Budget 2021: while important steps have been taken, bolder and better coordinated action is needed for a sustainable recovery

Anna Valero *writes that the underlying and urgent issues that were facing the UK economy before the pandemic, such as high levels of inequality and weak productivity, are still present, and are indeed more pressing than ever. She assesses the extent to which the 2021 budget addresses them.*

Thinking back to last year's budget, much has changed. At that point, the UK had still not entered its first lockdown. The scale of the health and economic crises caused by COVID-19, globally and domestically, was not anticipated then. Today, much uncertainty remains and current hopes are pinned to the resilience of vaccines to new variants. In the run up to Budget 2021, analysis at the LSE's Programme on Innovation and Diffusion set out the economic damage that would ensue if business support policies were to come to an abrupt end this spring. The extended support for workers and firms over coming months, including via the furlough scheme, new grants, and loan schemes is therefore highly necessary.

But, compared to one year ago, the underlying and urgent issues facing the UK economy have not changed, and have in fact become even more pressing. These include the commitment to reach net-zero greenhouse gas emissions by 2050; the need to address longstanding weakness in productivity; inequalities across and within regions which have been so painfully exposed by the crisis; and new challenges due to the UK's departure from the EU which has now become a reality. In order to move onto a sustainable and inclusive growth path, the UK must act quickly and at scale with the appropriate strategy, finance, and policies that will generate the required investments across physical, knowledge, human, natural and social capital. Moreover, actions at home will have wider global implications, particularly this year given the UK's leadership at COP26 and the G7.

Building a clean and inclusive future economy

A series of budget announcements relating to 'building the economy of the future' are innovative and promising. Importantly, the Chancellor confirmed that the new National Infrastructure Bank (a key recommendation of the LSE Growth Commission in 2013) will have a sustainability mandate. Novel financial instruments including Green Gilts and newly-announced Green Savings Bonds will help channel savings into sustainable investments; the £1bn net zero innovation portfolio will provide much needed support for clean innovation which our research has shown can generate opportunities for growth and 'levelling up'. Reflecting net-zero in the Bank of England's mandate is also an important development.

But given the scale of the challenges we face, we must now go beyond 'marginal changes' and ensure that incentives for clean investment, innovation, and practices are aligned across the economy. A key example of incentives not being aligned is the continued freezing of the fuel excise duty which will stifle demand for electric vehicles. And there were noticeable omissions in key areas, for example with respect to the need to roll out electric vehicle charging infrastructure, and on energy efficiency. In particular, the Green Homes Grant – a keystone green stimulus measure – had its funding withdrawn. Such inconsistencies or omissions create risks in terms of reaching net-zero but also hold back the potential to create new jobs quickly and secure longer term growth opportunities.

Stimulating business investment will be key to restoring productivity growth, and taxes are a key lever for incentivising this. While the main rate of corporation tax will rise significantly in 2023, it will still be the lowest in the G7 and the increase in the main rate will be accompanied by protections for smaller businesses and a number of new incentives for investment. A headline is the new 'super-deduction' tax incentive for companies investing in qualifying plant and machinery (whereby 130% of the costs can be deducted from taxable profits). But the UK is primarily a service-based economy, and this measure is very much focused on physical capital. With more relevance for services perhaps, R&D tax reliefs (which have been found to be an effective mechanism for increasing innovation) are to be reviewed, including the potential for bringing data and cloud computing costs into scope. Eight new 'freeports' were also emphasised as a mechanism for attracting inward investment and revitalising local economies (there are risks that these might simply divert economic activity from elsewhere). But across the different types of tax reliefs and schemes set out, there was no mention of embedding incentives towards the net-zero transition, for example via enhanced reliefs for investments in zero-carbon assets or innovation; or enhanced environmental standards applied to new developments in freeports.

The importance of managerial skills for recovery, particularly in SMEs, was highlighted, with two new programmes announced: 'Help to Grow: Management', and 'Help to Grow: Digital'. Such programmes will be crucial to ensuring that positive technological responses observed since the onset of the crisis can be supported into recovery, and it will be important to continue to build evidence on what works. Again, sustainable technologies and business practices, as relevant for SMEs, can be embedded in such programmes.

Skills of the wider workforce are a core component of economic growth, improving living standards for individuals and communities, and building labour market resilience in the face of the COVID-19 shock, the zero-carbon transition and broader technological change. Despite emphasising a number of skills programmes in the context of COVID-19 related support (e.g. Kickstart and Restart); a forward-looking approach to skills was not central in the discussion of the economy of the future. Increased investments in the education system (particularly in the further education sector) will be crucial, including enhanced support for the younger generation and those from disadvantaged backgrounds who have faced the most educational or labour market disruption. Moreover, in light of the declining trend in on-the-job training in recent years, there is also a strong argument for the introduction of human capital tax credits to encourage firms to invest in their existing employees.

Long-term policies and institutions for sustainable growth

Budget 2021 was accompanied by a separate report entitled Build Back Better: our plan for growth, which emphasises the importance of infrastructure, skills, and innovation. The urgent need to address chronic underinvestment in these three areas was highlighted in 2013 by the LSE Growth Commission, which has also argued for a stable industrial strategy for the UK with sustainability at its core. There has been progress in recent years setting frameworks and institutions around the UK's Industrial Strategy at the national and local levels. Axing the Industrial Strategy Council, and re-branding frameworks yet again risks diverting attention from what really matters: providing a clear sense of direction for businesses, and aligning incentives for the bolder, system-wide change that is required to achieve the sustainable and inclusive economy of the future.

About the Author

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