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Fiscal rules and the facilitation of public investment in energy infrastructure

A Prospect briefing

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Prospect's proposal

The government's fiscal rule relating to debt (to have public debt falling by the final year of the forecast period) should use a measure of public debt which excludes investment by public sector corporations which invest in revenue generating energy infrastructure.

The need for greater public investment

Greater public investment is required to achieve clean power by 2030 and net zero by 2050.

- **Significant public investment is required to achieve clean (and cheap) power by 2030**. The investment model for renewables over recent years—private investment that is de-risked by Contracts for Difference (CfDs)—may have been effective at establishing the sector and reducing costs, but the same model will not elicit the massive ramp up in investment that is required over the next 6 years to achieve clean power by 2030. Substantially increasing CfD budgets could help attract greater levels of private investment, but this would ultimately lead to higher bills, which is the opposite of what the government is trying to achieve with its drive for homegrown renewable energy. Ramping up public investment is the only way we have a chance of meeting the government's ambitious targets in a cost-effective way.
- **Significant public investment is required to get a new build nuclear programme off the ground**. Nuclear power stations are complex infrastructure projects with upfront risks and long payback times that make private financing difficult. As such, almost all of the UK's nuclear power plants were approved in an era (1955-79) when public investment was much greater. The only privately financed nuclear project that has been approved in recent decades, Hinkley Point C (HPC), required a very substantial CfD (£92.50 per MWh in 2012 prices, for 35 years) to reassure private investors. However, despite this lack of new projects in recent years, new build nuclear is baked to our plans to achieve net zero. The Climate Change Committee's balanced pathway projection assumes 10GW of nuclear capacity by 2050, but HPC will provide less than a third of that.[1] As Prospect has previously argued, a substantial new build programme is required, but it will only be possible if the government leads the way with significant public investment.[2]

Fiscal rules risk

However, fiscal rules risk constraining public investment in energy, even though such investments are in our long-term fiscal interest.

- **The public investment institutions required to drive the transition to clean power and net zero are being established, but they are not adequately capitalised due to fiscal rule constraints.** GB Nuclear has been established and given powers to invest in projects, but it has not been backed by substantial funding to do so. GB Energy and

[1] Climate Change Committee, 'The Sixth Carbon Budget: Electricity generation', 9 December 2020, p 29.

[2] Prospect, 'Delivering clean power A mission for the energy system', 23 May 2023.

the National Wealth Fund (NWF) are being established with initial capitalisations of £8.3bn and £7.3bn over the course of the parliament. However, various studies estimate that increased public investment in the order of tens of billions of pounds *per year* are required to drive the green transition.[3] The low capitalisations of these bodies are a result of fiscal rule constraint; they are paid for by a windfall tax on oil gas companies and borrowing a small amount each year to invest 'within the fiscal rules'.

- **As well as helping the government meet its clean power and net zero objectives, public investment in energy infrastructure would generate future revenue for the exchequer.** Some public investments require the government to accept a certain cost now in exchange for uncertain and immeasurable economic, social and environmental benefits in the future. However, as well as achieving other objectives, investments in nuclear power plants or renewable energy projects will generate monetary revenue for decades to come, as end-users pay for the electricity that they produce. Over the long-term, these revenues will pay back the initial project costs and create a positive financial return which can either be paid back to the exchequer or be used to fund further investment. Given that such investments would be in the long-term interest of the public finances, it does not make sense for the government's fiscal rules to constrain them.

Refining the fiscal framework

Therefore, Prospect advocates a fiscal approach which recognises the long-term benefits of investment in energy infrastructure.

- **We suggest that excluding public investment corporations (PICs) from the fiscal rules is a sensible and straightforward way of facilitating investment in our energy system.** In our recent report 'Energising a green industrial strategy' we argued that the HM Treasury needed to move beyond its traditional approach of focussing on short-term fiscal constraints, and place greater focus on its role supporting long-term economic development.[4] We believe that privileging PICs—such as GB Energy, the NWF and GB Nuclear—within the fiscal framework would be an effective way of doing that. Given that these bodies will create a positive financial return for the exchequer over the long-term through their investments, we do not believe it makes sense to treat public debt used to fund those bodies in the same way as other forms of public debt. We therefore propose that the government's fiscal rule relating to debt (to have public debt falling by the final year of the forecast period) should use a measure of public debt which excludes PICs. The activities of PICs would not be 'off balance sheet'; total public debt ('public sector net debt', or PSND) would still be measured and reported. However, the government's debt rule would be assessed with respect to this different measure (PSND ex PICs), which could be referred to as 'underlying' public debt. Financial markets would be able to see that total public debt was larger than 'underlying' public

[3] In its 2021 'Environment Justice Commission', the IPPR called for the government to spend £30bn per year on green investment. A more recent analysis by academics at the LSE's Grantham Institute, 'Boosting growth and productivity in the United Kingdom through investments in the sustainable economy', recommended £26bn per year. In 2020, in its 'Sixth Carbon Budget', the Climate Change Committee suggested that an additional £15bn of investment was required each year from 2025 if the grid was to be decarbonised by 2035.

[4] Prospect, 'Energising a green industrial strategy: Building a consensus for action', 4 September 2024, p 7.

debt, but it would be clear that the incremental difference between the two figures was accounted for by liabilities associated with revenue generating assets.

Benefits of adopting the proposal

Adopting the proposal could, make the government's energy objectives achievable, improve working conditions in the sector and lead to a step-change in public investment.

- **GB Energy and the NWF could be scaled up by an order of magnitude**. If the government believed it was necessary to meet its objectives, the capitalisations of these institutions could be increased without having to raise taxes, cut public spending or reduce 'headroom' against the fiscal rules.
- **Great British Nuclear could become a significant co-investor in new nuclear projects**. Substantial public investment in new build nuclear has been off the table in recent decades, however, if GB Nuclear could borrow to make investments, without impacting the government's ability to meet its fiscal rules, then such investment could become viable. However, for the fiscal logic stated above to apply, GB Nuclear would have to make investments in return for equity and/or a stakes in the future returns of projects, rather than provide unconditional subsidies which reduce risk for private investors without gaining anything for the public sector in return.
- **As a co-investor, the government could help improve working conditions in the renewables sector**. As we have previously argued, GB Energy should have an explicit mandate to create and support good jobs.[5] It could do this by attaching 'good jobs' conditions—such as on decent pay, health and safety, workforce diversity, and engagement with trade unions—to public support for clean energy projects. The greater role that GB Energy is able to play as an renewables investor, the more power it will have to spread good working conditions throughout the sector.
- **The proposal could lead to a resurgence in public investment more broadly**. During the high investment post-1945 decades, public corporations accounted for a significant amount of total public sector investment.[6] Under Prospect's proposal, they could do so again. Prospect's main concern is to free up public corporations which invest in energy infrastructure; however, the same logic could apply to public corporations which invest in other revenue generating assets (e.g. social housing or transport infrastructure). By taking revenue generating investments outside of the fiscal rules, there would be more remaining headroom within the fiscal rules for the government to invest in non-revenue generating assets. The additional economic growth that results from such investments would improve the fiscal position further, creating a virtuous cycle.[7]

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[5] Prospect, 'Delivering good work in clean energy: Five goals for the energy sector', 9 October 2023.

[6] The composition of public sector net investment from 1948 to the present is illustrated in Chart 2.2 of the following paper: Office for Budget Responsibility, 'Public investment and potential output', August 2024.

[7] The Office for Budget Responsibility paper cited above suggested that "a sustained 1 per cent of GDP increase in public investment could plausibly increase the level of potential output by just under ½ a percent after five years and around 2½ per cent in the long run".

Feasibility of the proposal

The proposal is precedented and would have broad support.

- **Other countries also exclude public investment institutions from their fiscal rules**. As illustrated in the table below, European countries have public investment institutions which are not captured by fiscal rules and they invest at a far greater scale than their UK counterparts, with assets worth hundreds of billions of euros.

	Launched	2022/23 Investment, £bn (% GDP)	Assets/ portfolio, £bn (% GDP)	No. of employees	Captured by fiscal rules
UK Export Finance	1919	£6.5 (0.3%)	£4.5 (0.2%)	523	Yes
British Business Bank	2014	£1.6 (0.07%)	£3.8 (0.17%)	609	Yes
UK Infrastructure Bank	2021	£1.1 (0.05%)	£0.66 (0.03%)	198	Yes
KfW (Germany's state-owned investment and development bank)	1948	€40 (1%)	€560 (14%)	8,149	No
Bpifrance (France's state-owned investment bank)	2012	€26.4 (1%)	€100.4 (4%)	3,860	No
European Investment Bank	1948	€75.1 (0.4%)	€566 (3.6%)	4,020	No

Source: Andy King and Daisy Jameson, 'Designing a UK fiscal framework fit for the climate challenge', 11 July 2024.

- **The previous government also adjusted the definition of public debt they used for their fiscal rules**. For their debt rule, they used a measure of public debt which excluded the Bank of England (PSND ex BoE). Amongst other things, using this definition meant that liabilities associated with the Bank's 'Term Funding Scheme' (TFS)— which guaranteed low-cost financing for SMEs—did not count towards the government's debt target. This scheme can be considered a form of industrial policy intervention of a similar scale to what we might like to see from the energy investment institutions mentioned above, amounting to almost £200bn or 10% GDP at its peak.[8] However, there was no significant debate about the definition of debt being used for the fiscal rules excluding the impact of the TFS, nor has the UK government been subject to pressure from financial markets as a result of concerns about 'real' public debt being higher than the measure the government was using for its fiscal rules.[9]
- **There would be broad support for such a move**. Various economists, think tanks and international organisations are in favour of constructing the fiscal rules in a way which facilitates public investment.[10] The 'National Wealth Fund Taskforce', which advised the Chancellor on how to structure and implement the NWF, recommended that it be excluded from the fiscal rules "calculus" to help it achieve its objectives.[11]

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[8] Institute for Fiscal Studies, 'Definitions of debt and the new government's fiscal rules', 7 August 2024.

[9] This is complicated by the fact that the Bank's quantitative easing programme, and its later unwinding, had also had a significant impact on the gap between PSND (total public debt) and PSND ex BoE. There has been a debate about that. For an explanation see Institute for Government, 'What are the different ways to measure public debt?', 24 September 2024.

[10] For example, Evening Standard, 'Rachel Reeves has more reasons to smile as OECD upgrades UK growth', 25 September 2024; Financial Times, 'Letter: UK national renewal requires step change in public investment', 16 September 2024; Benjamin Caswell, 'It's Time To Rewrite the UK's Fiscal Rules', NIESR, 3 July 2024; Resolution Foundation, 'Cutting the cuts: How the public sector can play its part in ending the UK's low-investment rut', 30 March 2023.

[11] See footnote 3 of National Wealth Fund Taskforce, 'Report', July 2024.