Briefing

green alliance…

The 2024 budget and spending review

October 2024

Summary

Chancellor Rachel Reeves will deliver the government's first budget on 30 October. She will also announce the details of the initial, one year spending review (SR) and give broad clues about the overall spending envelope for the first half of the parliament. The combined budget and SR come at a crucial time for the government, the economy and the environment.

In responding to these challenges, the chancellor should:

1. Set out a clear investment plan for infrastructure, and for clean energy and industries that will deliver stronger and more sustainable growth.
2. Change the basis of the fiscal rules, particularly the debt rule, to allow for more public sector investment. This should include the adoption of a target to improve the value of Public Sector Net Wealth.
3. Take immediate actions in the budget to tackle fuel and transport poverty, support industrial investment, help farmers deliver on nature commitments and cut emissions.

Powering up the economy through green growth and investment

The government appears to have three broad aims for this budget and SR. It needs to avoid imposing a new round of austerity on public services, stick to its pre-election commitments not to hike the main tax rates and raise the UK's sub-par rate of investment which is a drag on prosperity and holding back decarbonisation. Given the £22 billion overspend inherited from its predecessor, now put at up to £40 billion, this will be very difficult to pull off.

So it is vital that Rachel Reeves uses her statement to set out a clear path to faster, greener growth though more investment in clean industries, infrastructure and decarbonisation. Doing this will help, not hinder, the government in meeting its objectives by delivering a more dynamic, fairer and sustainable economy.

The government is right to have made achieving a faster rate of economic growth its number one mission:

- The UK's economy has grown more slowly than other advanced countries, and at an insufficient rate to properly fund net zero and maintain the social contract.
- This has been compounded by a series of policy errors (austerity, the mishandling of Brexit and a sluggish response to high inflation). But weak growth also reflects deeper structural problems in the UK economy (poor productivity growth, low public and private investment and Europe's starkest regional inequalities).

The government needs to understand the central role that the green economy can play in tackling these flaws and put in the necessary investment to unlock potential.

Decarbonisation will lower input costs for industry and cut heating bills for consumers. Backing the low carbon industries of the future will help British companies steal a march in fast growing global growth sectors. And supporting economically underpowered regions to move out of fossil fuels and into new green growth sectors, via a just transition, will close growth-sapping regional disparities in productivity and gross value-added.

Analysis by the CBI suggests clean growth opportunities, such as electric vehicles, heating and insulation could add up to £57 billion, or 2.4 per cent, to UK annual GDP by 2030. But, to deliver net zero and capitalise on these opportunities, the National Wealth Fund Taskforce estimates that annual low carbon investment, across the public and private sector, must increase to £50 billion by 2030.

Environmental damage costs the economy dearly

It's also clear that the government needs to recognise the impact of climate change and biodiversity on the economy, and factor this into its policy making. The Office for Budget Responsibility (OBR) warns that the direct and indirect costs of climate-related damage could increase debt by 23 per cent of GDP by the mid-2070s even if global warming is limited to 2°C, and by 33 per cent of GDP in the event of a rise of 3°C.

And nature loss in the coming years will cost the UK economy 12 per cent of GDP, more than the hit from the global financial crisis. As the Treasury-commissioned Dasgupta Review shows, preserving nature and investing to prevent climate change are critical to a healthy economy, and are therefore complementary to the government's goals. Mainstreaming net zero and tackling nature loss should be mainstreamed into all areas of government policy making, not least the Treasury.

The industrial strategy launched earlier this month is a positive signal. It will help to galvanise potential growth sectors, including in the green economy. But the strategy risks being undermined by a lack of investment in the economic infrastructure that supports growth. On current plans, the UK's already low level of public capital investment spending is set to fall by another £30 billion by the end of the parliament. Hopes that the government

will dig deep to reverse this look premature. Having scaled back its Green Prosperity Plan from annual investment of £28 billion to around £4.7 billion, it has also now cut by a fifth the money it pledged to the National Wealth Fund to invest in the green economy.

The private sector stands ready to invest in the green economy. Global financial institutions attending the investment summit earlier this month indicated they are keen to put money into the UK, if conditions are right. But initial public investment is often needed to crowd in private finance. By continually paring back its green ambitions, the government risks undermining business confidence.

Fiscal rules that encourage investment

The government is clearly signalling to financial markets that it wants to raise investment to boost growth and make the economy more sustainable. But it needs to develop a fiscal framework that secures this.

Instead, it has shackled itself with overly tight fiscal rules, including one mandating that debt should be falling as a share of GDP after five years. This damaging stricture makes no distinction between current and investment spending, producing a self-defeating tendency to cut growth boosting investment, rather than day to day spending, to balance the books when money is tight. This is why already perilously low investment spending is forecast to fall from 2.4 per cent to 1.8 per cent of GDP, by 2028-29. This will hit growth and imperil the government's mission to provide the infrastructure needed to grow the economy, restore nature and lower energy bills.

The chancellor is unlikely to ditch the rules as the political costs are too high. But she has already hinted that changes are afoot to how they are assessed, particularly regarding investment spending. Some options for this are summarised below.

The chancellor's fiscal rule assessment options

Reform	Pros	Cons	How much will it increase the scope for more investment?
Adjust the definition of debt to exclude **Bank of England** losses as it unwinds quantitative easing	Eliminates the anomaly whereby asset sales by the bank negatively affect fiscal forecasts	Risks undermining confidence in financial markets	£16 billion
Move assets of the **National**	Would allow extra borrowing	Markets might be suspicious that the	Planned new investment which

Wealth Fund (NWF) and **GB Energy (GBE)** off the government's balance sheet	equivalent to the capitalisation of these institutions	government is trying to smuggle non-investment through these institutions	could be moved off balance sheet: £5.8 billion (NWF); £8.3 billion (GBE)
Reassess how the OBR scores the **economic impact of investment**	Adopting a more 'optimistic' estimate of the pro-growth impact of investment means the government can invest more while still meeting its debt rule.	Could take a long time to free up substantially more investment	Substantial: all past and future investments could be assessed on the basis of recent OBR analysis suggesting that the long run (50 year) effect of a one per cent increase in public investment is a 2.5 per cent increase in output. (The current assumption is 0.5 per cent.) Some OBR critics would say an even higher figure could be used
Include **Public Sector Net Liabilities** (PSNL) on the government balance sheet	Brings assets traditionally considered too illiquid to include (eg the student loan book) onto the public balance sheet, increasing the amount of borrowing that can be set against this	As this measure does not include the assets created by investment (see below), it does not provide incentives to continue that investment in the future	£51 billion
Change the current debt rule to one mandating the government to increase the value of its assets (**Public Sector Net Worth)** over the term	Also brings more assets onto the public balance sheet (as with PSNL). But there is more emphasis on physical assets (bridges, the grid etc) and recognises the importance of investing in these to build economic	Can be hard to accurately value these assets, as they are more illiquid; backward looking, so it might be several budgets (years) before using that measure would produce an effect on investment	£56 billion

	value to benefit future generations		

Green Alliance's preference is for the government and OBR to adopt a target of increasing **Public Sector Net Worth** as its key fiscal objective, the final option outlined above. It should also capitalise on the OBR's willingness to treat investment spending more favourably. However, as these might take a long time to take effect, we would also recommend an immediate move to shift the assets of the National Wealth Fund and Great British Energy off the balance sheet.

These, together with other supply side reforms to boost the economy's growth rate, such as an industrial strategy, will help to close the investment and growth gap with peer economies.

Other measures the government should adopt in the budget

Ahead of a wider review of public spending and investment next spring, based hopefully on revised fiscal rules, there are several immediate actions the government should take in this budget. These would help support the growth mission, address ongoing cost of living concerns and help get the UK on track to meet its environmental targets.

Tackle fuel poverty: With around six million UK households still in fuel poverty, this is the government's last opportunity before the winter to offer a lifeline to struggling households. Support could take multiple forms but one support the government should consider is an improved and expanded Warm Home Discount to ensure those that need support most have access. This winter must be the last which merely implements a 'quick fix'.

Nobody in the UK should have to choose between heating and eating, so the government must work with charities, consumer groups and energy suppliers to design a new social tariff that protects the most vulnerable from the cost of energy.

Alongside this, we know that the only way to permanently bring down bills is through the rapid rollout of energy efficiency measures, so this budget must also lay the foundations for an ambitious Warm Homes Plan and Future Homes Standard, early next year.

Support industrial energy efficiency and electrification: The Industrial Energy Transformation Fund (IETF), which helps businesses with high energy use to cut their bills and carbon emissions, is close to running out of money. It was announced in 2018 and launched in 2020, initially with £315 million, with a top up of £185 million introduced in the 2023 budget which will shortly be spent as well.

Besides supporting industrial energy efficiency which has wider societal benefits, the fund is one of the only measures that supports companies looking to move from gas to electricity. That's despite electrification being a

more efficient solution to industrial decarbonisation in many cases than switching to hydrogen or carbon capture and storage, both of which are well supported by policy.

The fund should be extended with a focus on supporting electrification to provide more expertise and experience in this area to benefit industry more broadly and should also make access to funding for initial scoping studies than is currently available.

Wider public discussion is also needed about how to ensure power prices for critical industries are competitive and support decarbonisation without a net negative impact on other consumers. We have previously proposed that one solution could be government underwriting of power purchase agreements.

Help farmers deliver on nature commitments: The farming budget is core to delivering the government's manifesto promises, from its new deal for farmers to commitments to meet legally binding targets on climate, nature and water quality.

A reduced budget risks farms on the lowest incomes going out of business. Twelve thousand lowland grazing farms in England would have taken home just £7,800 on average last year, without government funding. These farmers can secure a fair wage through post-Brexit farming schemes, which pay them to create habitats and store carbon. But a smaller farming budget would mean less support for farmers to do this work.

With 70 per cent of UK land farmed and the sector behind on reducing emissions, agriculture needs the right resources to play its part in protecting the environment.

Green Alliance analysis suggests that cutting the farming budget by ten per cent would lead to agriculture in England falling at least 15 per cent short of its emissions reduction target for 2028-30, as well as putting at risk a target to reduce agricultural water pollution by ten per cent by 2028.

Extend the bus fare cap and invest in sustainable transport: The bus fare cap has kept the price of single bus journeys at £2 since 2022 but is due to end in December. The scheme was set up with £500 million from the government and was extended in May with an additional £300 million. In the year following the cap, bus journeys in England increased by half a billion, starting to reverse the decline caused by the pandemic.
Without this cap, more people will be impacted by transport poverty, with the effect felt most by groups such as jobseekers, who disproportionately use buses, and the lowest income groups, who are least likely to own cars.

To have a major effect on reducing levels of transport poverty and boosting public transport use, this cap should be reduced to £1 and extended for five years to give operators and local authorities certainty. This would cost £2.1 billion and is also a cost effective way save 3.85MtCO_2e in greenhouse gas emissions (equivalent to nearly half a million cars off the road).

On spending, reallocating funding from new large scale roads projects could make up to £15 billion available to maintain the existing road network and invest in sustainable transport infrastructure.

Fuel duty and transport tax: The most polluting modes of transport are not paying their fair share of tax. Fuel duty has remained frozen since 2011, and aviation fuel is not taxed at all. The fuel duty freeze should be lifted, alongside the kerosene tax at 9p per litre in 2025, increasing annually to reach 97p per litre in 2035 for all flights, where air service agreements allow. Taxing private jets could raise a further 200 million per year. To address longer term concerns, the government should appoint an independent cross party commission to design an equitable road pricing scheme.

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