# The living standards tax gap: a future risk to the public finances

A TUC report based on analysis by Spencer Thompson, Senior Economic Analyst, IPPR

## Executive Summary

The current government has not achieved its target for deficit reduction in this parliament. At the time of its first budget in 2010, the Office for Budget Responsibility (OBR) forecast public sector net borrowing of £37bn in the current year, 2014/15. By the time of the December 2014 autumn statement, this had increased to £91bn.

The key reason why deficit reduction is off track is not runaway spending, but weak government receipts. In fact, total public expenditure in 2014/15 is expected to be the same as forecast in 2010 (although £2.7bn more is set to be spent on in-work benefits than was planned). Of receipts, while corporation tax, fuel duty and national insurance contributions (NICs) have all performed worse than expected, income tax receipts are the biggest factor in the shortfall. In 2010, the Office for Budget Responsibility forecast income tax receipts of £195bn in 2014/15, but by the 2014 Autumn Statement they had revised this figure down to £163bn. Combined with the £11bn shortfall in NICs, this accounts for almost half the total 2014/15 deficit and over three-quarters of the overshoot compared with expectations in 2010.

This paper explores the factors behind the weak performance of both income tax receipts and national insurance contributions. It finds that lower than expected nominal earnings growth and the coalition's program of tax cuts are the major causes of the shortfall in these key government revenue streams;

- Had nominal earnings growth performed in line with the OBR's June 2010 forecast, an extra £36bn would have been raised in 2014/15 through higher income tax receipts and NICs and lower benefit spending
- Had the coalition not carried out a program of above-inflation increases in the personal tax allowance and below-inflation increases in the higher rate threshold, an extra £9bn would have been raised in 2014/15

Looking forwards, how and when earnings growth picks up will be key in determining the fiscal performance of an incoming government;

- Under the OBR's current forecasts for earnings growth, by the final year of the next parliament (2020/21), the cash value of income tax receipts is expected to grow by over a third to £218bn
- If the UK were able to achieve average growth rates in nominal earnings similar to that seen between 2000 and 2008, 4.3% per year, an extra £25bn would be generated in higher income tax receipts and NICs and lower benefit spending
- If, on the other hand, earnings growth undershoots the OBR's forecast by the amount seen in this parliament, £44bn would be lost through lower income tax and NICs receipts and higher benefit spending

These figures illustrate how sensitive government receipts and the deficit are to the rate of earnings growth; in the current parliament weak earnings growth has not just been a problem for the many families struggling to get by, but has also been a key reason why deficit reduction is being extended into the next parliament.

## Introduction

The UK has experienced an unprecedented fall in real earnings since the recession. Annual nominal regular earnings growth among employees has averaged 1.7 per cent over the last five years (ONS 2014a), while for the vast majority of this period consumer price inflation remained persistently higher, only falling below 2 per cent towards the end of 2014. Real earnings growth turned positive in the latest data, but it is likely to be many years before workers' real earnings regain their pre-recession value.

This has led to a considerable decline in material living standards for households and families. The proportion of employees earning less than the living wage has risen from 15 per cent in 2008 to 20 per cent in 2013 (Corlett and Whittaker 2014). And the number of working families in poverty is now greater than the number of workless or retired families in poverty (MacInnes et al 2014). It has also had an impact on the government's finances. Weak wage growth has meant tax receipts have performed worse than expected.

The current government's core strategy for tackling low pay has been to cut income tax. This has been done by above-inflation increases in the level of income workers can earn before they have to start paying income tax. While this has been justified as reducing the tax burden on the lowest paid workers by taking them out of tax, it has also been criticised as both expensive, in terms of lost tax revenue, and poorly targeted, since the majority of taxpayers benefit irrespective of income, and those on the lowest incomes (who are not earning or are only earning very low incomes) see no benefit.

The loss of tax revenue brought about by tax cuts has exacerbated the impact of weak earnings growth on receipts, leading to an even poorer performance of income tax revenues in recent years. A third complication is that much of the recent jobs growth has been in self-employment. While we have less up to date data on the earnings of the self-employed than employees, what we do know indicates that the typical self-employed worker earns considerably less (and therefore pays less income tax); one measure found that in 2011-12 the median self-employed worker had annual earnings 40 per cent less than the median employee (D'Arcy and Gardiner 2014).

Looking forward, how tax policy and earnings evolve in the coming years will play an important part in determining how the deficit is reduced.

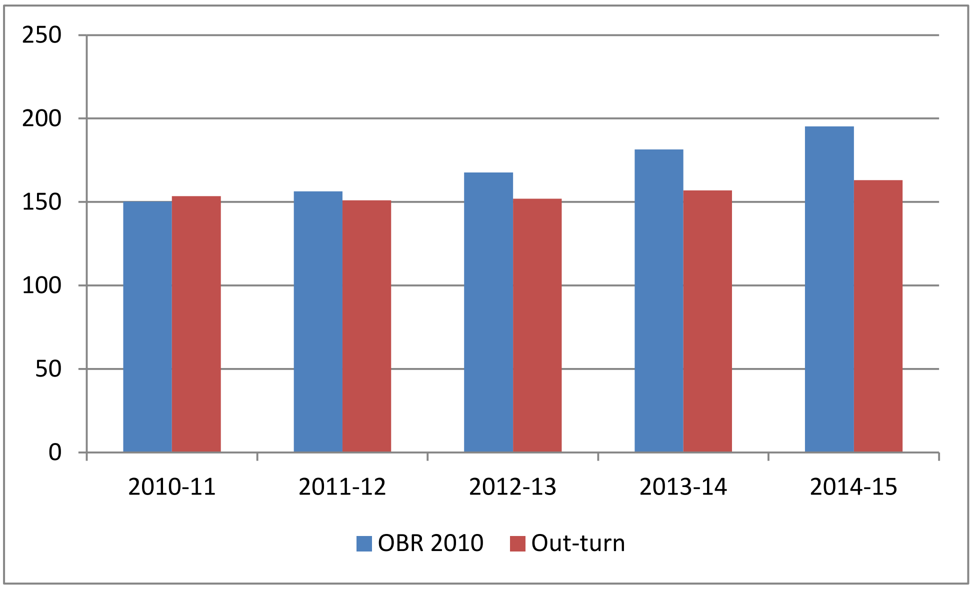
This paper explores these issues in detail by answering the following research questions:

- To what extent has weak wage growth affected tax receipts, alongside other factors such as tax cuts?
- What are the implications of different scenarios of earnings growth for tax receipts over the coming parliament?

## Section 1: Weak wage growth and tax receipts over the current parliament

Relative to the expectations of the independent Office for Budget Responsibility (OBR), tax receipts have performed poorly in the current parliament. When they published their forecasts alongside the June 2010 budget, the OBR predicted that in 2014/15 income tax receipts would total £195.2bn (OBR 2010). In their latest forecasts, published in December 2014, they have revised their expectations of income tax receipts in 2014/15 down to £163.0bn (OBR 2014). The difference between the out-turn and the 2010 forecast is shown in figure 1.1 for each financial year of this parliament. The gap of over £30bn in 2014-15 is equivalent to 5% of total receipts or 4.4% of total government spending. Moreover, if the UK government were able to collect the £195.2bn in income tax receipts predicted in 2010 the £91.3bn deficit, as measured by public sector net borrowing, would have been a third smaller (IBID).

**Figure 1.1 Out-turn and forecast income tax receipts, 2010/11-2014/15 (bn)**

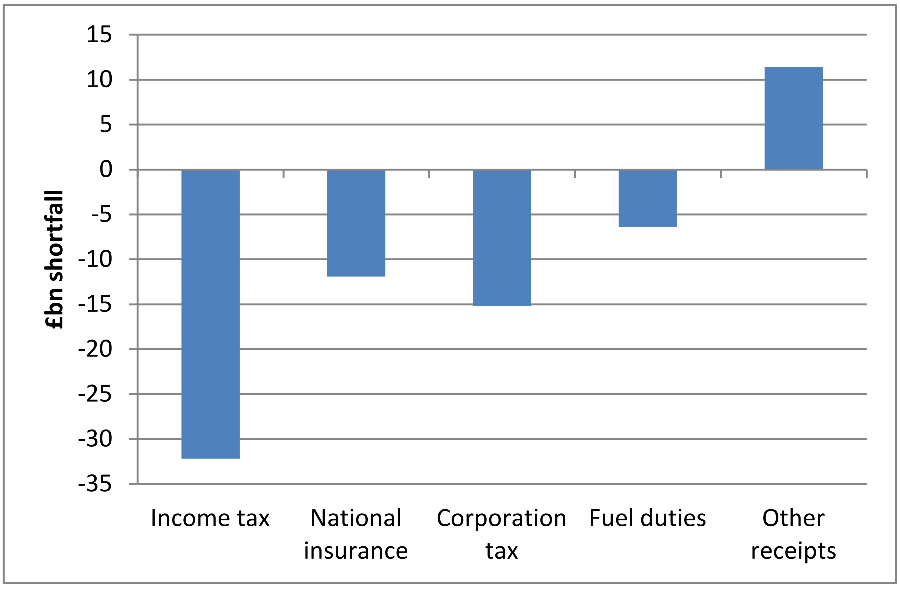



*Source: OBR (2010), OBR (2014) and HMRC (2015)*

Clearly then, the weak performance of income tax receipts has had an important impact on the public finances, and is one of the primary reasons why deficit reduction in this parliament has not been as successful as planned. Compare this to the evolution of public spending between the June 2010 and December 2014 forecasts. In June 2010 the OBR expected total managed expenditure in 2014/15 to reach £738bn, by December 2014 their forecast was hardly changed, at £737.1bn. Therefore, the £54.3bn gap between the 2014/15 public sector net borrowing requirement of £37bn expected in June 2010 and the £91.3bn forecast in December 2014 must be due to the weak performance of receipts, driven in large part by poorer income tax revenues.

Of receipts, by far the biggest factor in the overall shortfall has been £32.2bn lower income tax than forecast (figure 1.2). Other important shortfalls have been observed in national insurance contributions (£11.9bn), corporation tax (£15.2bn) and fuel duties (£6.4bn)[1]. Collectively, other receipts performed better than the 2010 forecast, with small improvements in VAT, capital gains and inheritance tax.

**Figure 1.2 2014/15 shortfall in government receipts – OBR December 2014 forecast compared to OBR June 2010 forecast (£bn)**



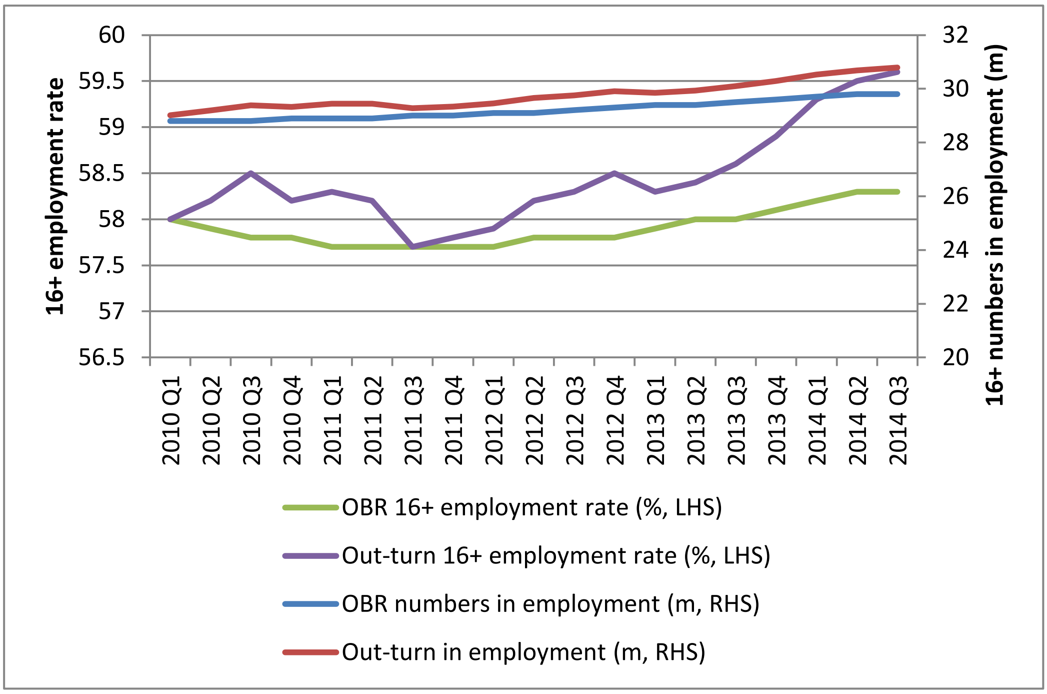

*Source: OBR (2010) and OBR (2014)*

Income tax receipts depend on three factors: the number of people in work, their earnings, and how the tax system treats these earnings. Each of these variables has evolved considerably differently over the current parliament than expected five years ago.

Jobs growth has been very rapid over the last five years. Employment increased by over 1.8 million between the start of 2010 and October 2014, and the adult (16+) employment rate rose from 58 to 59.5 per cent (ONS 2015). This is stronger than the OBR expected in their June 2010 forecast, when they predicted the economy would add 1.0 million jobs and the 16+ employment rate would rise to 58.3 per cent between Q1 2010 and Q3 2014 (OBR 2010), as shown in figure 1.3.

[1] A cut in the headline rate of corporation tax from 28 to 24 per cent was announced in the June 2010 budget, and is therefore not factored into the shortfall shown in figure 1.2, which does include the impact of the headline rate falling further from 24 per cent to 21 per cent by 2014, as announced in subsequent budgets.. Similarly, fuel duty has been frozen since 2011, resulting in a loss of revenue.

Figure 1.3 Out-turn and forecast jobs growth 2010-2014




*Source: ONS (2010) and OBR (2014)*

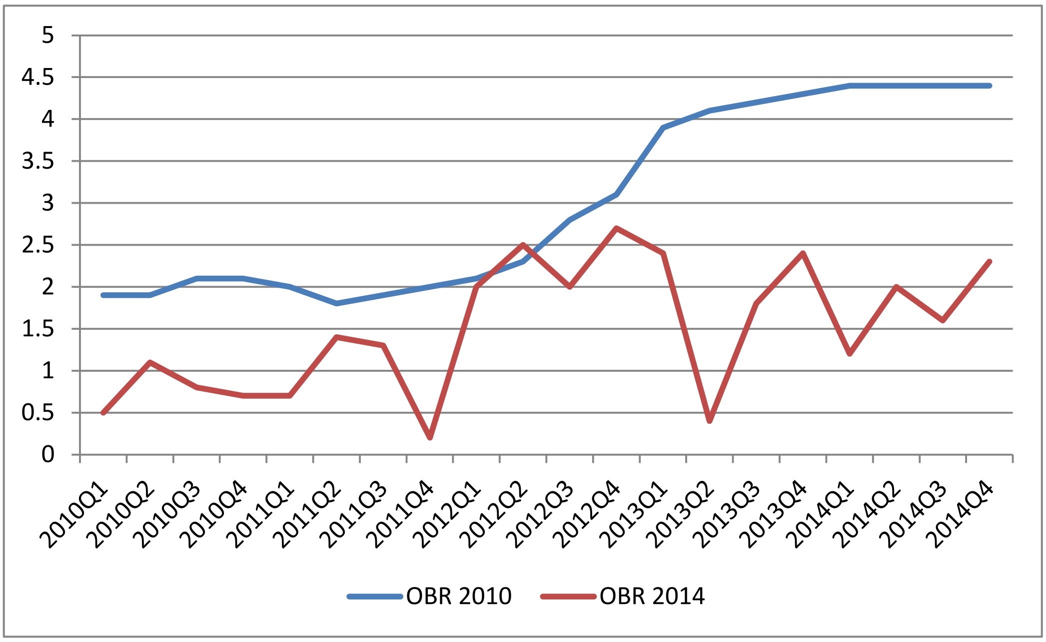
The strong performance of the labour market in recent years - in terms of the number of jobs - would have been expected to have led to an increase in tax receipts, other things being equal. Since more people in work implies more potential taxpayers, it must be a combination of the performance of earnings and changes to the tax system that have brought about the sizable short-fall in tax receipts seen in the current parliament. The rest of this section explores both of these factors in turn in order to disaggregate their impact on tax receipts.

## Earnings since 2010

UK real earnings growth has been negative for over 6 years, only turning positive in the last few months of labour market data (ONS 2015). But while real earnings influence individual and household living standards, it is the performance of cash, or nominal, earnings that determine income tax receipts, with a lower rate of growth translating into lower income tax receipts collected.

Nominal earnings have not grown as fast as forecast by the OBR in 2010. Figure 1.4 illustrates the difference in average earnings growth between the OBR's June 2010 forecast and the historical data presented within their December 2014 forecast. In every quarter except one, year on year growth in average earnings has been less than the 2010 forecast predicted. This is especially true of 2013/14 and 2014/15, where the gap between the earlier forecast and more recent OBR out-turn figures grew to over two percentage points.

**Figure 1.4 Out-turn annual average earnings growth 2010/11-2014/15 vs. OBR's 2010 forecast**




*Source: OBR (2010) and OBR (2014)*
*Note: OBR 2014 Q4 value is a forecast made at the time of the December 2014 Autumn Statement*

The poor performance of nominal earnings growth is caused by two factors. Firstly, weak earnings growth among those in continuous employment. Evidence produced by the Incomes Data Service shows that pay settlements averaged 3 per cent between 2001 and 2009, falling to less than 2 per cent in 2010 and recovering to slightly more than 2 per cent in 2011, 2012 and 2013 (TUC 2014a). This is a slightly better performance than the average employee earnings growth index shown in figure 1.4, but nonetheless represents a slow recovery of pay settlements which still haven't bounced back to their pre-recession rate. Such a recovery was probably factored into the OBR's earlier forecasts. Similarly, official estimates of annual growth in weekly pay for those in full-time employment for over a year have been consistently higher than estimates for all full-time employees, but remain lower than pre-recession growth rates. The ONS, using the Annual Survey of Hours and Earnings, found earnings growth in median full-time gross weekly earnings for the year to April 2014 of over 4 per cent for those in continuous employment, but less than 1 per cent for all full-time employees. In the year to April 2009 the figures were 7 and 4.5 per cent respectively, again implying an incomplete recovery in earnings growth (ONS 2014)[2].

Secondly, there has been a compositional effect. As jobs growth has picked up, those entering or re-entering the labour market following a spell out of work have, on average, entered lower-paying jobs. This is partly because of the types of

[2] It should be noted that these figures refer to growth in median pay, rather than average growth across the income distribution

people entering work, who tend to be younger, have less experience and therefore command a lower salary, but also because the occupational composition of the workforce has shifted away from managerial roles towards low-paid, lower-skilled jobs. One estimate suggests that this reduced nominal pay growth by around 0.3 percentage points between the first half of 2013 and the first half of 2014 (Gardiner 2014).

The ONS and OBR earnings growth figures are produced on a per-worker basis, rather than per hour, so weak growth in earnings is also likely to be linked to the substantial increases in part-time working and under-employment seen in recent years; between the first quarter of 2008 and the first quarter of 2014 the numbers of employees and self-employed who wanted to work more hours increased by 46 per cent (TUC 2014b).

It is also worth noting that the earnings growth data produced by the ONS, and forecast by the OBR, is not a complete measure of workers employment income, as it does not record earnings for the self-employed (ONS 2012). In 2011 the median self-employed worker earned just over half the weekly earnings of the median employee (Hatfield 2015). Given that the position of the self-employed in terms of hours and earnings has worsened relative to employees in recent years (IBID), and that the numbers in self-employment and in part-time self-employment have also been rising, the ONS/OBR figures are likely to over-estimate earnings growth for the workforce as a whole.

Taken together, it is clear that nominal earnings growth, whether for all employees, those in continuous employment or the self-employed, has performed poorly in recent years. In order to assess the impact of weak earnings growth on tax receipts, IPPR have undertaken original modelling of income tax receipts in 2014/15 under three different scenarios of earnings growth;

- Following the path of earnings growth between 2010/11 and 2014/15 as measured by the OBR in their December 2014 report
- Following the path of earnings growth between 2010/11 and 2014/15 as predicted by the OBR in their June 2010 report
- If earnings had grown between 2010/11 and 2014/15 by the same rate of annual growth achieved between 2001 and 2008, 4.3 per cent[3]

Our results show that;

Had earnings growth followed the OBR's forecast at the time of the June 2010 report, income tax receipts would be 13 per cent, or £21.3bn, higher in 2014/15. This represents around two-thirds of the total £32.2bn shortfall in income tax compared to the OBR 2010 prediction. Furthermore, had earnings growth achieved its historical annual rate of 4.3 per cent, income tax receipts would be 20 per cent, or £31.8bn, higher in 2014/15.

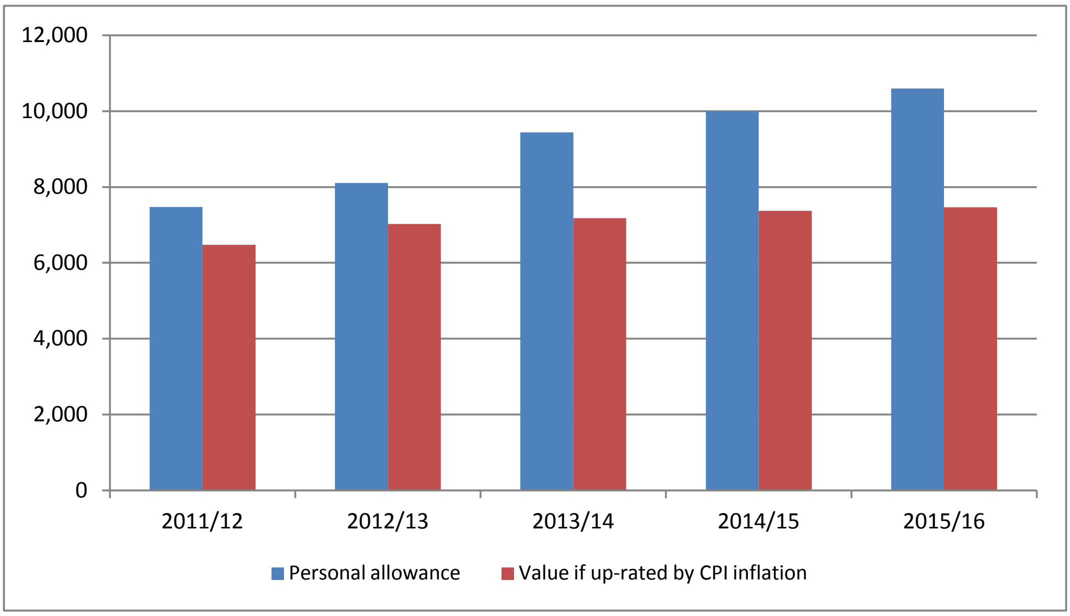
[3] As measured by monthly year-on-year growth in the ONS average weekly earnings index, including bonuses (ONS 2015)

## Evolution of the income tax system since 2010

The coalition government has made substantial changes to the income tax system over the current parliament, with the aim of reducing the tax burden on households. This has also had an important impact on tax receipts. The strategy has been achieved through increasing the value of the personal allowance, the amount of income that can be earned before being subject to the 20 per cent basic rate of income rate. When the current government came into office, the value of the personal allowance stood at £6,475. This has been raised in steps to its 2014/15 level of £10,000.

In the absence of any direct intervention of the kind seen in this parliament, the personal allowance automatically rises by inflation each year. While in years prior to 2010 retail price inflation (RPI) was used to uprate tax bands, as set out in the Income Tax Act 2007, the RPI measure has since been reviewed[4]. Assuming that consumer price inflation (CPI, the current central estimate of inflation) had been used to uprate tax bands, the personal allowance would have reached £7,370 by 2014/15[5]. Raising it to £10,000 therefore represents a total increase of £2,630 in its value, or a tax cut of just over £500 for those earning over £10,000. Figure 1.5 illustrates the steps taken to reach the £10,000 personal allowance, versus where it would have fallen if up-rated according to CPI inflation.

**Figure 1.5 value of the personal allowance under inflation up-rating versus policy changes**




*Source: IPPR Calculations*

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[4] The Johnson review into UK consumer price statistics, published in January 2015, recommended that the RPI index should be discontinued. It is unclear what measure of inflation will be used to uprate the personal allowance going forward.

[5] This assumes that the personal allowance is up-rated each financial year by the rate of CPI in the previous September

In order to limit the amount that those with higher incomes gain from these increases, the higher rate threshold (HRT), the amount of income that can be earned before being subject to the 40 per cent higher rate of income tax, has been reduced, reaching £41,865 in 2014/15, a fall of over £2,000 since 2010/11. Had it been increased in line with CPI, it would have reached £49,945 in 2014/15. This also has a knock-on impact on National Insurance Contributions, since the upper earnings limit, the amount of income earned before the rate of NICs falls from 12 to 2 per cent, is set at the same level as the higher rate threshold. This means that reducing the HRT leads to a reduction in NICs, even while it raises income tax receipts. It should be noted however, that the income tax raised through a lower HRT does not fully compensate for above-inflation increases in the personal allowance. This is because there are far fewer higher rate taxpayers than those whose total income is lower than the HRT.

Using the its tax-benefit model, IPPR have modelled the cost of these changes to the income tax system in the current year (2014/15), by comparing what income tax receipts would have been under the lower personal allowance and increased higher rate threshold that would have resulted from up-rating by inflation with receipts under the current, more generous tax system. This shows that income tax receipts would have been £7.2bn higher without the coalition's tax changes.

Combining the impact of these tax changes with the impact of earnings growth not being as fast as predicted by the OBR in 2010, income tax would have been £27.5bn higher if the OBR's original forecast for earnings growth had been achieved and the personal allowance and higher rate threshold had been up-rated by consumer price inflation only. This represents most of the total £32.2bn gap in 2014/15 income tax receipts between the OBR's 2010 and 2014 forecasts, with the remainder likely to be due to other factors including weaker earnings growth among the self-employed and changes to occupations, as outlined above.

## Impact elsewhere in the tax and benefit system

Both low nominal earnings growth and tax cuts have an impact elsewhere in the tax-benefit system. Employee national insurance contributions (NICs) are paid at 12 pence in each pound earned between £153 (the secondary threshold) and £805 a week (the upper earnings limit), and 2 pence on each pound thereafter, with employers also having to make contributions. Lower earnings growth will therefore translate into fewer employee and employer NICs being collected. And, as mentioned above, since the upper earnings limit of NICs is tied to the higher rate threshold (HRT), reductions in the HRT also reduce the amount of NICs collected.

In addition, many benefits such as tax credits and the new universal credit are means tested on earnings. Faster earnings growth therefore means more workers progressing through and out of the means-tested benefits system, reducing the need for the state to top up workers earnings through tax credits, or to help them meet other costs through benefits including housing and council tax benefit.

Using its tax-benefit model, IPPR have modelled the total fiscal impact of our scenarios for earnings and the tax system. The results, shown in table 1.1, indicate that the majority of the cost of both lower earnings growth and the coalition's income tax policy, come from lower income tax receipts. But the impact on both NICs and benefits spend is sizable; there would have been an extra £12.1bn of NICs receipts and £2.7bn less spending on in-work benefits if earnings had grown in line with the OBR's 2010 forecast. These figures rise to £17.8 and £3.7bn if earnings had grown at their historical average of 4.3 per cent.

CPI-linked uprating of the personal allowance and higher rate threshold would have led to £7.2bn more raised in income tax, and £2.5bn more in NICs. In this scenario there is a small increase in benefit spending (£0.4bn). This is because some benefits, such as housing and council tax benefit, are means-tested on after-tax income. Limiting rises in the personal allowance reduces after tax income, relative to a world of above-inflation uprating, and therefore increases eligibility for these benefits. This effect is very small in comparison to the extra income tax raised, however, with the total impact being a net fiscal gain of £9.3bn in 2014/15.

The combined impact of above-inflation up-rating of tax bands and weak earnings growth is £44.9bn, half the size of the OBR's forecast of the government deficit in 2014/15. This figure is comprised of £27.5bn of extra income tax revenue, £15.1bn of NICs receipts, and £2.3bn less benefits spending. This, alongside cuts to corporation tax and freezing fuel duty, account for the lion's share of the deficit overshoot, with the government's poor performance on the deficit solely due to weak government receipts, rather than higher than forecast spending.

**Table 1.1 Fiscal impact of earnings growth and alternative personal allowance/higher rate threshold scenarios in 2014/15 (£bn)**

| | | Income tax receipts | National insurance receipts | Benefits spending | Total |
|---|---|---|---|---|---|
| | **Baseline values under current policy and earnings** | 159.2 | 115.8 | 202.3 | |
| **Impact of:** | **OBR 2010 forecast of earnings growth** | 21.3 | 12.1 | -2.7 | 36.0 |
| | **Earnings growth at historical average** | 31.8 | 17.8 | -3.7 | 53.3 |
| | **CPI up-rating of personal tax allowance/higher rate threshold** | 7.2 | 2.5 | +0.4 | 9.3 |
| | **Combined impact of CPI up-rating and OBR 2010 earnings growth forecast[6]** | 27.5 | 15.1 | -2.3 | 44.9 |

*Source: IPPR calculations using IPPR tax-benefit model*

[6] Please note the combined impact of CPI up-rating and the OBR's 2010 earnings growth forecasts does not equal the sum of the separate scenarios due to interaction effects between tax bands and earnings growth

## Conclusion

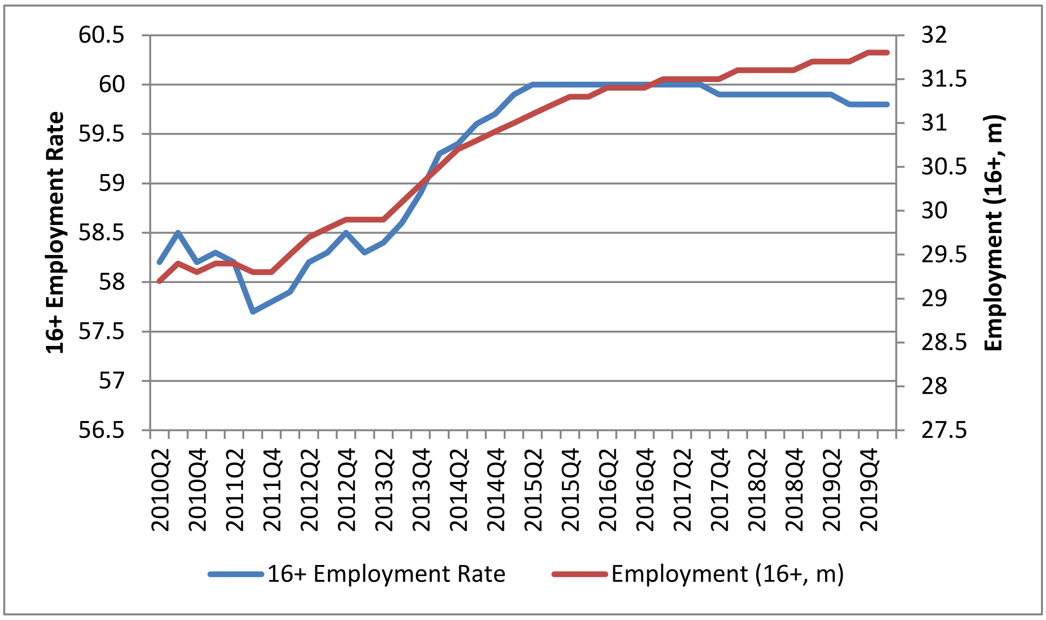
In 2014/15, the OBR expects the deficit, as measured by public sector net borrowing, to total £91.3bn, £54.3bn higher than they expected it to be at the time of their 2010 forecast. The lion's share of the difference between these two figures, £44.9bn, is accounted for by two factors: tax cuts delivered via above-inflation increases in the personal allowance, and earnings growth that has been weaker than forecast. This has led to weaker than expected receipts from income tax and national insurance, and higher benefit spending than expected.

These, alongside cuts to corporation tax and fuel duty, are the key factors that explain why deficit reduction has not been as successful as planned in the current parliament, rather than runaway government spending on services or benefits.

Section 2: The future path of earnings and tax receipts

Looking over the next parliament, what are the prospects for earnings, employment growth and tax receipts? The OBR, in their latest forecasts from December 2014, expect the strong job creation seen in recent years to slow down markedly throughout 2015 and beyond. While employment increased by 1.8 million in the current parliament, they expect an increase of only 0.7 million in the next. On the 16+ employment rate, their forecast suggests that it will peak at 60 per cent in early 2015, before gradually declining to 59.8 at the end of the parliament, presumably due to the impact of an aging population.

**Figure 2.1 OBR December 2014 employment out-turn and forecast**



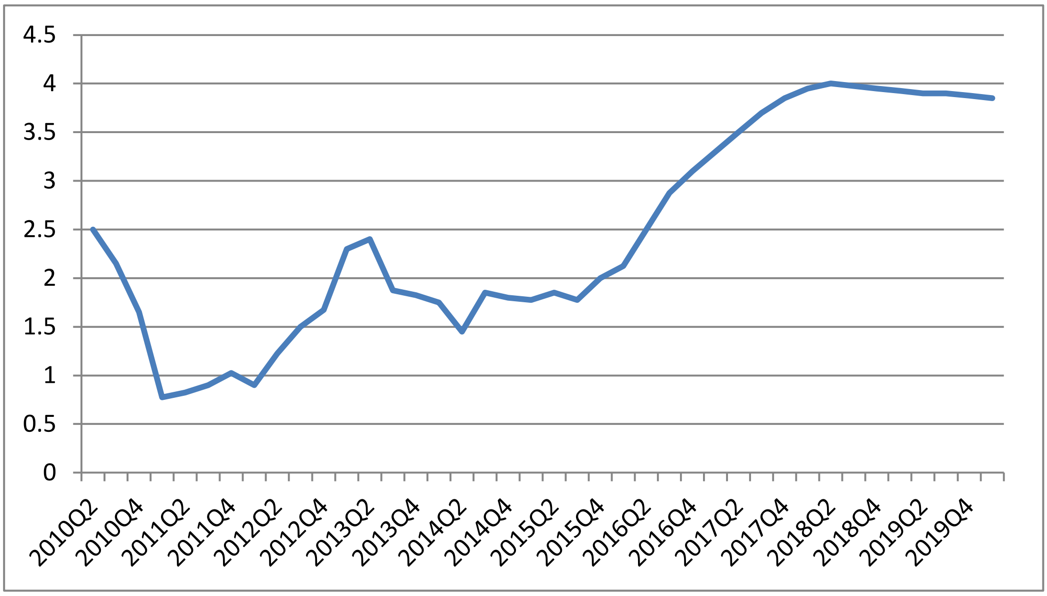

*Source: OBR (2014)*

Throughout 2015 they expect annual growth in average employment earnings to be 2 per cent, slightly higher than in recent years (fig 2.2). From 2016 onwards they are much more positive, however, predicting earnings growth will nearly double to 3.9 per cent in 2017 and 2018, before falling slightly to 3.8 per cent in 2019.

Is this plausible? It is far from unprecedented for nominal earnings growth to hit 4 per cent or more. Indeed, from 2002 through 2008 annual earnings growth averaged 4.2 per cent. If the unemployment rate, currently standing at 5.8 per cent, continues to fall it may generate increasing competition among employers for staff, which will act to increase wage pressure and the level of salaries offered.

But, the recent fall in the headline rate of inflation to 0.3 per cent, it is unclear whether earnings growth in the short to medium-term will be as strong. Such a low rate of inflation may feed through into pay settlements, which are often inflation-linked. And further occupational change is also likely, with growth in the number of low-skilled and highly-skilled jobs and a decline in the middle of the skill distribution. This may also influence average earnings growth going forward, although in what direction it is difficult to say. In addition, slower than forecast economic growth is also a risk to both pay and the fiscal position more broadly.

**Figure 2.2 OBR December 2014 annual earnings growth outturn and forecast (rolling 4-quarter average)**



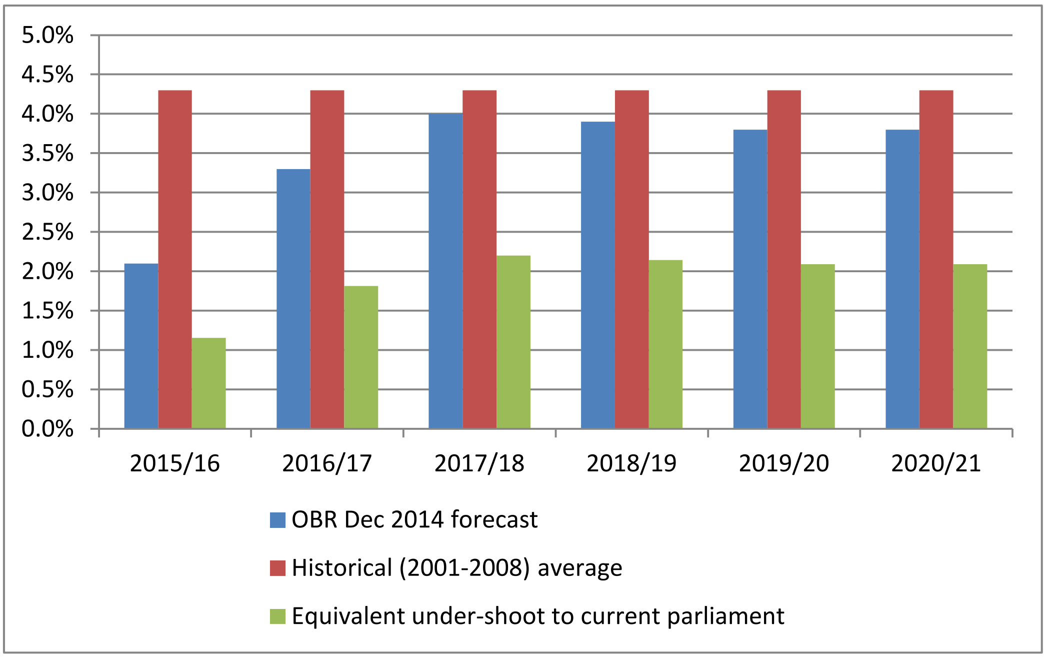

*Source: OBR (2014)*

As shown in the previous section, whether the OBR's forecast for tax receipts is realised is highly contingent on whether earnings growth picks up and by how much. The OBR expect income tax receipts to grow in nominal terms by just under a third in the next parliament, from £163bn in 2014/15 to £213.9bn in 2019/20. Our modelling estimate for the final year of the parliament, 2020/21, suggests that income tax receipts will rise to £217.2bn[7].

IPPR have tested the sensitivity of this figure to earnings over the coming parliament by modelling what income tax receipts would be if earnings outperform the OBR's prediction, growing by their historical average of 4.3 per cent a year. IPPR have also modelled the impact of earnings growth performing less well than forecast, by applying the average percentage under-shoot between the 2010-14 outturn and OBR's 2010 forecast for this parliament to their forecast for the next five years. A summary of these two scenarios of earnings growth is shown for each year of the next parliament in figure 2.3, alongside the OBR's December 2014 forecast.

[7] This assumes that earnings growth holds for a further year at the OBR's predicted annual growth rate for 2019/20, 3.8%

**Figure 2.3 Scenarios for average annual earnings growth 2015/16-2020/21**




*Source: IPPR calculations using OBR (2010), OBR (2014) and ONS (2015)*

The findings of our modelling, shown in table 2.1, suggest that if earnings grow by their historical average and not the OBR's forecast, an extra £15.7bn of income tax and £8.2bn of national insurance would be generated. If, on the other hand, they undershoot the forecast by a similar percentage as in the current parliament, we would expect income tax receipts to be lower by around £26.5bn and national insurance receipts lower by £14.5bn.

**Table 2.1 Impact on income tax and national insurance of earnings growth scenarios in the next parliament (2015/16-2020/21, 2020/21 £bn)**

| | | Income tax receipts | National insurance receipts | Benefits spending | Total |
|---|---|---|---|---|---|
| | Baseline value under current policy and OBR 2014 earnings assumptions | 217.6 | 151.9 | 217.6 | 396.5 |
| Impact of: | Historical average earnings growth of 4.3% | 15.7 | 8.2 | -1.4 | 25.3 |
| | Equivalent under-shoot to 2010-2015 parliament | -26.5 | -14.5 | 2.6 | -43.6 |

*Source: IPPR calculations using IPPR tax-benefit model*

## Conclusion

Due to their influence on tax receipts, national insurance contributions and benefit spending, how earnings (and employment) evolve over the coming parliament will be crucial in determining whether and how quickly the deficit is reduced. The OBR expects the pattern experienced in the current parliament of strong jobs growth and weak earnings to flip, with increases in the employment rate slowing down and earnings growth recovering. This is the basis for their December 2014 forecast, which predicts that tax receipts will grow by around a third over the next parliament, while the deficit moves into balance in 2018-19, achieving a surplus of £23bn in 2019-20.

But if earnings growth were able to attain its pre-recession average year-on-year growth rate of 4.3 per cent, then by 2020/21, the last year of the next parliament, an extra £25.3bn would be raised, substantially reducing the scale of spending cuts or tax rises needed to balance the books. On the other hand, if there is a similar weak performance of earnings relative to forecast in the next parliament as we have experienced over the last five years, the total fiscal impact would be a loss of £43.6bn in 2020/21. This would eliminate the OBR's forecast surplus, and require another extension of deficit reduction to achieve balance. This illustrates the importance of relatively small fluctuations in the rate of nominal earnings growth to the government's fiscal position.