amount of each country differs as it depends on the total annual compensation of the public-sector labour force. Assuming a fixed 1% of the total compensation as the investment share, countries that spend more on wages will have a higher investment in DTC.

Second, the impact of the investment depends on the initial conditions regarding the DTC stock. For countries with low investments in DTC, the impact of increased investment is likely to be greater than for those that already have a substantial stock of DTC. In such cases, other types of investments, such as those in research and development, could yield a greater impact.

Across all countries, the model showed that 100% of the targeted labour funds reallocation can be achieved through retirements from 2026 onwards. The average age of the public-sector workforce rises gradually in most countries, reflecting an ageing population (Figure 4.2). Each year, more than 1% of the total population becomes eligible for retirement, suggesting that this natural attrition could offset the investment cost. For the median country, the average age increases by two years over a 30-year period.

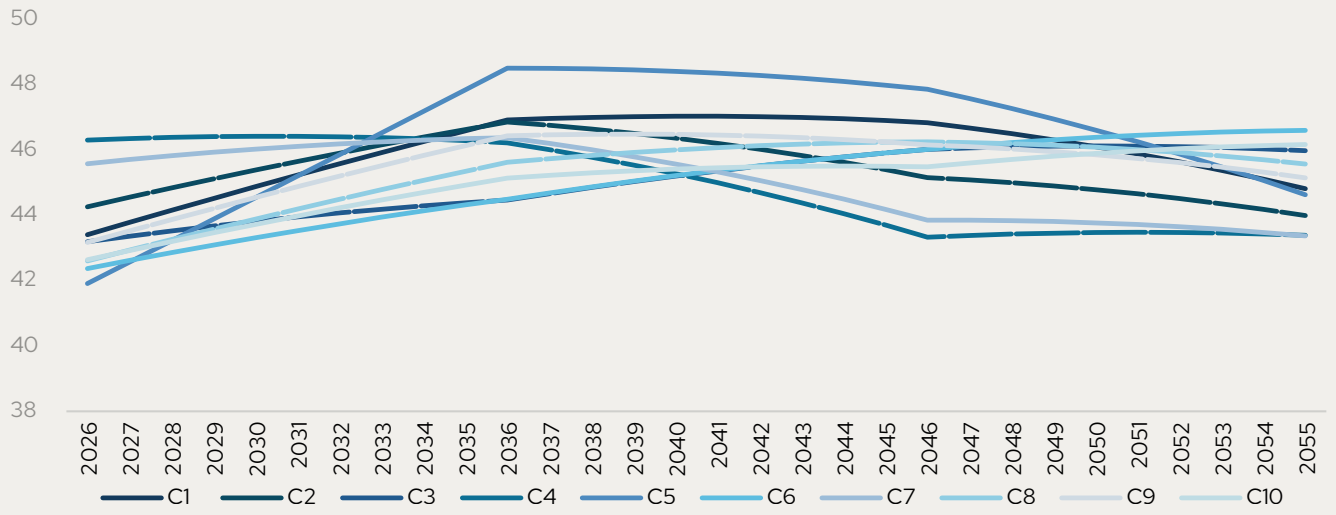
Although this approach utilises demographic trends to facilitate smooth workforce adjustments, it may result in a less dynamic and older workforce. This underscores the need for active investment in both hiring and upskilling to create a more productive workforce that evolves with service demands and sustains productivity.

In the second scenario, similar results in GDP growth can be achieved by investing in DTC financed through market borrowing. TFP spillovers and increased capital boost GDP. The combined effect of more capital and a stable workforce creates a stronger growth engine, with GDP growth amplified across all time horizons (Figure 4.3). For the median country, GDP growth peaks at 0.6% around year 10, declining to 0.3% at year 30, as the initial boost from digital and technological investments tapers off.

However, this approach also introduces some fiscal risk: higher government deficits

4.2. Ageing cohorts of the public sector workforce

Average age of the public sector workforce over time, years



Source: EY

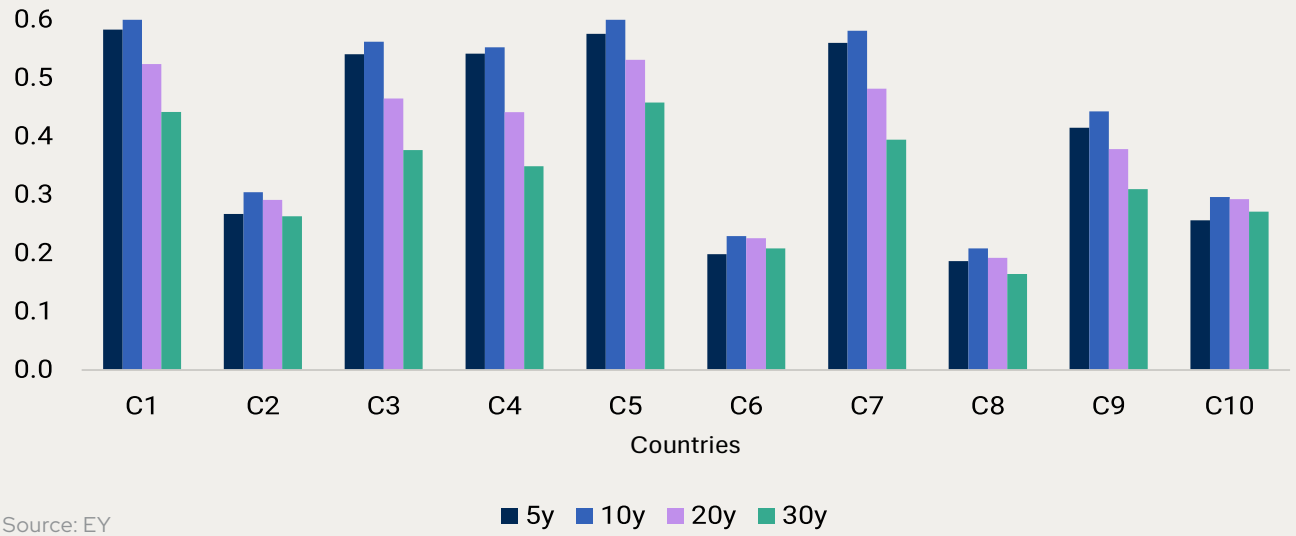
may offset economic gains if not managed carefully. Analysis of the fiscal impact of digital and technological investment financed through borrowing shows that the effect varies across countries. While some experience a reduction in their debt-to-GDP ratio due to strong growth, productivity gains and higher revenue, others see an increase due to slower growth responsiveness or less favourable initial conditions (Figure 4.4). This highlights the importance of tailoring investment strategies to each country's economic context.

The gains from GC investments

In the third scenario, funding GC investments through labour savings reduces

4.3. Robust GDP growth through market borrowing and DTC investment

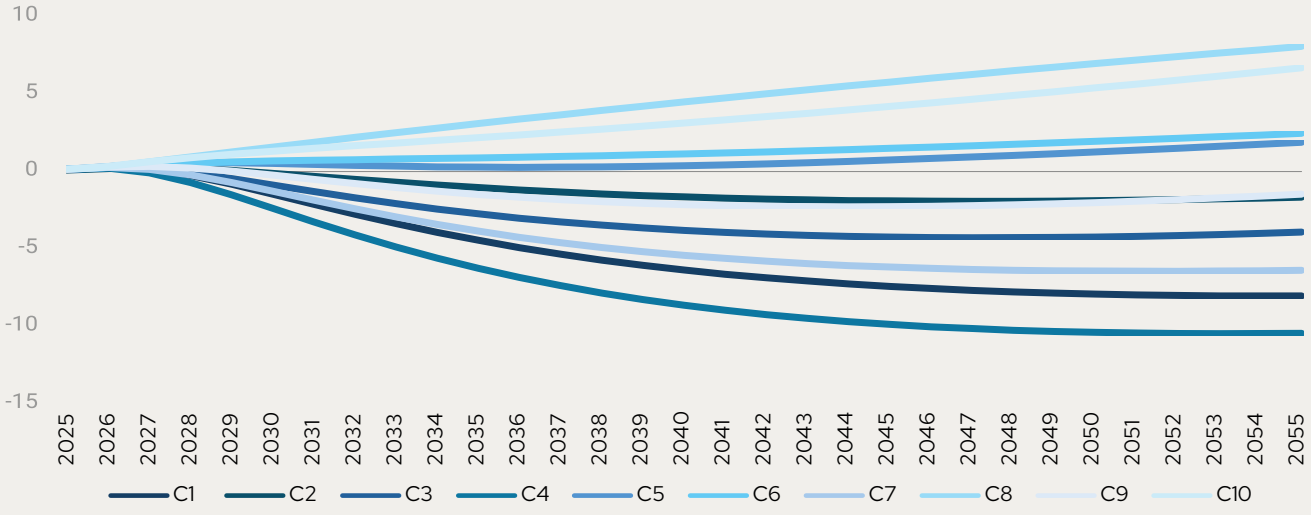
Average annual increase in GDP growth relative to the benchmark, %, across 5-, 10-, 20- and 30-year horizons



Source: EY

4.4. Investment and borrowing not without fiscal impacts

Cumulative change in debt-to-GDP ratio, %



Source: EY

productivity as capital deepening does not offset the loss from reduced workforce capacity. The decline in TFP is modest, but gradual and persistent, hitting technology-dependent economies hardest.

However, the resulting capital accumulation gradually supports long-term GDP growth over time (Figure 4.5). For the median country, gains emerge only after the first five years, rising to 0.2% by year 30. These gradual improvements illustrate the incremental nature of gains from GC, which require sustained investment and supportive policies to accelerate.

In the fourth scenario, financing GC investment through capital market borrowing results in gradual long-term GDP gains, as capital accumulation gradually compensates for modest productivity losses (Figure 4.6). For the median country, GDP growth gains increase to 0.3% at 30 years. However, these gains remain below those from investments in DTC.

A path for debt sustainability and fiscal competitiveness

Investing in both GC and DTC yields positive returns in terms of GDP growth. However, investing in DTC yields better returns over time. If the choice is to borrow from capital markets, fiscal discipline remains critical as the long-term success of this strategy depends on managing debt and avoiding crowding out private investment.

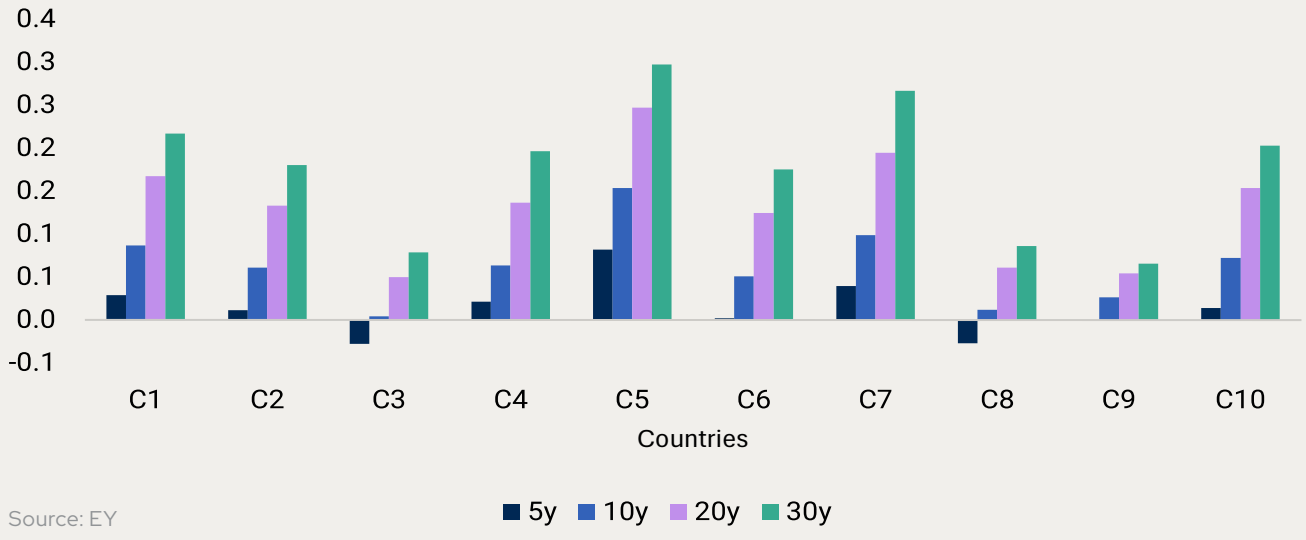
Borrowing for high-quality public investments, such as digital and technological infrastructure, can improve fiscal sustainability. As investments boost productivity and accelerate GDP growth, they expand the sustainable revenue base, surpassing the benchmark scenario. If the additional revenue is allocated to debt repayment, the trajectory of the debt-to-GDP ratio begins to decline, supporting a more sustainable debt path and enabling future investment (Figure 4.7).

Notably, while revenue gains from higher productivity typically strengthen public finances, their distribution can vary across levels of government, making it essential to align incentives to ensure all areas can benefit from and invest in productive assets.

Country 3 behaves similarly to the median country. Analysis of C3's debt-to-GDP ratio under the four scenarios reveals a robust and sustained decline for both labour-funded and debt-funded digital and technological investments (Figure 4.8). In the first case, there's a 5% reduction by 2036 and cumulative decreases of 8.5% by 2055 compared to the benchmark scenario. In the second case, the initial borrowing slightly increases debt levels, but as economic performance improves, the

4.5. Gradual improvements in GDP growth

Average annual increase in GDP growth relative to the benchmark, %, across 5-, 10-, 20- and 30-year horizons



Source: EY

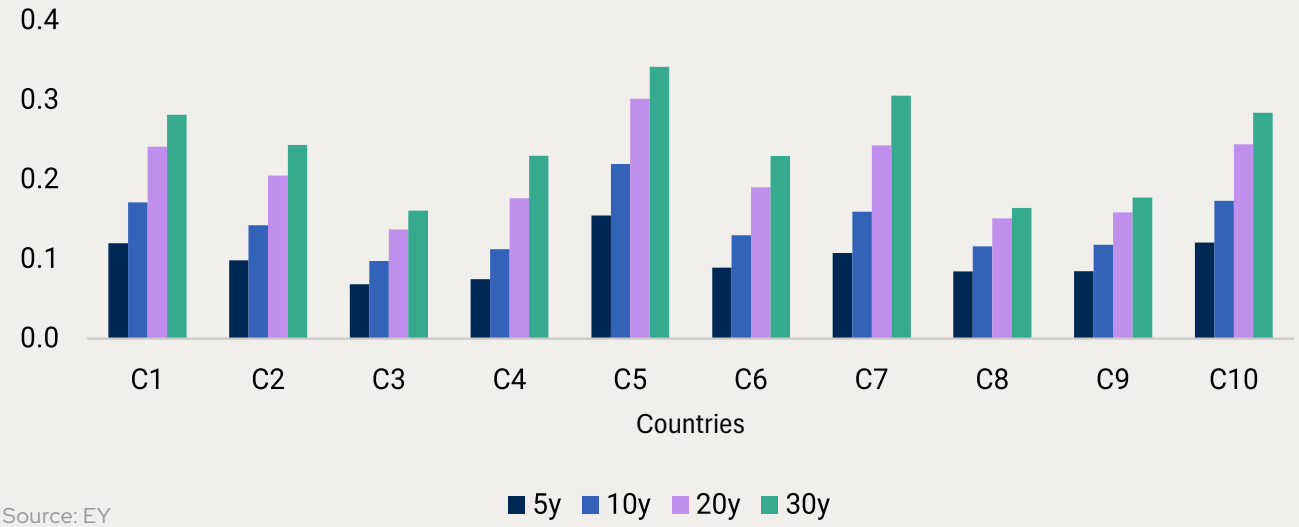
positive effect reduces debt-to-GDP ratios by 3% in 2036.

While these positive effects moderate over time due to diminishing returns and faster depreciation of digital and technological assets, the cumulative impact remains favourable, with a 4% reduction in debt-to-GDP by 2055 compared to the benchmark scenario.

The relatively low marginal productivity of GC compared to borrowing cost keeps the debt-to-GDP ratio increasing over time in the debt-funded scenario. In the case of the labour-funded scenario, no additional

4.6. Steady increases in GDP growth gains

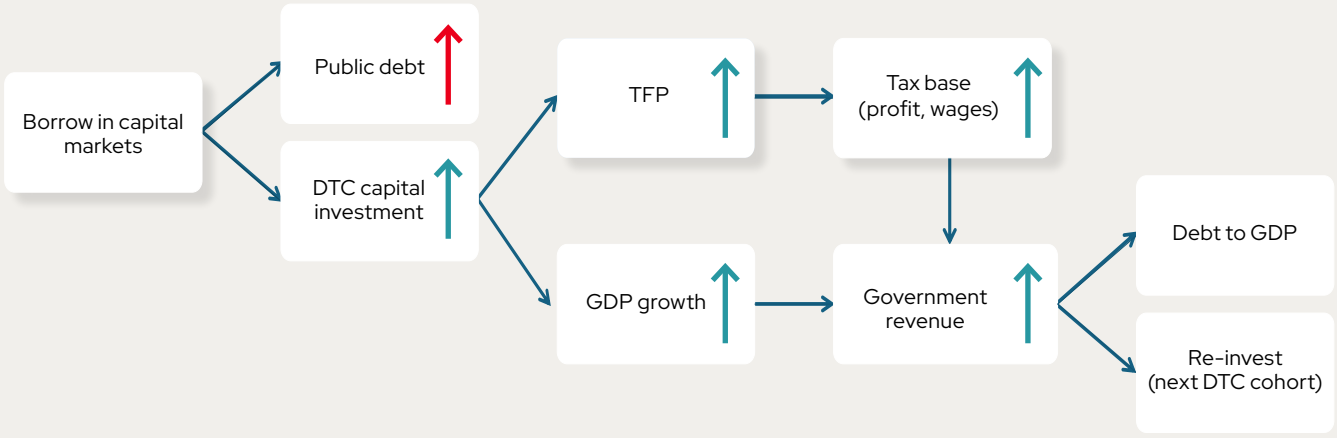
Average annual increase in GDP growth relative to the benchmark, %, across 5-, 10-, 20- and 30-year horizons



Source: EY

4.7. DTC investment over time can reduce debt-to-GDP ratios

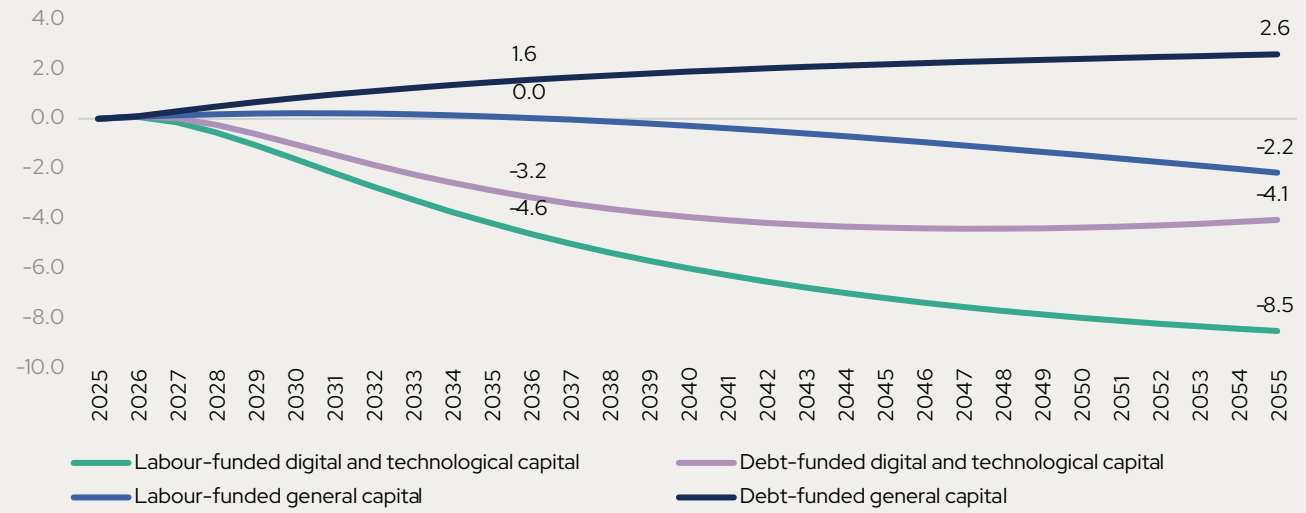
The cycle of borrowing and investing to increase productivity and growth, collecting more taxes and managing debt more efficiently



Source: EY

4.8. Impact on debt trajectory for all investment scenarios

Cumulative change in debt-to-GDP ratio, %



Source: EY

borrowing costs and gradual gains in GDP reduced the debt-to-GDP ratio by 2% over time.

This analysis underscores the importance of exploring alternative sources of funding for public investment, such as capitalising on demographic shifts for fiscal opportunities. As older public-sector workers retire and governments redirect natural labour attrition into productive investment, demographic change becomes not only manageable but a funding source for transformation, freeing up resources to invest in technology, enhance growth and productivity, and clear the path for debt reductions.

Funding DTC investment via labour savings can also be beneficial in terms of fiscal competitiveness. Country competitiveness is evaluated across productivity, employment, sustainable growth and debt sustainability, with results shown for the 10 western European countries in 2055. When a country such as C3 is the first to implement this strategy, it exhibits strong competitiveness. By 2055, the competitiveness index rises to 53 from 40, with significantly steeper improvements compared to other countries (Figure 4.9).

On the contrary, if the rest of the countries implement this investment strategy but C3 does not, C3's competitiveness growth is modest, while other countries catch up or surpass it. By 2055, the competitiveness index increases to 48, with significantly lower increases compared to other countries.

From evidence to action

The modelling exercise demonstrates how alternative allocation strategies can shape long-term productivity, growth and fiscal sustainability. Its purpose is to show how governments can test the consequences of different investment choices. The scenarios highlight that, when investment is targeted towards high-return assets, especially DTC, stronger growth and more resilient public finances can emerge even without expanding overall expenditure.

More broadly, the analysis shows that fiscal competitiveness is rooted in strategic investment rather than higher spending. Redirecting naturally occurring labour savings, or repurposing existing borrowing, can support productivity-enhancing capital investment while maintaining fiscal discipline. What matters is the capacity to measure the effects of these decisions, model different pathways and manage the risks and trade-offs transparently. This is what it means to change the rules of the fiscal game: moving from managing scarcity to creating value.

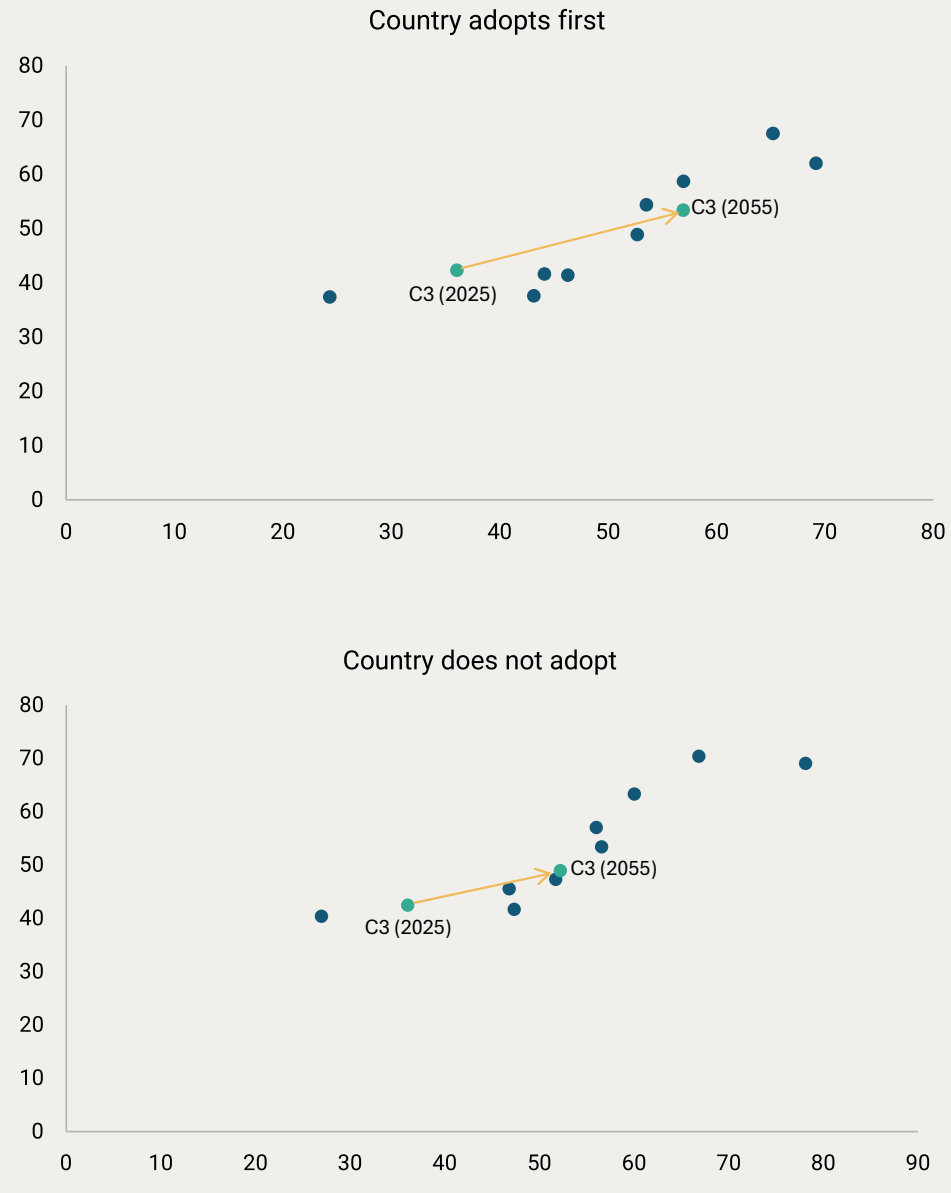
The analysis presented here

Demographic change also creates natural savings as greater numbers of public-sector workers retire from the labour force, resulting in cost savings that can be redirected into productive investments.

The productive state becomes the competitive state: one that creates enduring public value by aligning fiscal strategy, technological innovation, and institutional strength with long-term economic and social outcomes.

demonstrates that a different fiscal future is possible. The findings suggest that governments can widen their economic base and strengthen fiscal sustainability by allocating resources towards investments with the highest public returns. This is the shift at the heart of a value-driven fiscal strategy: combining fiscal discipline and prudence with targeted innovation, ensuring that technological investment complements human capital and building the institutional capacity to make every decision accountable. In doing so, the productive state becomes the competitive state: one that creates enduring public value by aligning fiscal strategy, technological innovation and institutional strength with long-term economic and social outcomes.

4.9. Clear incentives to adopt the investment strategy early
Competitiveness index (0-100) versus GDP per capita, €, thousands



Source: EY

A ROADMAP FOR INVESTMENT-DRIVEN PUBLIC VALUE

The next decade offers an opportunity for governments to transform public finances by combining public investment innovation and outcome-driven governance.

KEY FINDINGS:

1. Transforming fiscal outcomes requires institutional innovation. Governments, finance ministries, markets and international bodies can play pivotal roles in setting and upholding standards.
2. To bridge the gap between aspiration and delivery, a phased implementation approach is essential. There should be targets and priorities for the short, medium and long term.
3. Future research should focus on refining sectoral investment strategies, developing benchmarks for value measurement and exploring institutional models that best support outcome-driven public finance.

THE next decade will require governments to strengthen how public investment is selected, financed and assessed. The central objective is to improve the allocation and governance of public investment by drawing on the whole pool of public money – budgetary resources, sovereign assets, public financial institutions and risk-sharing instruments – while operating within coherent macro-fiscal and macro-financial frameworks. To achieve these aims, the next steps must focus on mobilising capital, strengthening institutions and embedding robust auditability and accountability into the heart of fiscal policy.

The investment needs associated with climate transition, digital infrastructure, demographic change and productivity growth cannot be met solely through conventional budgeting; they require a fresh approach to capital mobilisation. Governments should draw on innovative financing instruments and partnership models that can unlock both public and private resources at scale.

Scaling such instruments across more jurisdictions, coupled with a broader use of blended structures, dedicated digital infrastructure funds and outcome-based public–private arrangements, can raise both

The potential for public investment to drive prosperity, resilience and trust hinges on the choices made in the coming years.

the volume and quality of public investment without weakening fiscal sustainability. Capital markets have a complementary role in incorporating investment quality, institutional capability and credible long-term strategies into sovereign pricing and credit assessments.

A consolidated public balance-sheet perspective is essential. Integrating data on assets, liabilities and contingent exposures enables governments to identify opportunities for intertemporal smoothing, risk diversification and strategic asset deployment. It also clarifies the roles of public institutions, especially sovereign funds and development finance entities, in addressing early-stage risk, correcting market failures and mobilising private capital.

By placing public value at the centre of public investment, this approach also encourages innovation and shifts the productivity mindset within the public sector. It enables governments to prioritise outcomes that matter most to citizens, strengthening the perception that tax revenues are being used effectively and for meaningful purposes. When citizens can see that public money is used productively, the legitimacy of taxation is reinforced and political support for future revenue mobilisation becomes easier to sustain.

This shift has the potential not only to return more revenue to the budget through better investment but also to reduce complaints about wasteful public spending and increase civic engagement. Instruments such as participatory budgeting can deepen civic engagement and public trust. Higher-quality public capital also strengthens long-term fiscal capacity by boosting growth and improving budgetary returns.

Working across institutions and phases

Delivering on this agenda requires coordinated action across government, markets and international institutions. Institutional capability is a key determinant of investment outcomes. Governments should establish dedicated public investment evaluation units with mandates to appraise, monitor and subject major projects to systematic ex-ante and post-assessment. Transparency dashboards and open-data platforms can enhance auditability, enable real-time scrutiny and permit evidence-based adjustment of investment plans. Finance ministries should adopt value-based appraisal and reporting standards. International bodies can assist by updating fiscal and investment guidance to reflect outcome-orientated principles. Capital markets and rating agencies should reward transparency, discipline and demonstrable long-term value creation.

To bridge the gap between aspiration and delivery, a phased implementation approach is essential. In the short term, governments should pilot new investment vehicles, test institutional arrangements and introduce outcome-based evaluation frameworks in selected sectors. These pilots can identify operational constraints, build implementation capacity and generate early demonstrations of value.

In the medium term, effective practices should be scaled and integrated across sectors, supported by closer alignment among public investment strategies, fiscal planning and capital-market conditions. In the long term, the aim is to embed these approaches so that value-based investment selection, transparent governance and disciplined balance-sheet management become the default expectation for all public spending.

Future research should focus on refining sectoral investment strategies, developing benchmarks for value measurement and exploring institutional models that best support outcome-driven public finance. The potential for public investment to drive prosperity, resilience and trust hinges on the choices made in the coming years. Governments that treat public money as strategic capital, build capacity, measure outcomes, govern and communicate transparently, and allocate for long-term value will be better positioned to meet the demands of a more challenging global environment. By moving from analysis to execution, governments and their partners can redefine the fiscal paradigm for a new era. ■

Productivity modelling appendix

This appendix summarises the structure, methodology and assumptions of the productivity model used to analyse the impact of digital and technological investment on economic growth and fiscal sustainability in Chapter 4. It includes the core equations, estimation approach and key behavioural assumptions.

Model structure and approach

The analysis in this report examines how public-sector digital and technological capital – also known as ICT capital – relative to general capital influences productivity and economic growth across 10 western European and Nordic countries, using annual data from 1995 to 2024.

Production function estimation

The model's foundation is a Cobb-Douglas production function that relates real gross domestic product to real capital stock and labour input (total hours worked).

Empirical specification:

$$\ln Y_{ct} = \mu_c + \alpha_K \ln K_{ct} + \alpha_L \ln L_{ct} + \varepsilon_{ct}$$

Where:

- Y_{ct} : Real GDP for country c in year t
- K_{ct} : Chain-volume real capital stock
- L_{ct} : Total hours worked
- μ_c : Country fixed effect
- α_K, α_L : Output elasticities for capital and labour (estimated as 0.62 and 0.39, respectively; both statistically significant)
- ε_{ct} : Error term

Modelling total factor productivity

Total factor productivity is first calculated as the residual from the production function. In the second stage, TFP is modelled as a function of the share of digital and technological capital in total capital, controlling for time effects:

$$\ln A_{ct} = \tau_t + \beta_1 \mathrm{ICTShare}_{ct} + \gamma R\&D_{ct} + \mathrm{u}_{ct}$$

Where:

- $\ln A_{ct}$: Estimated log TFP for country c in year t
- τ_t : Time fixed effect
- $\mathrm{ICTShare}_{ct}$: Share of ICT capital in total capital
- $R\&D_{ct}$: Total research and development expenditure (tested, not significant)
- β_1 : Estimated elasticity of TFP with respect to ICT share (≈ 0.10, significant)
- u_{ct} : Error term

Digital and technological investment mechanism

Each year, an amount equivalent to 1% of total public labour compensation is allocated to digital and technological investment. This annual commitment is carried forward, with an additional 1% based on the current year's labour spending added each year.

Funding can come from capital market borrowing (raising public debt) or from savings generated by retirements in the public labour force (reducing compensation costs without layoffs). The amount of digital and technological investment is the same in both cases; only fiscal and workforce impacts differ.

Digital and technological investment is distributed across sectors in proportion to their existing capital stocks, reflecting higher depreciation and replacement needs in digital and technological-intensive industries. The model assumes a depreciation rate of 25% for digital and technological capital and 5% for general capital. >

Calibration and fiscal feedback

Baseline growth rates for capital, digital and technological capital, and labour are set using historical 10-year averages. TFP growth is also anchored to its historical average. The model is calibrated so that the baseline GDP forecast for 2060 matches Organisation for Economic Co-operation and Development projections.

Any additional GDP generated by digital and technological investment is converted into extra government revenue, assuming the current tax-to-GDP ratio remains constant. In borrowing-funded scenarios, initial debt increases may be offset over time by higher revenues, potentially stabilising or reducing the debt-to-GDP ratio. In retirement-savings scenarios, fiscal pressures are eased by lower compensation costs.

Key assumptions

- The model uses a Cobb-Douglas production function with pooled, statistically significant output elasticities of 0.62 for capital and 0.39 for labour.
- TFP is treated as endogenous to the digital and technological capital share, with an elasticity of 0.10. This means that a 10-percentage point increase in the digital and technological capital share results in a 1% rise in TFP.
- Each year, an additional digital and technological investment is made, equal to 1% of total public labour compensation.
- Historical public labour statistics are from ILOSTATS and are used to keep track of workers' age in the model. As people retire at the age of 65, the model assumes new employees will be hired at the age of 22.
- The source of funding does not impact the amount of digital and technological investment, but it does influence fiscal and workforce outcomes.
- Digital and technological investment is distributed across sectors in proportion to their existing digital and technological capital stocks.
- Depreciation rates are set at 25% for digital and technological capital and 5% for general capital.
- Baseline growth rates for capital, digital and technological capital, labour and TFP are determined by historical 10-year averages and are calibrated to align with OECD GDP forecasts for 2060.
- Fiscal feedback is modelled by assuming a constant tax-to-GDP ratio when converting additional GDP into government revenue.

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