THE GREEN NEW DEAL GROUP

How to pay for a Green New Deal: Public sector borrowing

The UK needs a major programme of investment in order to move our economy beyond fossil fuels, improve our public services and tackle the cost-of-living crisis. This is one of five briefings summarising how that investment can be paid for. To read the other briefings, visit greennewdealgroup.org.

We often hear anxieties from politicians and the media about government borrowing, alongside analysis of how much 'fiscal headroom' the Chancellor might have. The reality is that public sector borrowing is a necessary part of the economy, and borrowing to fund the transition beyond fossil fuels is absolutely essential.

Investing to move beyond fossil fuels will pay for itself.

Our dependence on oil and gas is costing us a fortune. According to ECIU, failing to invest in renewable energy, insulation and electric vehicles over the last decade cost the UK nearly £30bn in 2023 alone, while Energy UK has found that action on climate now will generate between £32bn-£174bn more private investment a year by 2050 than under business as usual. The Office for Budget Responsibility has estimated that if no further action is taken to decarbonise, the cost of continued dependence on gas could be twice the level of public investment required to reach net zero by 2050.

Investing in decarbonisation will also cut costs to government in other areas – for example, ill-health caused by cold homes costs the NHS more than £500m a year, which could be saved by investing in insulation and affordable clean heat.

The government is best placed to make large-scale investments for public benefit.

Decarbonising our economy will bring huge economic benefits, but also requires major investment. In many cases – such as heat pumps and insulation – those short-term costs can either fall on households, who are already struggling with housing, energy and other costs, or on the government, which is ideally placed to make that upfront investment.

Returns will come in the form of better health outcomes; import substitution as a result of reduced gas dependence, which supports the value of the pound; and tax revenue from jobs created. In some cases, investment could be in the form of low-cost loans, meaning that the money will eventually be recouped from those households which can afford it. It is irresponsible for government not to be investing in these things when it is best placed to do so – and it is a political choice to impose the costs on households instead.

UK public investment is currently projected to fall — that's unacceptable.

The UK is crying out for investment, both public and private – yet government forecasts in November 2023 showed public sector net investment forecast to fall from 2.6% of GDP in 2023-24 to 1.8% in 2028-29. The Institute for Fiscal Studies (IFS) has found that even an

additional £20bn a year of capital investment, as previously pledged by Labour, would still leave investment falling as a percentage of GDP by the end of the next Parliament.

'Fiscal rules' have led to underinvestment.

'Fiscal rules' were introduced by the last Labour government as a way of convincing voters and investors that it would be responsible with public money. Subsequent chancellors have introduced at least nine different sets of fiscal rules, usually relating to the deficit or the ratio of debt to GDP. 'Fiscal headroom' refers to the amount of additional spending or tax cuts a government can introduce without breaking its fiscal rules.

These rules are not fixed by any external force; they are policy choices like any other, and they tend towards cutting the size of the state to get spending off the government's books. While fiscal rules are theoretically intended to promote long-term responsible fiscal policy over short-term 'giveaways', current evidence suggests they are having the opposite effect – in part because they fail to properly factor in the long-term economic benefits of investment, or the fact that some types of investment bring more benefits than others.

Despite widespread agreement across civil society and business that the UK desperately needs investment, the current government has published spending plans which show investment falling as a share of GDP over the next five years. These unrealistic projections have created some imaginary 'fiscal headroom', allowing the government to say it has improved the public finances and can cut taxes ahead of the general election.

There are limits to how much a government can borrow without destabilising the economy, but this is dependent on a range of factors including the productive capacity of the economy (work to do, people and materials to do it) and the value of public assets, rather than any simple debt-to-GDP calculation.

Fear of public borrowing can leave us paying more in the long run.

Because UK government bonds are such a safe place to invest, the UK government can borrow more cheaply than the private sector. When it comes to an essential public good where competition is either impossible or undesirable, like water infrastructure or a new hospital, public investment is likely to provide better value for money. In recent decades, however, anxiety about public sector debt has led to some imprudent government decisions – most notably the private finance initiative (PFI) which ran from 1992-2018.

Under PFI, the government awarded contracts to private firms to build and operate public infrastructure such as schools and hospitals. The private sector provided the upfront cost, and the state made regular payments for the duration of the contract. It was reported in 2019 that the NHS faced a total bill of around £80bn for just £13bn of investment, which the state itself could have provided at a lower borrowing cost. In the name of looking 'fiscally responsible', the government (mostly the Labour government of 1997-2010) oversaw a colossal rip-off for which the public sector is still paying.

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