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Economic Power and national security: a new framework for blended finance

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A STUDY BY

Dr Rebecca Harding

Independent Economist · Rebeccanomics

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The strategic role of blended finance

Blended finance has traditionally been understood as a mechanism for mobilising private capital alongside public resources to support sustainable development and climate objectives to correct market failure. Its objective is to use relatively small amounts of strategic capital to mobilise substantially larger volumes of private investment and working capital where there may be a reluctance for the commercial financial sector to get involved because returns are low or costs are too high.

By way of example, the Export Credit Sector's remit has been to use this process across national strategic priorities aligned with the multilateral regulatory and policy framework of the Paris Climate accord, COP negotiations and the United Nations Sustainable Development Goals (SDGs). The goal has been to use public money alongside private finance to a correct market funding failures such as mitigating and adjusting to climate change and biodiversity loss or to enhance economic development.

We are no longer in a world where we can focus just on environmental, social and governance (ESG) issues. While these are no less important, the challenge now is how to harness ESG within a much broader context of persistent geostrategic competition, climate security, economic coercion and technological rivalry while dealing with the obvious challenges of fighting, or kinetic, wars between Russia and Ukraine and in the Middle East.

This means that this is the moment in time to reconfigure how we think about blended finance and the role of governments in correcting "strategic market failure" rather than a more orthodox view of market failure where resources are not properly allocated. It may well be the case that markets *are* allocating resources rationally by prioritising commercial return and using government resources to engage where those returns are lower. However, the challenge in the current era is that this is no longer providing certainty, economic security or industrial and defensive resilience.

The purpose of this short note is to look at what this means for how governments engage with markets to enable economic security to be an offensive tool as well as a defensive reaction to geoeconomic and geopolitical threats. Its central proposition is that the financial architecture between fiscal policy, financial markets and national productive capability needs to be reframed to create a long term economy capable of preventing and responding to these threats.

Strategic market failure, productive security defined

There are two definitional points that are critical to understanding the link between financial institutions and policy makers through blended finance. First, market failures now have to be understood as "strategic market failures". Strategic Market Failure is the current reality whereby markets are operating efficiently according to commercial incentives but simultaneously failing to produce the capabilities essential for long term national security and resilience. This means that by definition they are insufficiently capable of generating "productive security" which is defined as the ability of an economy to harness the productive capabilities of an economy for national security and long-term prosperity.[1]

In other words, security has become an economic as well as a military concern through this strategic market failure. Yet the issue of resilience against the dual pressures of economic uncertainty alongside conventional conflict means that governments increasingly need strategic financing architectures to deliver both strategic and commercial returns.[2] This has to be done through the frameworks of public guarantees, export credit agencies, multilateral development banks, institutions and private financial markets. Together the goal of blended finance must be to create productive security by working together to create and design financing institutions that combine commercial returns with strategic outcomes.

The role of blended finance in the future will not be as a simple, market correcting financing instrument but as a mechanism for creating productive security and therefore productive power through the provision of strategic productive liquidity.

As such, the purpose of blended finance fundamentally shifts. Rather than acting as a mechanism for de-risking investments that private markets would otherwise avoid, its strategic role is to create a mechanism for building strategic productive capacity. Public capital (such as export credits, guarantees or investments) should no longer be seen just as correcting information asymmetries or addressing externalities. It is also signalling long-term strategic priorities, reducing uncertainty and creating investment conditions under which private capital can participate in markets that are valuable in economic security terms but difficult from a commercial point of view.[3]

Towards an institutional design

This distinction matters because many of the sectors now regarded as strategically essential share common characteristics. Defence manufacturing, advanced semiconductors, quantum technologies, resilient communications, critical minerals, energy infrastructure and secure digital systems all involve long investment horizons, uncertain demand, significant technological risk and substantial positive spillovers. Left entirely to market forces they are consistently under-financed despite generating considerable public value.

The challenge therefore becomes one of institutional design rather than financial engineering with the objectives of building ecosystems that do two things:

- Allow private capital to support strategic objectives without replacing markets or undermining commercial discipline. In the current volatile economic environment, markets are increasingly challenged to price risk and uncertainty – this is where government's supporting role is essential. Under this, the government supports the private sector to invest or provide working capital in commercially difficult sectors or in sectors where risk pricing has become difficult because of conflict (for example in the Middle East while Hormuz remains blocked.
- Allow the right money to get to the right place at the right time within critical national infrastructure supply chains allowing the businesses in these sectors to scale using a blended finance "escalator". This requires novel approaches to debt and procurement since governments cannot always develop strategic funding paths with sufficient speed to identify where funding escalator gaps are. Under this, private financial institutions, or even a private credit fund, support procurement contracts and receivables purchases by government in areas where government spending is itself constrained but the need for the supply side to adjust quickly to create productive security is pressing.[4]

Such an approach also changes the way in which blended finance should be evaluated. Traditional metrics focus on leverage ratios, volumes mobilised and financial additionality, but these measures only capture part of the value created. Strategic blended finance also generates broader returns through innovation, supply chain resilience, industrial capability, skilled employment and of course, productive security and strategic deterrence.

The role of a Sovereign Productive Security Fund in the UK

If strategic market failure represents the growing gap between commercially efficient markets and strategically resilient economies, then governmnts require institutions that are capable of bridging that gap by creating the conditions under which markets can achieve strategic outcomes. Yet governments, specifically the UK government, will struggle to do this under the current economic assumptions, especially given the nature and scale of the economic and defence and security challenges that this gap represents. However, if the government is transparent about the nature and extent to which the global economy is at war[5] it has the means to approach markets and investors in a different way to address the fiscal challenges it faces.

There is little doubt that there is appetite amongst the private sector to view the macroeconomic challenges that the UK and many NATO countries face as a strategic problem that requires new thinking. At a recent event run by the Centre for Economic Security, nearly 200 senior leaders from finance, industry, innovation and defence and security as well as senior academics and government officials worked together to form the Bush House Agreement, one pillar of which was an "Investment Compact" which would leverage City wealth into critical national infrastructure support and investment.[6]

This "investment compact" could take the form of a Sovereign Productive Security Fund that is raised from contributions originating in the private sector indicatively through pension funds, asset managers, banks and family offices amongst others. If the UK is to plug the gap between 3.5% of GDP by 2030 and its current expenditure plans on defence alone, then this fund would need to be at least £35bn in assets under management by the end of 2030.

There are three ways to make this happen without the UK government increasing its overall debt burden assuming that the fund itself can be raised:

- The government would need to encourage investment into the fund through the tax system, including potentially reversing decisions around inheritance tax, capital gains tax and taxation of non-UK residents who have assets in the UK should they invest instead in this fund.
- The government would need to use the fund as a source to support procurement by allowing it to lend against contracts enabling the gap between procurement and capacity building in the supply side, especially the SME sector.
- Encouraging financial institutions to overcome their reluctance to invest directly in defence by developing a framework linking investments at a local level to job creation and productive security – in other words, a framework of Security Returns on Investment.[7]

At present, procurement in government is treated as a fiscal transaction reflecting a fundamental difference between the macroeconomic frameworks that procurement sits within government and the use of procurement in trade finance and working capital provision, irrespective of sector. Governments see procurement as expenditure to be managed within annual budgets; trade and receivables finance professionals see procurement as a predictable future cashflow capable of supporting immediate investment. A new approach to blended finance, and therefore productive security, means combining these two perspectives.

A private sector led wealth fund would be able to trade procurement as future cash flow or future receivables – in other words, to fund the contracts over longer cycles with money to the right player in a supply chain at the right time against delivery milestones. Money would be made in the normal way that receivables or payables financing organisations make money – through the interest rates charged and the accumulation of value in the fund. Equally, risks would be guaranteed by the entire blended finance ecosystem – the export credit agency (UKEF), the British Business Bank, the National Wealth Fund and even any multilateral systems, such as the Multilateral Defence Mechanism or the Defence Security and Resilience Bank once these are established and membership frameworks agreed.

Not only would this approach mean that a strategic priority of encouraging investment in UK businesses and infrastructure be reached, it would also make sure that the money reaches the parts of the SME sector that need financing quickly:

- The Fund would be able to finance cashflows arising from certified payment obligations thereby creating a "productive receivables market" to raise additional liquidity.
- Engaging with the Fund would not require the government to increase debt levels in the UK or alter the way in which its debt is treated because the SME is borrowing against future receivables and not the government. All the Fund is doing is speeding up the process of getting money into the base of supply chains.
- Allowing the Fund to trade "productive receivables" would not breach the procurement terms under which government contracts are agreed. Contracts themselves cannot be traded, but the capacity to trade cashflow allows the fund itself to have alternative revenue streams.

So the Fund is not simply deploying capital into strategic sectors. It would also increase the velocity of productive investment by creating liquid markets for sovereign-backed receivables. By purchasing, guaranteeing or refinancing payment obligations arising from approved public procurement, the Fund would enable firms through critical supply chains to access working capital substantially earlier than under conventional procurement models. Government expenditure would remain unchanged, but productive capacity would be created more rapidly allowing private capital rather than public borrowing to accelerate national resilience by providing productive liquidity into the market and turning debt into a productive asset.

Productive security as an Economic Power lever - concluding comments

In an era of economic conflict and uncertainty the point about power is essential to acknowledge. Economic power is arguably understood in terms of market size, access to finance, technological leadership or the ability of a state to impose sanctions and trade restrictions which currently many countries lack.[8] In an era of geoeconomic conflict, the "Strategic Market Failure" described here, is a failure to see the importance of economic power projection and how that underpins, not just competitiveness but also the ability to adapt productive capability swiftly to respond to changes in the geopolitical context. In short, it undermines both the capacity to fund and to fight wars.

The value of the concept introduced here of productive security is that it is not just improved productivity, it is also improved deterrence and improved offensive capability in a financial and economic sense. A government may announce, for example, accelerated energy investment, expanded digital infrastructure or greater defence procurement. But unless financial markets and industry possess confidence that productive capacity can be created rapidly with those commitments, there is a risk of creating inflation, sucking in imports or just leaving the announcements as aspirations because markets cannot adapt and scale quickly enough to create operational capabilities.

The proposed Sovereign Productive Security Fund becomes the institutional expression of blended finance in an era of strategic market failure by turning long term commitments into immediately investable assets. It is the mechanism through which governments, financial institutions and private investors can jointly create productive security while maintaining the market discipline and openness that underpins the values system of a liberal market democracy. Properly designed, it also provides the UK initially but the EU as well over a longer period of time with a financial means of using the economic power represented by blended finance in strategic sectors, trade and investment offensively.

This has profound implications for deterrence. Military capability is only credible if it can be sustained industrially. But equally, economic sanctions and other weapons of economic warfare are only credible if domestic production and supply chains are sufficiently resilient to withstand retaliation. Industrial policy is only credible if private investment believes governments possess the financial mechanisms (the blended finance and fiscal frameworks) to deliver it. In this context, the increase in food and energy prices since Russia invaded Ukraine can be seen as the manifestation of Strategic Market Failure across Europe.

The challenge for the 21st Century is therefore not choosing between markets and the state, or between economic efficiency and national security. Rather, it is designing institutions that are capable of allowing both to reinforce each other. Strategic Market Failure identifies where markets alone are insufficient. Productive security defines the economic outcome and blended finance provides the institutional architecture through which governments and markets jointly create productive capability.

The Sovereign Productive Security Fund is one possible institutional expression of that architecture. Its ultimate purpose is not simply to mobilise capital but also to strengthen the economic power upon which both prosperity and security ultimately depend.

https://rebeccanomics.com/research/productive-security/ ↑

https://rebeccanomics.com/commentary/future-of-security-and-bretton-woods-2-0/ ↑

https://rebeccanomics.com/commentary/towards-a-defence-spending-model/ ↑

ibid ↑

Harding, R. (2025): “The World at Economic War: How to Rebuild Security in a Weaponized Global Economy” *London Publishing Partnership*, London ↑

Centre for Economic Security and ECCRG King’s College London, Bush House Agreement, June 29th and 30th 2026: https://ces-global.net/the-bush-house-agreement/ Note, this could be seen as potentially building on the Mansion House Accord https://www.abi.org.uk/news/news-articles/2025/5/pension-industry-unites-on-mansion-house-accord/ focused directly on pension funds and a voluntary agreement to put at least 10% of their direct contributions into UK private markets. ↑

Security Returns on Investment can be defined as capturing the wider strategic value of an investment or transaction beyond financial returns. They capture improvements in productive capability, deterrence and national preparedness. In the same way that ESG expanded the definition of investment value beyond profit, Security Returns on Investment expand it to include security and resilience outcomes. https://rebeccanomics.com/research/ ↑

Economic Warfare: A Foundation for Twenty-First-Century Strategic Practice Greg Kennedy, Antulio J. Echevarria II, and Anna Brinkman-Schwartz Editors July 2026 ↑