Briefing

Spring budget 2024: the need for green investment

February 2024

Why green investment is needed

With the UK economy in recession and the government set to miss its clean energy targets, the case for more green investment has never been stronger.

Yet, while current government spending plans include a large cut in public investment over the rest of the decade, the pre-budget debate is all about which taxes to cut.

Meanwhile, Labour has bowed to political pressure and gutted its £28 billion a year Green Prosperity Plan, leaving question marks over how it will deliver its pledge to green the economy and ensure the UK's competitiveness.

Low investment is one of the main causes of the UK's dismal productivity and the stagnation in real incomes since 2010-11. The way to sustainable economic growth and rising living standards is through investing in the energy efficient industries that will dominate the mid twenty first century.

The case for change, starting in the spring budget, is compelling:

- **Public investment, already far too low, is forecast to fall by a third as a percentage of GDP between now and 2028-29.** Unprotected government departments also face a 17 per cent real terms cut in funding per capita in the next parliament.
- **This is a longstanding problem. Annual UK total investment, as a share of GDP, has been, on average, four percentage points below that of other G7 economies since 1990.** Had the UK managed even OECD average levels of public investment over the past two decades (at around 3.7 per cent of GDP a year, 50 per cent higher than the UK), around £500 billion more would have been invested (at 2022 prices).
- **This is a colossal lost opportunity.** We estimate that this £500 billion would have been enough to build over 150GW of offshore wind, along with the interconnectors necessary for electricity export to the EU. By 2030,

accounting for the expected electrification of heat and transport, this would have been enough to return the UK to being a net energy (not just electricity) exporter, supplying a sixth of the EU's total electricity demand. Put another way, the UK could be exporting more power than either France or Germany consumes, making electricity a large export earner.

While we can't correct past mistakes, we should try to not make the same ones in future. While the UK has made good progress on decarbonisation, the dividends of the UK's early investment in renewables are beginning to run out, and the UK now requires a new wave of investment in clean heating, transport, nature restoration and heavy industry.

How much investment is needed, and how can it be delivered? The LSE's Grantham Institute has costed the main policies to get the UK on track to meet its climate obligations and estimates that it will require around £26 billion of public investment, which is less than one per cent of GDP.

Our analysis also found that Labour's abandoned target of £28 billion of annual public investment was in the right ballpark. Currently neither major party has a credible plan for the green investment the UK needs.

Two major reforms

Two major sets of reforms can unshackle public sector investment and incentivise private capital investment:

1. Adopt new fiscal rules that encourage rather than penalise investment

The fiscal rules adopted by both parties prioritise current rather than investment spending, even though more investment would boost GDP and help to meet the rules themselves. We have set out alternative fiscal rules that would exempt green investment from the sustainable debt rule or include a mandate to increase net wealth and the stock of natural capital over the course of a parliament.

2. Build mechanisms to encourage more private capital into nature and net zero

Even with pro-investment fiscal rules, the bulk of the £50 billion a year the Climate Change Committee estimates is needed by the end of the decade will still come from the private sector. Therefore, it is vital that the government sets out a net zero investment plan, with sectoral roadmaps, to give private investors more certainty about the opportunities and payoffs. It should also deliver on the core commitments of its Green Finance Strategy, including speedy delivery of a comprehensive green taxonomy.

We also argue for measures to attract private capital into protecting nature by developing natural capital markets, drawing on the Treasury's own pioneering Dasgupta Review. These could include 1) using the existing Environmental Land Management schemes budget to create an initial pipeline of high quality nature projects that appeal to investors; 2) investing public money based on outcomes, rather than activities, to create market information for potential private investors; 3) building confidence and trust in the market through strong standards and an independent body to verify business claims.

Other priorities

Also in the budget, the chancellor should act to clarify the government's economic and environmental strategy and dispel uncertainty which is seriously inhibiting climate action. These actions should be:

Reform CfD auctions for continued development of offshore wind

The government responded to the failure of the most recent contracts for difference (CfD) auction to attract offshore wind projects by increasing the strike price for the coming round 6 by 66 per cent for offshore wind and 52 per cent for floating offshore. But it has not announced the size of the total budget. It is crucial that the government matches the higher strike price with sufficient funding.

In the medium term, the sector needs a longer term approach that encourages operators to invest in infrastructure, skills and new technologies. Setting out a roadmap for the next two to three years and enabling companies to bid for contracts several years ahead, would address the logistical problems companies face in delivering over a single year.

Further auction rounds should take more account of non-price factors, such as the need to invest in skills and ensure the supply of cables and other equipment, particularly for floating offshore wind. This would ensure the UK retains more of the economic upside of green investment.

Invest to keep energy bills down

A third of households were obliged to spend more than ten per cent of their incomes on heating last year. Rather than subsidising energy bills, the government should encourage investment in making energy cheaper and homes warmer. We have two suggestions:

- **Clean Heat Market Mechanism (CHMM).** Recent reports suggesting a potential withdrawal of the CHMM would be a backwards step on the path to low carbon, lower cost heating for all. Our analysis shows that retrofits with heat pumps can provide cheaper heat than retrofits with boilers. The government should confirm that the CHMM is still due to launch on 1 April 2024 as planned.

- **Rebate to renovate.** To support investment in private rented homes, the government should introduce tax incentives to spur landlords to invest and improve security of tenure which will encourage tenants to apply for grants. They should introduce an Energy Savings Stamp Duty to make upgrading properties more attractive to homeowners and reduce the running costs of clean electric heat to ensure affordability.

Encourage greener transport

With public spending under pressure, the government needs to do more to shift resources away from environmentally harmful modes of transport and towards greener, cleaner travel. Our analysis (available on request) suggests there is up to £10.6 billion of public money to be recovered by not taking forward some contentious major new road projects. Spending this money instead on sustainable transport projects, such as active travel infrastructure, bus priority measures and public transport fare caps would benefit far more people and communities across the country.

The government should also phase in a kerosene tax on flights outside the UK and European Economic Area from 2025. A charge of £0.09 per litre in 2025 would raise £800 million. If raised to a level consistent with the government's predicted carbon value in 2035 it would raise £8.6 billion a year, which could be used to offset investment shortfalls in other areas.

The government should set up an independent commission to assess the looming fiscal challenges presented by falling fuel duty revenues and design an equitable road pricing scheme to limit the financial loss to the Exchequer.

Invest to encourage the circular economy

The government needs to address the massive under-investment in infrastructure necessary to support a more circular economy.

The main fund the government has, the Waste Infrastructure Delivery Programme, has £3 billion committed up to 2042. But it is dedicated to residual waste treatment, predominately generating energy from waste. There is no equivalent fund for recycling, or indeed to reduce the amount of resources used or waste generated in the first place. Nor does the new UK Infrastructure Bank have circular economy as part of its remit, only waste.

To encourage circular businesses of the future to thrive (those that reduce resource use and design out waste), another significant source of potential growth in the economy, this focus must shift, which is why we have recommended an £800 million kickstarter fund to begin to redress this imbalance. This will help truly circular economy businesses to get off the ground, as well as the supporting infrastructure and logistics providers.

For more information, contact
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