Briefing

green alliance...

Autumn Statement: investment, not tax cuts, will grow the economy and deliver net zero.

November 2023

Summary

- The centrepiece of this pre-election Autumn Statement was £20 billion of tax cuts for businesses and individuals, the largest in decades.
- But these giveaways are largely being paid for by taking the axe to public spending in a manner set to sharpen dividing lines with Labour over the role investment in net zero industries could play in driving up our growth rate.
- There was also very little in the statement on climate and nature, and we await the detailed response to the US Inflation Reduction Act that had been promised.
- Although there were some good planning reforms, which may free up much needed investment in the grid, also missing were the trailed announcements on a Carbon Border Adjustment Mechanism and a battery strategy to support electric vehicle manufacturing.

The economy and public finances

The government opted to use an unexpectedly large undershoot in borrowing to deliver the largest tax cut since 1988. It slashed national insurance contributions by 2p in the pound and made permanent a tax break for business investment ('full expensing').

However, the tax cuts rest on the fiscal fiction that inflation raises tax revenues but not spending on public services, so borrowing comes in lower even though the underlying fiscal position has not really changed.

This still has to be paid for, so big cuts to public spending are on the way to balance the books. Non-protected departmental spending will need to fall by 2.3 per cent a year in real terms from 2025-26, according to the Office for Budgetary Responsibility (OBR). Public sector net investment, already far too low, is likely to fall by a third as a percentage of GDP between now and 2028-29.

Even these steep cuts will not stop taxes rising over the parliament. Coupled with high inflation, the outlook for living standards is grim.

What the UK needs, and has been lacking, is sustained growth in real GDP per capita (the most meaningful measure of wealth, as it strips out the effects of inflation and a growing population), which will boost household wealth and put public finances on a sustainable footing. Yet the forecast for growth in 2024 has been halved from 1.8 per cent to 0.7 per cent and will continue to disappoint thereafter.

The divide is political

What the statement did achieve, however, is to sharpen the political divide with Labour over the economy and net zero.

The chancellor compared his £20 billion in tax giveaways, which will ultimately be funded by extra borrowing, to Labour's proposed £28 billion Green Prosperity Plan, which will also be funded by borrowing. The question is whether the government's plans will deliver productivity enhancing growth and carbon cutting investment.

The government is pinning its hopes on lower taxes and a clutch of pro-competitive measures, including the full expensing for investment, as mentioned, a £4.5 billion package for advanced manufacturing in green and other sectors, and a collection of 110 different supply side reforms designed to free up private investment.

These are not insubstantial. The OBR is forecasting that full expensing will deliver a boost to growth of about 0.2 per cent annually. However, it is untargeted when it could have been directed to support businesses to be both greener and more productive at the same time. Instead, it could end up funding new investments in coal, oil and gas, which would deliver neither higher productivity nor decarbonisation.

The Resolution Foundation cautions that the boost to private investment will be largely nullified by the huge cuts to public investment. The government clearly believes the trade-off is worthwhile, as it assumes private companies are better at spotting opportunities than the public sector. But initial public investment is often needed to crowd in private spending. Many green sectors, like carbon capture and storage and hydrogen are highly capital intensive and need massive upfront investment to get off the ground. Meanwhile, the £4.5 billion advanced manufacturing package, which is much better targeted, looks paltry in comparison with the US's £310 billion Inflation Reduction Act.

The government also thinks there are too many regulatory barriers that discourage private investment. For example, it estimates planning reforms

detailed in the statement could increase grid investment by up to £10 billion a year, while an ongoing review of prices led by Ofwat could raise investment by water companies by £6 billion a year. But much of this investment is mandated anyway and already in the pipeline, so it is unclear whether the net effect will be anywhere near the £20 billion boost to investment claimed.

What does it mean for the next parliament?

Labour's solution to the problem of low growth is more public investment, especially in green industries via its Green Prosperity Plan.

The government's reluctance to take the bull by the horns on the public finances may limit Labour's room for manoeuvre if it forms the next government, as under-funded frontline services will be competing with its Green Prosperity Plan for cash.

This would be understandable, but short-sighted. We have previously set out the economic case for green investment, arguing that Labour's proposed investment of £28 billion would pay for itself over the medium to long term, allowing Labour to meet its fiscal rules. Moreover, the political advantage of spending on infrastructure early is that the productivity generated should arise by the end of a single parliamentary term, giving whoever forms the next government an economic tailwind before a general election.

Looking across the Atlantic, Joe Biden's Inflation Reduction Act was passed just two years ahead of his re-election campaign. Several hundred billions of dollars of private investment has already flowed from it, but it may not lead to economic change in time to see him returned to the White House.

Green investment is certainly a better long term bet than unfunded tax cuts. But the clear lesson is that it's better to go big and go early.