Briefing

Budget 2025: focus on fairness and growth, not tax rises

November 2025

Summary

A sluggish economy and tight public finances will make for some difficult budget choices, with further tax rises looking inevitable.

To navigate this backdrop we suggest three areas of focus for the chancellor to boost the economy, while also helping to reverse nature decline and improve the UK's response to climate change, both necessary for the UK's economic security:

- end the costly and harmful freeze on fuel duty increases as part of moves towards a fairer and **more sustainable tax system** that supports growth;
- continue focus on delivering **clean growth and investment**, which the government has called the "economic opportunity of the century";
- target **help towards high energy bills for households and industry**.

Introduction

Labour's second budget on 26 November will be more difficult than its first. While the economy has been growing, the government has so far failed to provide a strong enough signal of the economic transformation it promised for its term in office. The UK faces further stagnation from a stalling labour market and stubbornly high inflation. The tax burden is at a 75 year high, yet parts of Britain are now poorer than Lithuania and Slovenia.

The £22 billion 'black hole' in the public finances the government identified on coming into office is now put at anything between £30 billion and £50 billion. To close it and ensure compliance with its 'stability' fiscal rule (requiring day to day public spending to be covered by revenues by 2029-30), further tax rises in the budget are almost certain. Attempts to curb borrowing through other means, such as slowing the rate of growth of the welfare budget, have foundered politically.

Supporting green investment

All this casts a shadow over the government's plans to spend on green infrastructure and its appetite for regulation to support private sector investment in the low carbon economy and natural assets.

The government clearly recognises the long term social and economic value of investing in UK resilience and clean growth. It laid out substantial plans, including recommitting, in its spring 2025 spending review (SR), to funding nature friendly agriculture and creating warm homes, and providing additional support for transport infrastructure. The Industrial Strategy a few weeks later singled out clean power and advanced manufacturing, including transport electrification, as important growth sectors to nurture.

But the UK's actual record of sustaining investment and long term support for new growth industries is patchy at best. The all important investment pledged in the SR is theoretically protected by the 'sustainable investment' fiscal rule, which omits capital spending from the borrowing figures, since it is assumed to pay for itself. However, the current state of the public finances could still complicate the timely delivery of the SR's plans, since most major projects are delivered through a combination of current and capital spending.

Public investment is intended to 'crowd-in' a greater amount of private investment, but political uncertainty over the government's economic approach, as well as uncertainty over policy delivery, could undermine private sector confidence. Further geopolitical turmoil could also force the government to bring forward its target for defence spending to reach three per cent of GDP in the next parliament, squeezing out other investment in the third year of this SR and the start of the next SR.

Three important considerations

1. **Fair tax rises that support sustainable decisions and have a low impact on growth, inflation and incomes**

Having apparently ruled out changes to the main tax rates, the government has limited its other options. But **there is a series of tax reforms focused on**

achieving environmental ends that could raise revenue while eliminating subsidies for harmful activities. The following are obvious areas for action:

- **Fuel duty**. It is time to end the 14 year freeze on fuel duty and increase it in line with inflation. It was government policy to increase duties annually in line with RPI, but successive governments have cancelled all the planned rises since the freeze took effect. An additional 5p 'temporary' duty cut during the energy crisis in 2022 has compounded the financial and environmental impact. The freeze alone means UK CO_2 emissions are now as much as five per cent higher than they would have been otherwise, and it has cost the Treasury over £100 billion in lost tax revenues. Letting fuel duty rise in line with inflation could **raise around £5 billion a year**.

  While drivers and haulage businesses would have to pay higher pump prices, it is worth noting that the current duty rate is the lowest it has been since March 2009 in cash terms and the lowest since March 1993 in real terms. Continuing the freeze undermines the government's claim to fiscal rectitude.

  Failure to replace the lost revenue has been cited by the Office for Budgetary Responsibility (OBR) as a long term risk to the stability of public finances, and the House of Commons has criticised the 'fiscal fiction' of the government submitting forecasts to the OBR predicated on an end to the freeze when it has no intention of doing so.

  There have been reports that Government plans to consult on pay per mile charges for EVs to be introduced from 2028. As more people drive electric vehicles, they won't pay fuel duty, so revenues must be replaced in the long term. But the premature introduction of pay per mile schemes could slow the transition to cleaner electric vehicles if not matched with further moves to incentivise a switch to cleaner forms of transport. Any moves in this direction would make it even more important to end the freeze.

Will ending the freeze on fuel duty be inflationary?

A road haulage business group has cautioned against ending the freeze, arguing it will fuel inflation. Is this true? Our analysis, based on ONS methodology, suggests that reintroducing the Retail Price Index (RPI) linked increases to fuel duty in November 2024 (after the last budget) would have driven a 0.06 percentage point increase in overall, month to month all items Consumer Price Index (CPI). Reversing the 'temporary' 5p cut would also have had a small impact on inflation, driving a 0.16 pp increase in month to month all items CPI.[1]

Inflation has been lower since April 2025 than the 12 month headline rate of CPI inflation. The annualised rate in the five months to September was 1.9 per cent (this means that if inflation kept going at the rate it had for the period from April to September for a year, the annual CPI would be 1.9 per cent).[2] That's below the Bank of England's two per cent target and means the RPI-linked fuel duty increase would, in fact, bring inflation towards the target rate of two per cent.

Overall, our analysis shows that increasing fuel duty does not bring significant inflationary risk. Therefore, the government should implement the RPI linked increase as soon as possible to maximise revenue and avoid a rise in duty coinciding with potential domestic energy price rises in April 2026. As we have mentioned, the reversal of the 5p cut could then be implemented later.

Our calculated inflationary impact of fuel duty rises may be an overestimate. Petrol and diesel retailers may absorb some of the price rises, particularly due to their higher than normal profit margins. Petrol retail spreads are averaging 13.3p per litre, according to the latest data, which is more than double the average level for 2015-19, when spreads were at 6.5p per litre. That shows that retailers would easily be able to maintain high margins with the RPI linked increase in fuel duty (2.9p per litre). Further, the government is aiming to launch 'Fuel Finder', a tool to provide fuel price information to motorists, by the end of 2025. This should create its own downward pressure on fuel prices as retailers are forced to compete more efficiently for a market share.

Other tax measures:

- **Aviation**. Flying is highly polluting and under-taxed. Fairly taxing aviation fuel and private jets could **raise about £4 billion** a year (equivalent to putting 1p on income tax).
- **The Energy Profits Levy** should be made permanent. The last budget increased the rate from 35 per cent to 38 per cent and removed the investment allowance. The levy is forecast to **raise £1 billion a year** by 2029-30.
- **The Plastics Packaging Tax** should be escalated with a clear trajectory to improve investment in recycling facilities in the UK. Although the proportion of plastic packaging reported to have at least 30 per cent

recycled content has increased slightly, the tax, set at £223.69 per tonne, is too low to address the price gap between virgin material and recycled material. An escalator, as was used so effectively in the Landfill Tax should be added to both the rate of the tax and the level of recycled content, to provide the industry with a clear signal of bankable conditions. This should be paired with measures like planned Deposit Return Scheme to ensure recycling is economically viable in the UK.

2. **Green growth, not just deregulation**

Since the budget deficit is expressed as a percentage of GDP, the simplest way to bring it under control and meet the fiscal rules is to increase the size of the denominator, ie to grow the economy at a faster rate.

The green economy is the obvious place to look for growth, it is currently the UK's fastest growing segment. CBI analysis shows the economic value of clean sectors grew by ten per cent in 2024. McKinsey has put the size of the prize available to UK firms supplying goods and services for the global clean energy transition at up to £1 trillion by 2030. The UK has a comparative advantage in clean technologies compared with some other economic sectors, including AI, meaning industry could be poised to exploit this market if conditions were right.

The SR and Industrial Strategy laid out detailed plans for achieving a faster rate of clean growth and it is vital the budget prioritises this over some of the government's other growth ideas. For example, a third Heathrow runway will do little to boost the economy but much to jeopardise the country's emission reduction targets.

City deregulation, announced in the chancellor's Mansion House speech, risks repeating earlier mistakes by treating financial services mainly as a growth sector in its own right while ignoring its more important, but less successful, role in allocating capital to the rest of the economy. It is also important that wider deregulation of business does not sacrifice important environmental protections.

And, more can be done:

- **Circular economy.** An ambitious circular economy strategy could lead to innovative business models that reuse, repair and remanufacture products and materials rather than buying new goods from abroad and then shipping them overseas as waste at the end of their lives, leaking significant resource value out of the UK economy. Conservative analysis by PWC suggests that matching competitor countries on the circular economy in just four sectors could **boost growth by up to one per cent**, potentially create 170,000 jobs and raise labour productivity by 0.4 per cent over five to ten years.

- **Renewables supply chains.** As the power grid is decarbonised there are huge opportunities to build out renewables supply chains, as the Clean Energy Industries Sector Plan recognises. While capital expenditure for new wind power projects is mostly funded through contracts for difference (CfDs), too much of the components' supply chain is based abroad. However, UK suppliers need help to scale up. While the supply chain fund of Great British Energy has been allocated £300 million over the course of the parliament, on top of the previous government's £1 billion Green Industries Growth Accelerator, this is probably insufficient given the size of the potential market. For example, only two per cent of the steel used in British offshore wind projects over the past five years was made in the UK. The forthcoming steel strategy must ensure the UK can make the steel plate and electrical steels needed for an expanding clean power system. **Substantial opportunities for onshoring component production** also exist around building out the electricity grid.
- **Tax credits.** The government should **steer investment towards fast growing green sectors**. One of the most effective ways of doing this is to lower the cost of capital through selective tax breaks. The CBI has suggested a new tax credit with a headline rate of 40 per cent to unlock private sector R&D and innovation in a range of green technologies and more favourable capital allowance rates for some investments too. We add that green investments should have a minimum of three years' relief to reflect the payback period for business investments, as opposed to the current 12 months.
- **Electric vehicles (EV).** The UK was Europe's leading market for EVs last year, but the wider UK car industry is struggling with Chinese competition, US tariffs, high energy costs and disruption from hackers. The CBI estimates that a transition to manufacturing EVs instead of polluting cars **could add £16.1 billion to the gross value added (GVA)** of the UK's automotive sector by 2035. We argue that supporting domestic EV manufacturers to invest in the skills and technologies for the next wave of innovation could pay huge dividends. In the shorter term, the government should accelerate incentives for EV adoption, improve the US and EU trading environment for UK-built EVs, and encourage inward investment into the industry and its supply chains.

3. Affordable energy for businesses and consumers

While energy prices have come down from their record highs, around 11 per cent of households remain in fuel poverty and industry faces Europe's highest power prices, so acting on energy costs will put more money in people's pockets and relieve cost burdens on heavy industry.

For consumers, the Treasury is reportedly considering lowering the five per cent VAT rate on domestic energy bills to zero at a cost of £2.3 billion per year. Instead, this money could be better targeted to achieve the same average household bill reduction while also making heat pumps more financially attractive by removing £2.6 billion of policy costs for legacy renewable price support schemes (the Renewables Obligation (RO) and Feed-in Tariffs (FiT)). Unlike zero rating VAT, it is a time limited increase in government spending as payments under the RO and FiT schemes will have ended before 2040.

By reducing inflation, this would also help to counteract the (fairly small) inflationary effect of the end to freezing fuel duty we propose (see point one above).

A slightly longer term alternative the government could consider is a social tariff, offering percentage discounts on gas and electricity bills for lower income households, which would provide far more effective support than existing flat rate schemes. We estimate targeted support could **lift between 12 per cent and 50 per cent of fuel poor households above the poverty threshold**.

For industrial users, it is imperative the government introduces the British Industrial Competitiveness Scheme (BICS) to reduce electricity costs for automotive and other sectors, by shifting some of the policy costs off their bills earlier than proposed, and before the promised date of 2027.

We also urge the government to introduce an electrification business model to help close the gap between gas and power prices and make it more economical for companies to switch to more efficient electric technologies, reducing pressure on the grid. This should be government funded to avoid extra burden on other billpayers. The Treasury should also consider a VAT exemption or other similar measure which kicks in when industrial gas prices are particularly high.

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Endnotes

[1] To reach our figures for the change in inflationary impact of inflation, we first calculated the actual impact since November 2024, and then calculated an equivalent counterfactual by varying the fuel price over the same period. The methodology we used for calculating the change was taken from the ONS, as was all of our source data. Further details available on request.
[2] Office for National Statistics (ONS), CPI All Items index: 100 x (2025 SEP/2025 APR)^(12/5) – 100 = 100*(139.3/138.2)^(12/5)-100 = 1.92%