



The  
University  
Of  
Sheffield.

SPERI British Political Economy Brief No. 9

# Income tax revenue and economic change in the UK.

---

speri.

Sheffield Political Economy  
Research Institute.

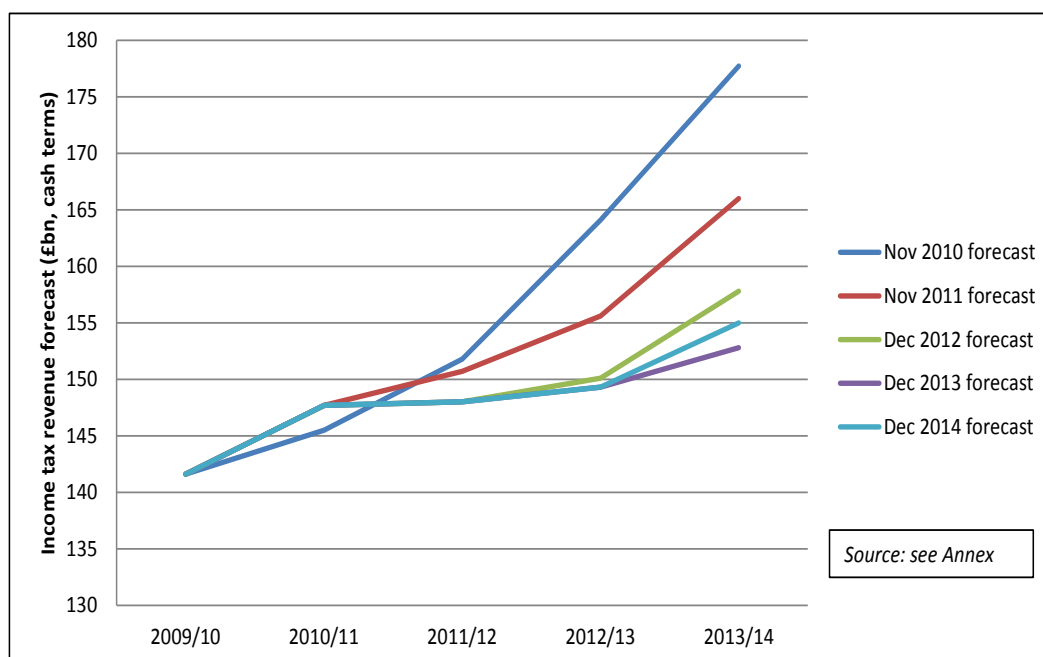
In this Brief, the Sheffield Political Economy Research Institute (SPERI) responds to the coalition government's 2014 Autumn Statement by considering the optimism and accuracy of the Office for Budget Responsibility's income tax revenue forecasts, and related forecasts, since 2010. The Autumn Statement confirms the comprehensive failure of the coalition's deficit reduction agenda, in part due to lower than expected tax revenue forecasts, but the consistent mismatch between economic forecasts and economic reality reveals a failure to acknowledge the profound changes in the UK economy which have accelerated since the financial crisis.

## Background

- In the wake of the financial crisis and associated increase in the UK's budget deficit, the coalition government formed in 2010 sought to impose 'austerity' on the public sector and commenced an ambitious programme of public spending cuts.
- This programme depended on an understanding of the causes of budget deficit which emphasised profligate public spending.
- However, George Osborne's (Chancellor of the Exchequer) latest Autumn Statement (delivered on 3 December 2014) gives significant weight to an alternative explanation, that is, that the increasing deficit is largely the result of the impact of an under-performing economy on tax revenues.
- Office for Budget Responsibility (OBR) analysis published alongside the Autumn Statement revealed considerably lower than expected income tax revenues (the main source of UK government revenue).
- Osborne, following an earlier speech by David Cameron (Prime Minister), sought to explain such results with reference to problems within the wider global economy. Osborne said today that 'the warning lights are flashing over the global economy... Britain cannot be immune to the risks'.
- However, there is a clear need to explore whether low income tax revenue is really the result of unexpected headwinds disrupting an otherwise sound economic recovery in the UK, or whether it is in fact the result of other problems.
- The analysis below therefore assesses the validity of the coalition government's explanation by considering the accuracy of OBR forecasts against the backdrop of well-documented changes within the UK labour market.

## Evidence

- At each fiscal event, the OBR publishes a range of fiscal and economic forecasts alongside the previous year's outturn statistics.
- In 2013/14, income tax revenue was £155 billion. Yet, at the 2010 Autumn Statement, the OBR forecast that income tax revenue (in cash terms) would be £178 billion (an over-forecast of 15 per cent).
- This figure has been revised down at each subsequent Autumn Statement. In 2014, revenue was slightly above the figure expected at December 2013, yet, as usual, the forecast has been revised down in each subsequent year. Full details of forecasts can be found in the Annex.
- In November 2010, the OBR expected income tax revenue to increase by an average of 6 per cent per year. In reality, the annual increase has averaged 2 per cent.



- While the coalition government has sought to reduce income tax for some groups, it appears that this significant failure arises mainly from over-optimistic earnings growth forecasts.
- In 2010, the OBR expected average earnings growth of 3 per cent up to the end of 2013. The actual average annual growth was 2 per cent.
- Wage stagnation has implications for benefit expenditure as well as tax revenue. In every single year from 2010 onwards, tax credit expenditure (benefits for those in work) has turned out to be higher (in cash terms) than in every previous forecast.
- The cause of this failure – in terms of both coalition policy and OBR forecasts – can be related to sluggish (and currently negative) productivity growth.
- The OBR expected an average annual productivity growth rate of 2 per cent between 2010 and 2013, yet the average increase has actually been 0.5 per cent. Full details of forecasts can be found in the Annex.

## Analysis

- The fall in income tax revenues is not a sudden, unexpected dilemma confronting the coalition government. Revenue has been consistently below expectations – despite unemployment being much lower than had been anticipated.
- The coalition's understanding of the budget deficit as a problem caused by over-spending is significantly challenged by this analysis. Now, as in the immediate aftermath of the financial crisis, the deficit is being sustained by the failure to restore sustainable growth to the UK economy, leading to stagnation in earnings growth and near-stagnation in tax revenue growth.
- Low unemployment has not only failed to mitigate these circumstances; it is in fact produced by the same underlying trend, that is, the transition of the UK economy towards a services-based low-paid economy.

- In this economic model, employment opportunities are plentiful, but concentrated in low-paid and insecure industries (Wren, 2013).
- Low unemployment is also associated with an unprecedented rise in self-employment, yet income from self-employment is now significantly lower than the pre-crisis period (Murphy, 2013).
- This analysis points not only to the failure of the coalition government's austerity agenda, but also the failure of economic forecasters to account accurately for the implications of a services-led economy.
- This is troubling, given that the OBR's consistently over-optimistic account of earnings growth and income tax revenues has sustained the legitimacy of the coalition's austerity agenda.
- The fact that productivity has also consistently performed below expectations helps to explain the transition to a low-paid, services-led economy.
- Again, flaws in the OBR's forecasts, leading to over-optimistic predictions, have helped to defend the coalition government against the charge that it has failed to facilitate increased investment in productive activity, by creating the impression that a market-led approach will (eventually) bear fruit.

## Conclusion

The consistent mismatch between economic forecasts and economic reality reveals a failure to acknowledge the profound changes in the UK economy which have accelerated since the financial crisis. A services-dominated economy generates jobs, but relatively low-paying jobs, meaning that income tax revenues are lower than might otherwise have been expected. The coalition has in fact exacerbated this transition through its macroeconomic policies, and an austerity agenda that must now be described as self-defeating.

## References

- Wren, A (2013) (ed) *The Political Economy of the Service Transition*, Oxford University Press.
- Murphy, R (2013) *Disappearing Fast: The Falling Income of the UK's Self-Employed People*, Tax Research LLP, available at <http://www.taxresearch.org.uk/Documents/SEI2013.pdf>.
- Office for Budget Responsibility (2010) *Economic and Fiscal Outlook: November 2010*, available at <http://budgetresponsibility.org.uk/economic-and-fiscal-outlook-november-2010/>.
- Office for Budget Responsibility (2011) *Economic and Fiscal Outlook: November 2011*, available at <http://budgetresponsibility.org.uk/economic-and-fiscal-outlook-november-2011/>.
- Office for Budget Responsibility (2012) *Economic and Fiscal Outlook: December 2012*, available at <http://budgetresponsibility.org.uk/economic-and-fiscal-outlook-december-2012/>.
- Office for Budget Responsibility (2013) *Economic and Fiscal Outlook: December 2013*, available at <http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2013/>.
- Office for Budget Responsibility (2014) *Economic and Fiscal Outlook: December 2014*, available at <http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/>.
- Office for National Statistics (2014) *Labour Productivity: Q2 2014 Dataset*, available at <http://www.ons.gov.uk/ons/rel/productivity/labour-productivity/q2-2014/tsdq214.html>.

## Annex: OBR forecasts

	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20
Income tax revenue (£ billion, net of tax credits)											
Nov 2010	141.6	145.5	151.8	164.1	177.7	192.2	205.5	--	--	--	--
Nov 2011	X	147.7	150.7	155.6	166	177.4	190.5	204.1	--	--	--
Dec 2012	X	X	148	150.1	157.8	168.8	179.7	193.1	206.4	--	--
Dec 2013	X	X	X	149.3	152.8	164.6	175.3	187.9	200.9	214	--
Dec 2014	X	X	X	X	155	163	170.7	181	191.5	202.1	213.9
Income tax revenue (annual % increase)*											
Nov 2010	X	2.8	4.3	8.1	8.3	8.2	6.9	--	--	--	--
Nov 2011	X	4.3	2	3.3	6.7	6.9	7.4	7.1	--	--	--
Dec 2012	X	X	0.2	1.4	5.1	7	6.5	7.5	6.9	--	--
Dec 2013	X	X	X	0.8	2.3	7.7	6.5	7.2	6.9	6.5	--
Dec 2014	X	X	X	X	3.8	5.1	4.7	6	5.8	5.5	5.8
Tax credit expenditure (£ billion)											
Nov 2010	22.9	24.1	25.6	26.5	26.3	26.4	26.9	--	--	--	--
Nov 2011	X	25.2	27	27.8	28.4	28.8	29.6	30.3	--	--	--
Dec 2012	X	X	27.2	27.8	27.9	28.6	30.5	32.5	34.1	--	--
Dec 2013	X	X	X	28.7	28.8	28.6	28.8	31	33.7	35.1	--
Dec 2014	X	X	X	X	29.7	30.1	29.9	30.8	32	33	33.8
Tax credit expenditure (annual % increase)*											
Nov 2010	X	5.2	6.2	3.5	-0.8	0.4	1.8	--	--	--	--
Nov 2011	X	10	7.1	2.9	2.1	1.4	2.8	2.4	--	--	--
Dec 2012	X	X	7.9	2.2	0.4	2.5	6.6	3.6	4.9	--	--
Dec 2013	X	X	X	5.5	0.4	-0.7	0.7	7.6	8.7	4.2	--
Dec 2014	X	X	X	X	3.5	1.3	-0.7	3	3.9	3.1	2.4
Average earnings growth (wages and salaries per employee, annual % increase)											
Nov 2010	1.8	2.3	2.2	2.4	3.8	4.4	4.4	--	--	--	--
Nov 2011	X	2.1	0.9	2	3.1	4.3	4.5	4.5	--	--	--
Dec 2012	X	--	2.2	2.7	2.2	2.8	3.7	4	4	--	--
Dec 2013	X	--	--	2	1.5	2.6	3.3	3.5	3.7	3.8	--
Dec 2014	X	--	--	--	1.8	1.8	2	3.1	3.9	3.9	3.8
Potential productivity (output per hour, annual % increase)~											
Nov 2010	-2.6	2	2	2	2	2	2	--	--	--	--
Nov 2011	X	2	--	1	1.6	2.1	2.2	2.2	--	--	--
Dec 2012	X	X	1.3	-0.1	1.2	1.6	1.8	1.9	1.9	--	--
Dec 2013	X	X	X	-1.2	0.6	1.6	1.8	1.9	2	2	--
Dec 2014	X	X	X	X	-0.2	1	1.4	1.7	1.9	2	2.1

Source: Office for Budget Responsibility 2010; 2011; 2012; 2013; 2014 (~ = Office for National Statistics 2014)

\* = Author calculations based on OBR forecasts; x = Figure not published; -- = Not applicable

Boxed figure = outturn result



The  
University  
Of  
Sheffield.

December 2014

Research and writing by Craig Berry and Christopher Kirkland

Sheffield Political Economy Research Institute  
Interdisciplinary Centre of the Social Sciences  
219 Portobello  
Sheffield S1 4DP

T: +44 (0)114 222 8346  
E: [speri@sheffield.ac.uk](mailto:speri@sheffield.ac.uk)