

# Living Standards During Previous Recessions

IFS Briefing Note BN85

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## 1. Introduction

The current recession is the first that the UK has experienced since the early 1990s. Much has changed since then, and society's collective memory of who fared worst during previous recessions seems likely to have faded. Many workers in their 20s or early 30s have not experienced a recession during their working lives – including both authors of this report, one of whom had just started secondary school at the end of the last recession and the other of whom had just started junior school.

This Briefing Note thus aims to document the course of average living standards, and those of particular subgroups in society, during the previous three UK recessions. It will also show what happened to measures of poverty and inequality during these periods.

Given that recessions vary in their origins, such a backward-looking approach still leaves us guessing as to the likely effects of the current recession on living standards and poverty. However, the experience of

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previous recessions is one of the few pieces of empirical evidence one has when it comes to evaluating the possible effects of the current recession. We will therefore use this information to engage in some informed speculation as to how this recession might be different, without making any concrete predictions.

Section 2 sets out how we measure living standards, poverty and inequality for the purposes of this Briefing Note, as well as how we identify years of recession. In Section 3, we set out relevant economic theory and review the literature. Section 4 shows how overall living standards, and those among particular subgroups, evolved during previous recessions, while Section 5 examines income inequality during previous recessions. Section 6 sets out how levels of poverty have changed during previous recessions, including levels among particular subgroups such as children and pensioners. Section 7 speculates on how the current recession might be different from previous ones and Section 8 concludes.

## **2. Definitions and measurement**

In this section, we briefly define how we measure living standards, poverty and inequality for the purposes of this Briefing Note. We then discuss how we identify years during which the UK economy was in recession.

### *2.1 Living standards, poverty and inequality*

In this Briefing Note, we utilise the Households Below Average Income (HBAI) data set, which is created annually by the Department for Work and Pensions and used to measure progress against the government's targets for child poverty. It takes current disposable income, adjusted for family size and composition, as a proxy for living standards. More details about this can be found in our most recent poverty and inequality report.<sup>1</sup>

The HBAI data covering the start of the current recession will not be available until Spring 2010 at the earliest, so it will be some time before we can gauge how living standards have been affected. Nonetheless, in Section 7 we use other sources of data, with shorter lag times, to gain a very preliminary insight into the effects of the current recession.

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<sup>1</sup> M. Brewer, A. Muriel, D. Phillips and L. Sibieta, *Poverty and Inequality in Britain: 2009*, Commentary no. 109, Institute for Fiscal Studies, London, 2009 (<http://www.ifs.org.uk/comms/comm109.pdf>).

Our measures of poverty in this Briefing Note will be ‘snapshot’ measures of income poverty – that is, poverty measures that draw a line somewhere on a given year’s income distribution and designate everyone to the left of the line as ‘poor’ and everyone to the right of the line as ‘not poor’. These measures have well-known drawbacks (they take no account of the depth or persistence of poverty, for example), but they are comparatively easy to calculate and are widely watched by governments and the media alike. We will examine both ‘relative’ poverty indicators (where the poverty line moves in line with average incomes) and ‘absolute’ poverty indicators (where the poverty line is fixed in real terms).

In our discussions of income inequality, we will be adopting a relative notion of inequality. This means that should all incomes increase or decrease by the same proportional amount, we would conclude that income inequality had remained unchanged. The measures of inequality we use include the Gini coefficient and ratios of different percentile points in the income distribution.<sup>2</sup>

## *2.2 Identifying recessions and downturns*

A commonly-used rule of thumb says that a recession can be identified as two or more successive quarters of falls in GDP (real-terms). In the US, the Business Cycle Dating Committee of the National Bureau of Economic Research (NBER) uses a slightly more sophisticated definition of a recession:<sup>3</sup>

A recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales. A recession begins just after the economy reaches a peak of activity and ends as the economy reaches its trough. Between trough and peak, the economy is in an expansion.

While these definitions use quarterly (or monthly) statistics to identify recessions, data on poverty and inequality are only available on an annual basis. Therefore, for our purposes, we need to use an annual classification of recessions, while acknowledging that some years contain both periods of recession and periods of economic expansion.

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<sup>2</sup> More details on these measures can be found in Brewer et al. (2009, op. cit.).

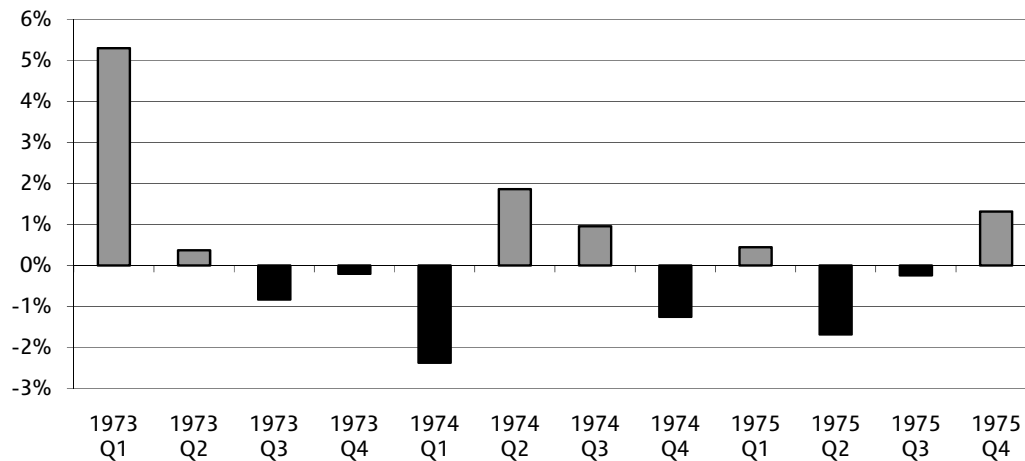
<sup>3</sup> See Business Cycle Dating Committee, *The NBER’s Recession Dating Procedure*, NBER, 21 October 2003 (<http://www.nber.org/cycles/recessions.html>).

After 1961 – the start of our continuous time series of poverty and inequality – there have been three recessions in the UK,<sup>4</sup> with a fourth beginning in mid-2008 and ongoing at the time of writing. We illustrate these recessions in Figures 1a–1d.

Panel a shows the recession of the mid-1970s. The UK economy was in the midst of the ‘Barber boom’ during the first two quarters of 1973 – a period of unsustainably high economic growth presided over by Chancellor Anthony Barber, ultimately generating high inflation and confrontation with trade unions. This boom was followed by three successive quarters of negative growth. There was a slight recovery in mid-1974, but this was followed by negative growth in three out of the next four quarters. We thus say that the mid-1970s recession lasted from 1973 to 1975. However, given the substantial growth during the first quarter of 1973, we might expect the effect on living standards to be different in 1973 from that in 1974 and 1975 (in fact, the growth in the first quarter of 1973 is the highest quarterly growth in GDP that the UK economy has experienced since at least 1955).

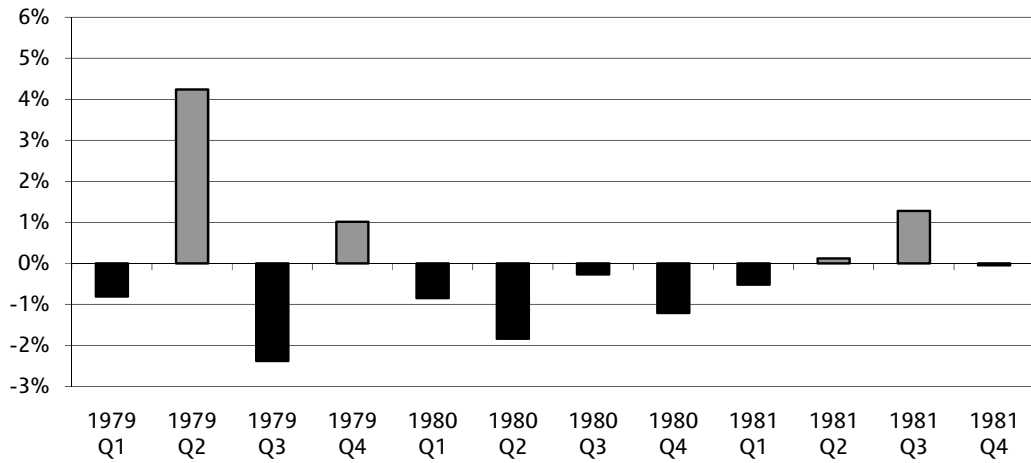
**Figure 1. Quarterly change in real GDP during previous recessions**

**a) Mid-1970s recession**

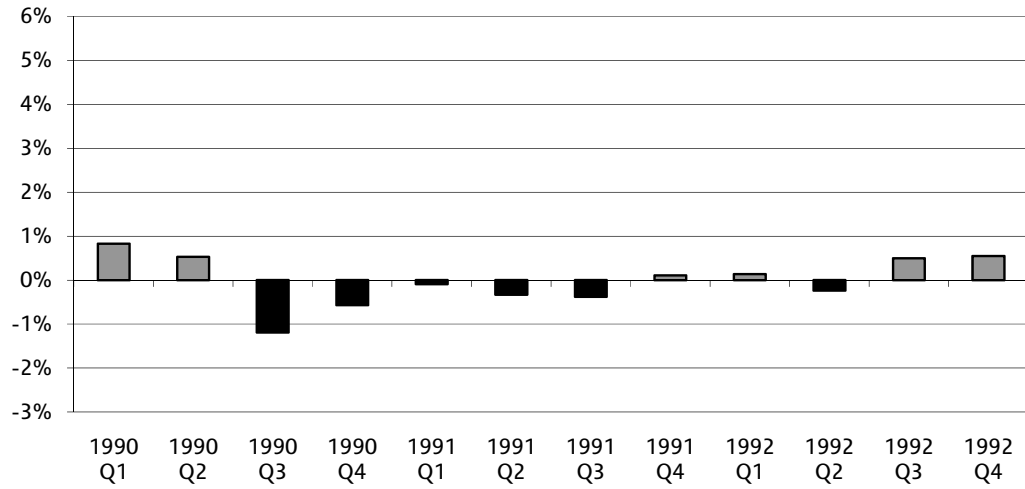


<sup>4</sup> Readers should note that there was a short recession during 1961 lasting for two quarters. However, as our data on poverty and inequality start in 1961, there is no way to compare them with data before 1961. We therefore do not discuss the 1961 recession any further.

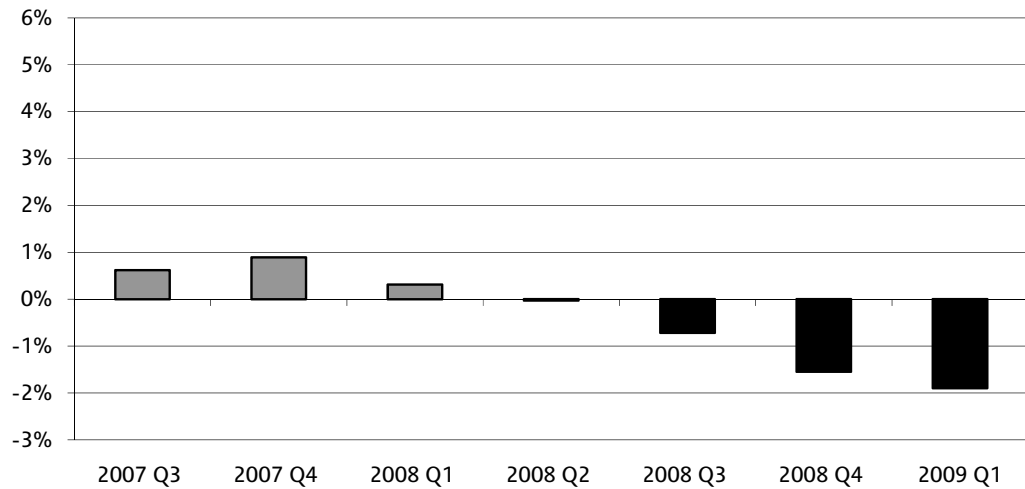
**b) Early 1980s recession**



**c) Early 1990s recession**



**d) Current recession**



*Note:* Gross domestic product at market prices, chained volume measures, seasonally adjusted, constant 2003 prices.

*Source:* Office for National Statistics, series ABMI.

Panel b shows the recession of the early 1980s. The economy contracted in the first quarter of 1979, but grew again during the second quarter. This pattern of contraction followed by growth was repeated in quarters 3 and 4. However, the economy then experienced a continuous decline until 1981Q2. In the analysis below, we treat the early 1980s recession as lasting from 1979 to 1981.

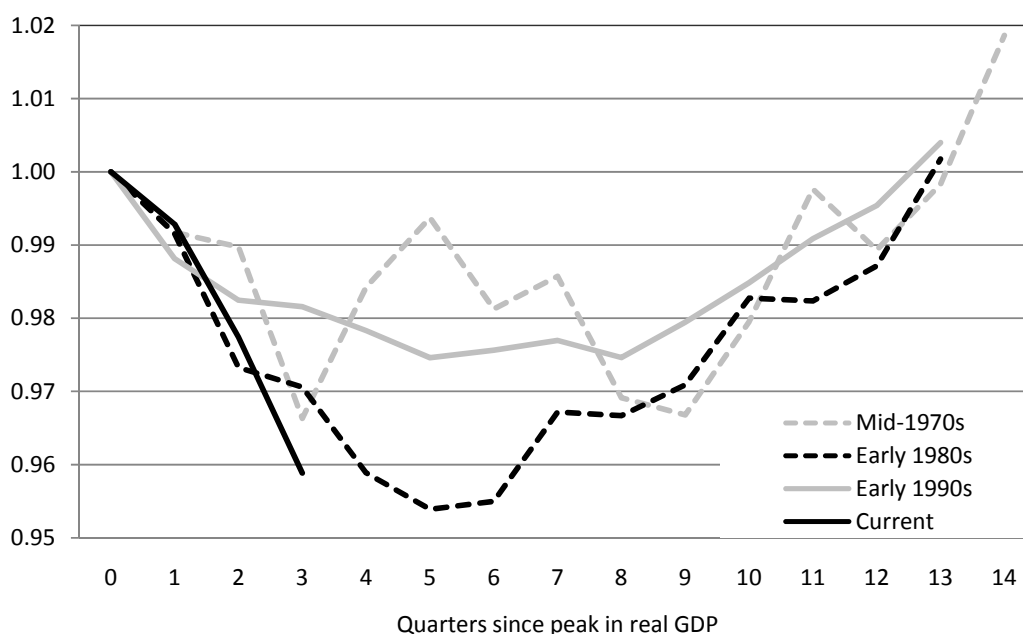
Panel c shows the recession of the early 1990s. The economy expanded during the first two quarters of 1990, but then experienced a continuous decline from 1990Q3 to 1991Q3 inclusive. The economy was static during the next two quarters and contracted again in 1992Q2. The recovery appears to have started in later 1992. We thus treat the early 1990s recession as lasting from 1990 to 1992. It should also be noted that the reductions in real GDP are a lot smaller than those observed during the previous two recessions.

Panel d shows the current, ongoing UK recession. The economy was expanding during late 2007, but growth fell to zero in the second quarter of 2008, after which the economy began to contract and has continued to do so ever more rapidly. In the latest quarter for which we have data (2009Q1), the economy contracted by 1.9% – the fastest quarterly contraction since 1979. From the first quarter of 2008 to the first quarter of 2009, the economy has contracted by more than 4%. This has effectively wiped out all gains in real GDP over the last two-and-a-half years, leaving real GDP back at its level of mid-2006.

How do these four recessions compare with each other, in terms of depth and duration? Figure 2 offers a simple means of comparison, showing real GDP in each recession, indexed so that it equals 1 at its pre-recession peak. We can see that the current recession, by its third quarter (the latest for which we have data), has seen the fastest decline in real GDP of all four recessions since the 1970s.

The recession beginning in 1973 might be thought of as a ‘double dip’ recession, with GDP almost returning to its pre-recession level within about a year, but then falling back again, so that the 1973 level of real GDP was not regained until at least three years later. The recession of the early 1980s (after the fourth-quarter peak of 1979) was the deepest of the three full recessions, with real GDP falling by nearly 5% over the course of a

**Figure 2. Real GDP in the last four recessions (real GDP = 1 at pre-recession peak)**



*Notes:* Gross domestic product indexed to 1 at pre-recession peak, using seasonally adjusted GDP, constant 2003 prices. The peaks in real GDP during the four recessions shown occurred in 1973Q2 (mid-1970s), 1979Q4 (early 1980s), 1990Q2 (early 1990s) and 2008Q2 (current).

*Source:* Office for National Statistics, series ABMI.

year. The recession of the 1990s was the mildest of the three, with real GDP only falling by about 2½% at its lowest point.

In terms of duration, there is very little to choose between the three full recessions. Despite the differences in the depth of each recession, in all three cases it was at least three years before real GDP regained its pre-recession level.

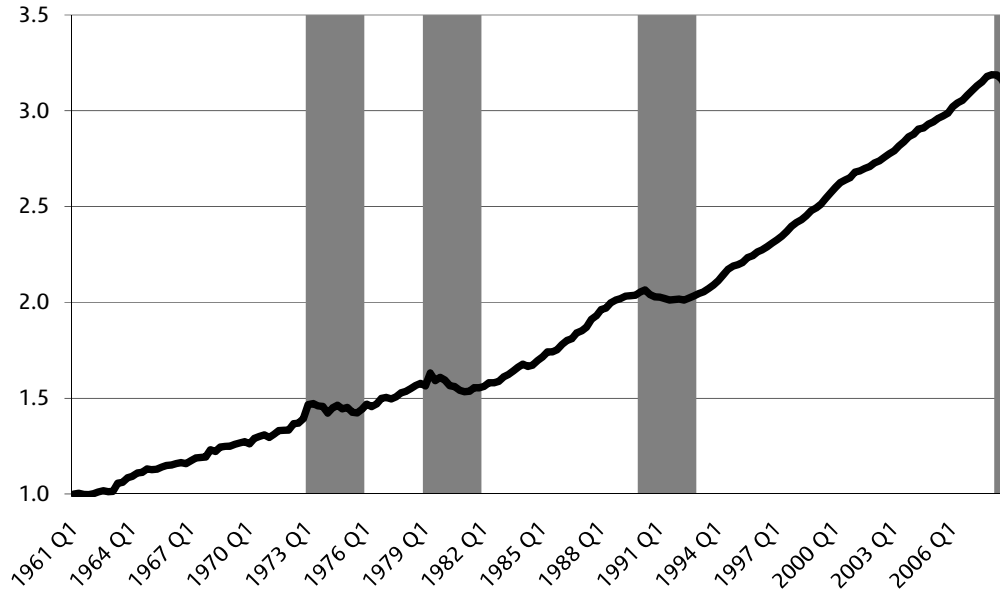
To illustrate these recessions in a longer time frame, Figure 3 shows the quarterly level of GDP from 1961 to the present day, in constant 2003 prices (indexed to 1 in the first quarter of 1961). The four recessions are indicated by the vertical grey bars. As can be seen, they correspond very well to the periods of continuous decline in GDP observed over this period.

Another important macroeconomic indicator of recessions is the level of unemployment. Indeed, this is likely to be one of the most important mechanisms through which recessions affect living standards and well-being. Figure 4 shows the level of unemployment between 1971 and 2008 (using the International Labour Organisation (ILO) definition of



unemployment). It shows that unemployment rose during each of the three previous recessions and was also rising in 2008 as the current recession began.

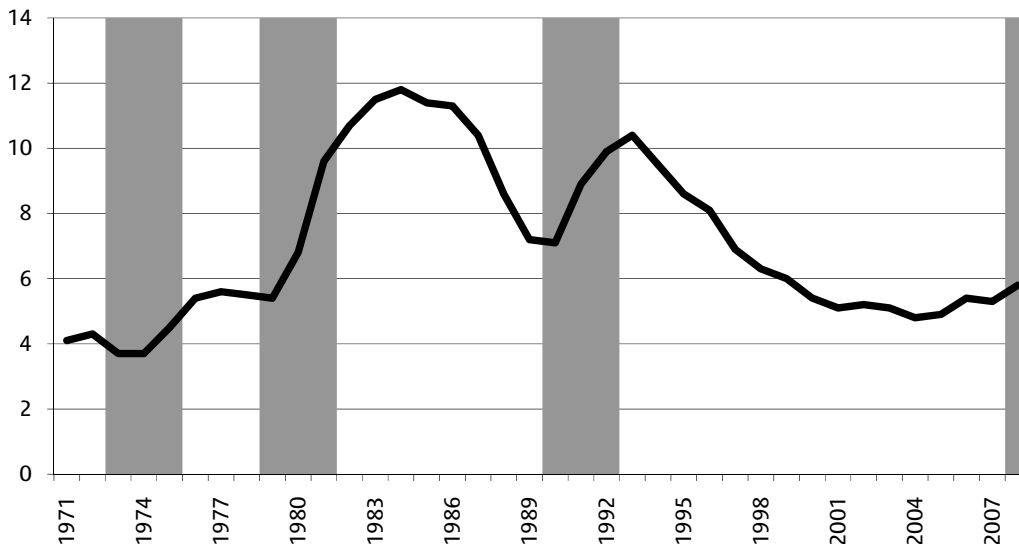
**Figure 3. Level of quarterly real GDP, 1961Q1 = 1 (recessions shaded in grey)**



*Note:* Gross domestic product at market prices, chained volume measures, seasonally adjusted, constant 2003 prices.

*Source:* Office for National Statistics, series ABMI.

**Figure 4. Rate of unemployment in the UK, % (recessions shaded in grey)**



*Note:* Unemployment is defined on an annual basis using ILO definition, seasonally adjusted.

*Source:* Office for National Statistics, series MGSX (unemployment rate for all aged 16 and over); denominator is the economically active population.

The largest rise in unemployment occurred during the early 1980s recession, with unemployment continuing to rise even after the recession had finished, not peaking until 1984. However, it is worth noting that unemployment did not rise until the second year of the recession in all three cases (this is why economists call unemployment a 'lagging indicator' of recession). This suggests that the full impact of a recession may not feed through to living standards until several quarters after the recession officially begins.

### **3. What effect would we expect recessions to have on living standards?**

As stated earlier, a recession can be identified (according to the NBER) by a decline in economic activity 'visible in real GDP, real income, employment, industrial production, and wholesale-retail sales'. Average living standards, measured by incomes, will thus (by definition) decline at some point during a recession. However, this decline in living standards will not be experienced equally by all groups in society. The effect of a recession on measures of inequality and poverty is also far from clear. In this section, we consider what the current economic literature has to say about these issues. Which groups have been found to suffer most during recessions? And what implications might this have for inequality and poverty?

Periods of economic *expansion* have certainly differed in the extent to which they benefit different groups. Cutler et al.,<sup>5</sup> analysing data for the US, show that the 1980s were 'far less beneficial to the disadvantaged than were previous periods of economic growth'. Freeman,<sup>6</sup> however, shows that during the 1990s, economic expansion did improve the living standards of those towards the bottom of the income distribution. He nonetheless concludes that there are around 6–8% of Americans who 'cannot be helped' by improved economic conditions. These 'residual poor' include elderly retirees, some disabled individuals (and those caring for disabled relatives), and less-educated immigrants with very low skills.

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<sup>5</sup> D. Cutler, L. Katz, D. Card and R. Hall, 'Macroeconomic performance and the disadvantaged', *Brookings Papers on Economic Activity*, vol. 1991, no. 2, pp. 1–74.

<sup>6</sup> R. Freeman, 'The rising tide lifts...?', NBER Working Paper no. 8155, 2001 (<http://www.nber.org/papers/w8155.pdf>).

While much of this literature focuses on the benefits of growth, rather than the impact of recessions, many of the findings are relevant to both questions. Just as individuals with low attachment to the labour market are unlikely to gain directly from economic expansion, they are also less likely to see their incomes fall as a direct result of a recession. Recessions lead to rising unemployment and slow (or negative) real earnings growth, and so it is individuals who are part of the labour market whom we would expect to have highly cyclical income growth (on average).

It is too simplistic, however, to suppose that labour force non-participants are entirely insulated from the effects of an economic downturn. Hines et al.<sup>7</sup> find that public provision of goods and services, including income transfers, tends to rise when the economy is growing. Thus ‘a rising tide has the potential to raise the boats of individuals who do not have oars in the job market’,<sup>8</sup> while the reverse may be true in a recession.

Focusing solely on individuals who are part of the labour market, important questions remain. When we consider the cyclical nature of labour market outcomes (such as employment, earnings and wages), is it the high-skilled, highly-paid jobs which are most cyclical, or the low-skilled, lower-wage jobs? Hines et al. find that employment and work hours in the US clearly move with the economic cycle, but that this is particularly true for low-skilled workers.<sup>9</sup> They conclude that ‘the benefits of strong economic growth for the disadvantaged are at least as great as they are for the more advantaged, and the costs of a downturn are borne disproportionately by the disadvantaged’.<sup>10</sup>

Okun<sup>11</sup> suggested another labour market cost of recessions. He hypothesised that in a slack labour market (as in a recession), workers might find themselves ‘downgraded’ – with ‘high quality workers accepting low quality and less productive jobs’ in order to avoid outright

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<sup>7</sup> J. Hines, H. Hoynes and A. Krueger, ‘Another look at whether a rising tide lifts all boats’, NBER Working Paper no. 8412, 2001 (<http://www.nber.org/papers/w8412>).

<sup>8</sup> Ibid., page 45.

<sup>9</sup> Ibid., page 2.

<sup>10</sup> Ibid., page 1.

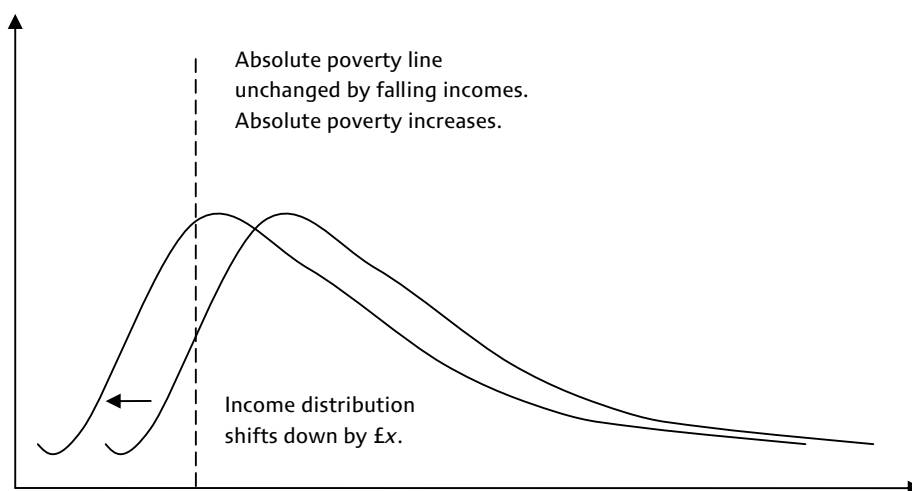
<sup>11</sup> A. Okun, ‘Upward mobility in a high pressure economy’, *Brookings Papers on Economic Activity*, vol. 1973, no. 1, pp. 207–52.

unemployment. Hines et al. find evidence to support this hypothesis, concluding that ‘workers tend to gravitate toward jobs in sectors with steeper seniority-wage profiles when times are good, and tend to gravitate toward dead-end jobs when times are bad’.<sup>12</sup>

The expected effect of recessions on measures of inequality and poverty is more ambiguous. Most such measures depend not just on the level of average incomes, but also on the *shape* of the income distribution. In fact, the effect of a recession on measures of poverty (both absolute and relative) is intimately bound up with its effect on inequality, as we illustrate below.

Let us start by looking at a recession that leaves the shape of the income distribution (and hence some measures of inequality) completely unchanged. This is, of course, rather implausible – it would require incomes for all individuals in the economy to fall by the same absolute amount (in pounds), shifting the entire income distribution down while preserving its shape – but it is a useful baseline case. Such a recession would unambiguously increase absolute poverty, because the absolute poverty line remains in the same place (in real terms) while the income distribution shifts lower. This is illustrated in Figure 5.

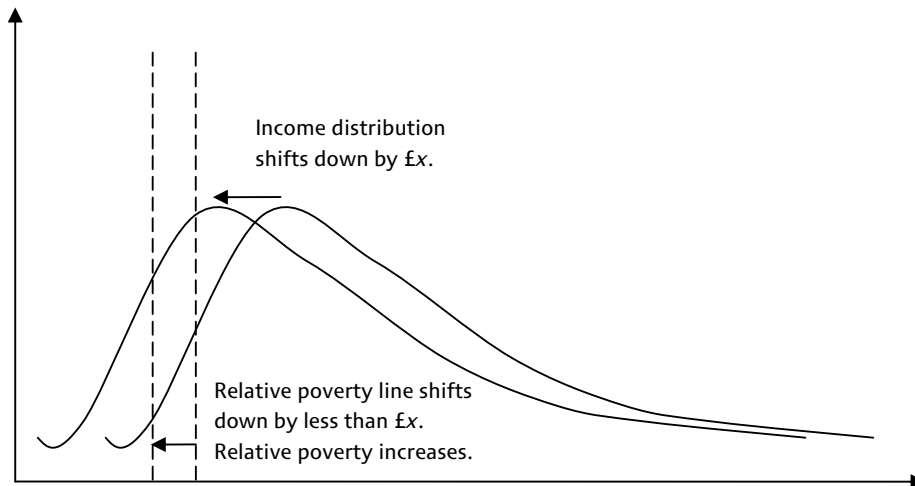
**Figure 5. Falling incomes with stable income distribution – absolute poverty increases**



<sup>12</sup> Hines, Hoynes and Krueger, 2001, op. cit., page 44.

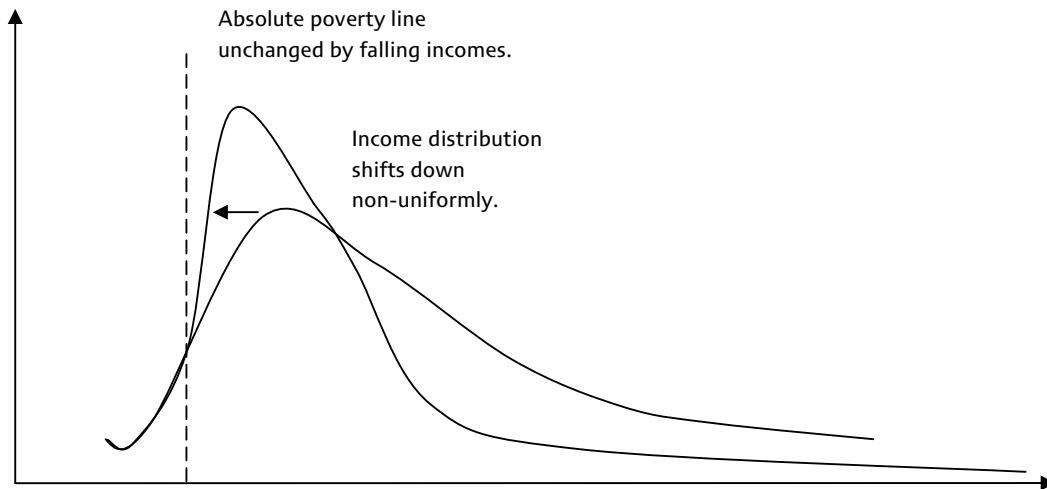
This recession would also cause relative poverty to increase somewhat, because the relative poverty line will fall by less than average income. If the relative poverty line is defined as 60% of median income, and the income distribution shifts downwards by  $\text{£}x$ , then the poverty line will shift down by only 60% of  $\text{£}x$ , as illustrated in Figure 6.

**Figure 6. Falling incomes with stable income distribution – relative poverty increases**



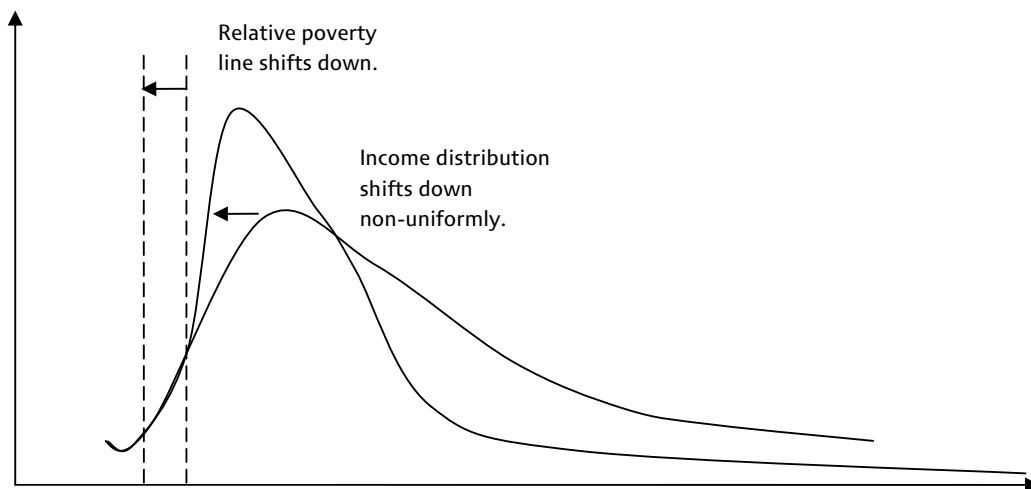
Now let us suppose instead that the recession reduces incomes towards the top of the income distribution more than it reduces incomes towards the bottom of the distribution. This is not wholly implausible, as incomes towards the bottom of the distribution are likely to contain a large fraction of state benefits (many of which are fixed in real terms), while incomes higher up the distribution will be more dependent on labour earnings (which are likely to fall in real terms during a recession). Such a recession will reduce income inequality, as incomes towards the top of the distribution fall closer to those at the bottom. Unlike the recession shown in Figure 5, this recession may not change absolute poverty at all, as shown in Figure 7.

**Figure 7. Fall in average incomes offset by reduced inequality – absolute poverty unchanged**



Relative poverty will actually fall during such a recession, as shown in Figure 8, because the relative poverty line declines with average incomes while incomes at the bottom of the distribution remain unchanged. Figure 8 encapsulates a common objection to relative poverty measures – that they can be ‘improved’ (i.e. poverty can be reduced) by impoverishing those above the poverty line.

**Figure 8. Fall in average incomes with reduced inequality – relative poverty falls**



In the converse case, in which a recession lowers incomes at the bottom of the distribution more than incomes at the top, we might see both absolute and relative poverty increase substantially (as the poverty line remains more or less unchanged while more individuals fall below it).

Unfortunately, as the discussion above should make clear, the effect of a recession on poverty is not clear-cut a priori. It will depend on which groups' incomes are worst affected by the economic slowdown, and this effect could vary from one recession to another. Burgess et al.<sup>13</sup> use data from the UK to show that aggregate unemployment rates and poverty rates (at least in the 1990s) do not appear to be strongly linked. However, when they examine the experiences of different demographic groups, they find wide variation in the extent to which their poverty rates respond to the economic cycle.

As Freeman<sup>14</sup> points out, the composition of the population near the poverty line will be a key determinant of the responsiveness of poverty to a recession. If the population around the poverty line contains more labour market participants, then poverty will be more likely to increase during a recession (as labour market participants suffer increased unemployment or wage cuts). If, on the other hand, the population around the poverty line is made up of more non-participants (whose incomes often come from sources fixed in real terms, such as pensions and benefits), the poverty rate may be less responsive to a recession. Indeed, in relative terms, individuals on fixed incomes (such as pensioners) may 'catch up' with the rest of the income distribution during periods of stagnant or negative earnings growth.

In summary, then, the economic literature gives a reasonably clear answer as to which groups' living standards are likely to be most cyclical, and hence worst affected by recessions – we expect to see strong effects of recessions on the incomes of working-age individuals, but weaker effects on individuals who are retired or who are not strongly attached to the labour force. In the next section, we examine whether these predictions are borne out by the data for the UK since 1961.

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<sup>13</sup> S. Burgess, K. Gardiner and C. Propper, 'Why rising tides don't lift all boats: an explanation of the relationship between poverty and unemployment in Britain', CASE Working Paper no. 46, 2001 (<http://sticerd.lse.ac.uk/dps/case/cp/CASEpaper46.pdf>).

<sup>14</sup> Freeman, 2001, op. cit.

The effects of recessions on poverty and inequality are more ambiguous, although the effect on poverty is closely related to changes in inequality. For some groups, such as pensioners, we can make clear predictions – we expect relative poverty amongst pensioners to fall during recessions (or at least to grow more slowly), as they ‘catch up’ with working-age individuals. For other groups, and for overall levels of poverty and inequality, we cannot make clear predictions, and we can only look at how these measures changed in previous recessions. We do this in Sections 5 (for inequality) and 6 (for poverty).

#### **4. Living standards during previous recessions**

This section explores the evolution of measures of average living standards and living standards among particular subgroups during previous recessions, according to their family type, age and level of education. Box 1 sounds two notes of caution in using past trends in average incomes as a guide to the likely impact of the current recession. Such concerns also apply to our later analysis of poverty and inequality.

##### **Box 1. Notes of caution in using past recessions as a guide to the current recession**

It might be tempting to use experiences during previous recessions as a guide to the likely impact of the current recession. However, it is important to sound two notes of caution in this regard.

First, recessions are not uniform events. Past recessions differ from each other in both their causes (from banking crises to oil price shocks) and their effects. Therefore, while we can report the ‘average’ experience during previous recessions, we must bear in mind that recessions are individual events, and we must examine the differences as well as the similarities between previous recessionary experiences. The current recession will differ from those of the past, in ways that we are unlikely to be able to predict with any confidence. In Section 7, we tentatively note some potential differences between the current recession and previous ones – but these should be seen as preliminary thoughts rather than definitive judgements.

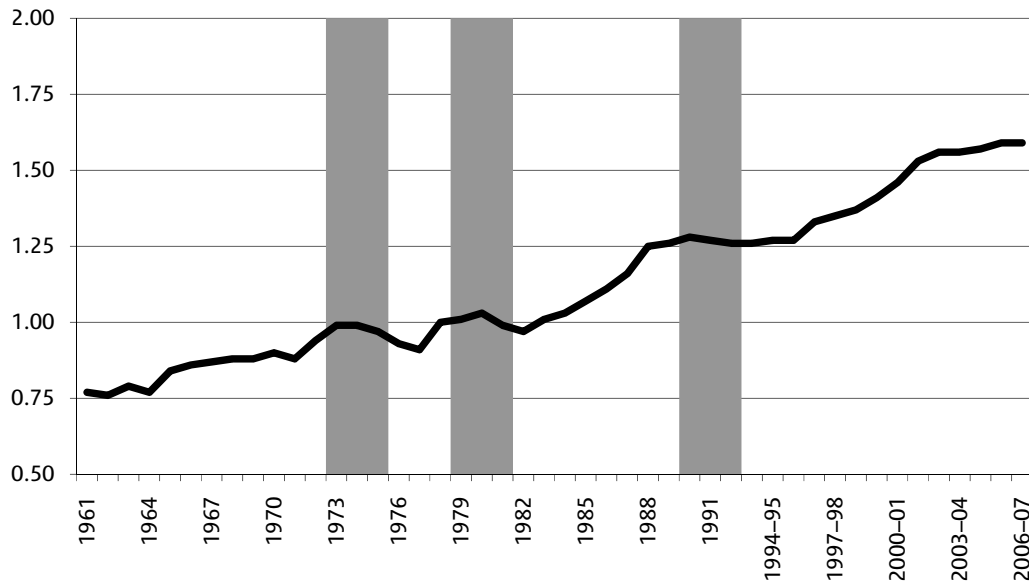
Second, trends in living standards and inequality during previous recessions reflect many other changes in public policy and other socio-economic changes, as well as what we might consider the ‘direct’ effects of recession. For instance, the increases in top rates of income tax during the recession of the 1970s, and the cuts to top rates of income tax during the recession of the early 1980s, affected living standards for those on higher incomes during these recessions but were implemented for reasons largely independent of the recession. Public policy also responds directly to a likely recession, as with the £25 billion fiscal stimulus announced in the 2008 Pre-Budget Report. Such policy changes mean that living standards do not evolve as they otherwise would have done (had policies before the recession continued unchanged).



#### 4.1 Average incomes for the whole population

Here we examine trends in measures of average living standards, namely the level of median income. Given that recessions are periods of real-terms declines in national income, one would also expect them to be periods of declining average living standards in real terms. Indeed, one can see from Figure 9 that periods of recession in the past (shaded in grey) were periods when median, or average, household incomes fell in real terms.

**Figure 9. Median real income, 1978 =1 (recessions shaded in grey)**



*Notes:* Incomes have been measured before housing costs have been deducted. Figures are for Great Britain only.

*Source:* Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

However, it is worth noting that the falls in average incomes did not begin until the second year of these recessions. This is not surprising, given that we earlier showed unemployment to be a lagging indicator of recession and that the recessions did not begin in the first quarter of a year.

Just as the decline in average household incomes appears to lag the start of recession, so its return to growth appears to lag behind the start of the recovery. In all three recessions, average household income growth was still negative in the year following the recession, by significant amounts in 1976 and 1982. After the end of the early 1990s recession, median incomes continued to stagnate until at least 1995–96. Again, this might be

expected, given that unemployment continued to rise for some time after each recession ended.

While these patterns of income growth during recessions come as no surprise, they are likely to mask significant variations in the experiences of different subgroups of the population. It is to the average experience of these subgroups, classified by family type, age and years of education, that we now turn.

#### *4.2 Average incomes by family type*

Figure 10 shows average, or median, income levels for six family types between 1961 and 2006–07 (with values presented in 2007–08 prices). Panel a illustrates median income levels for lone parents, single pensioners and couple pensioners. It shows that average income levels for these three family types, though quite volatile, were steadily increasing over time up until about 1990. From then on, average income levels for lone parents and pensioners continued to increase, but at a much faster rate. These trends do not appear to be interrupted by recessions; indeed, some of the fastest increases in average income for pensioners and lone parents took place during the recession of the early 1990s.

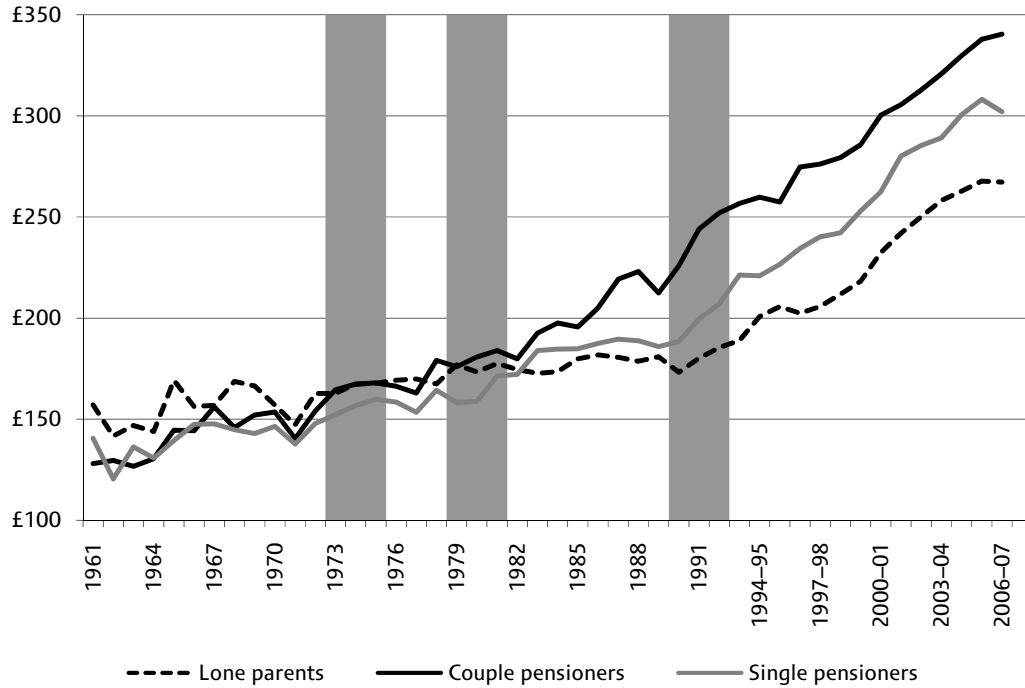
Panel b shows average incomes for single people without children and for couples with and without children. The pattern of income growth for these family types is quite different from that shown for pensioners and lone parents in panel a. Couples (with and without children) and single people without children experience positive average income growth in most years, with falls during and just after recessions, which coincide with periods of rising unemployment in Figure 4.

Therefore there seem to be two groups of families. One group – with strongly cyclical income growth – comprises single individuals without children and couples (with and without children). The second category of families is pensioners and lone parents, who seem to experience secular income growth over time, which is not interrupted by periods of recession.

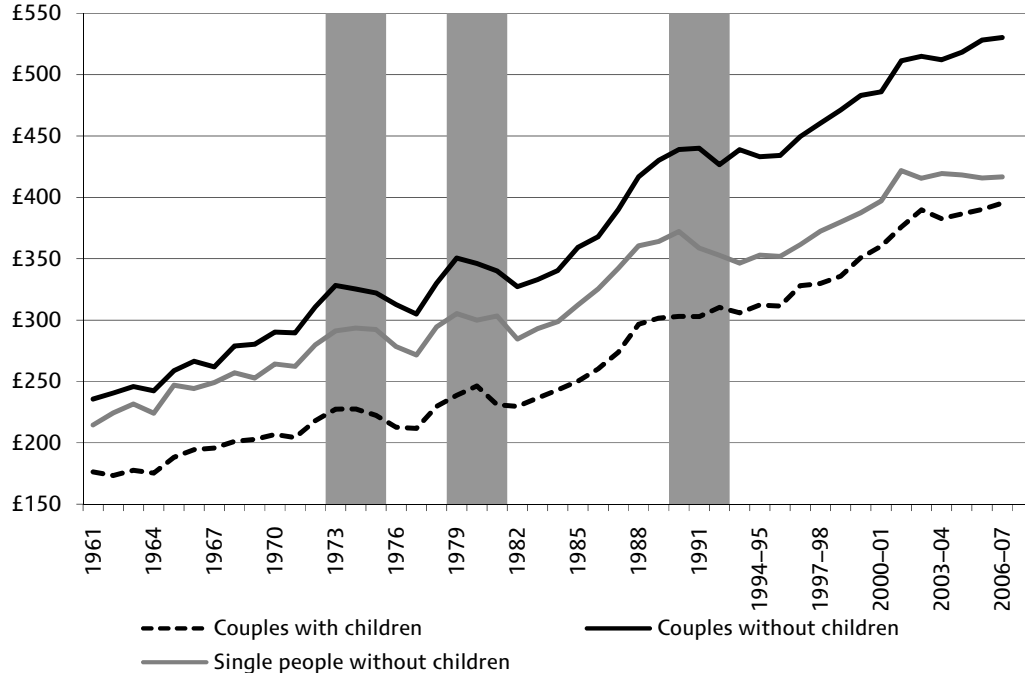
What could explain the different income growth across these family types? As we suggested in Section 3, the most natural explanation would be their relative dependence on the labour market for their income, given that it is likely to be via unemployment and depressed earnings growth that a recession impacts most upon family incomes.

**Figure 10. Median real income by family type (recessions shaded in grey)**

**a) Lone parents and pensioners**



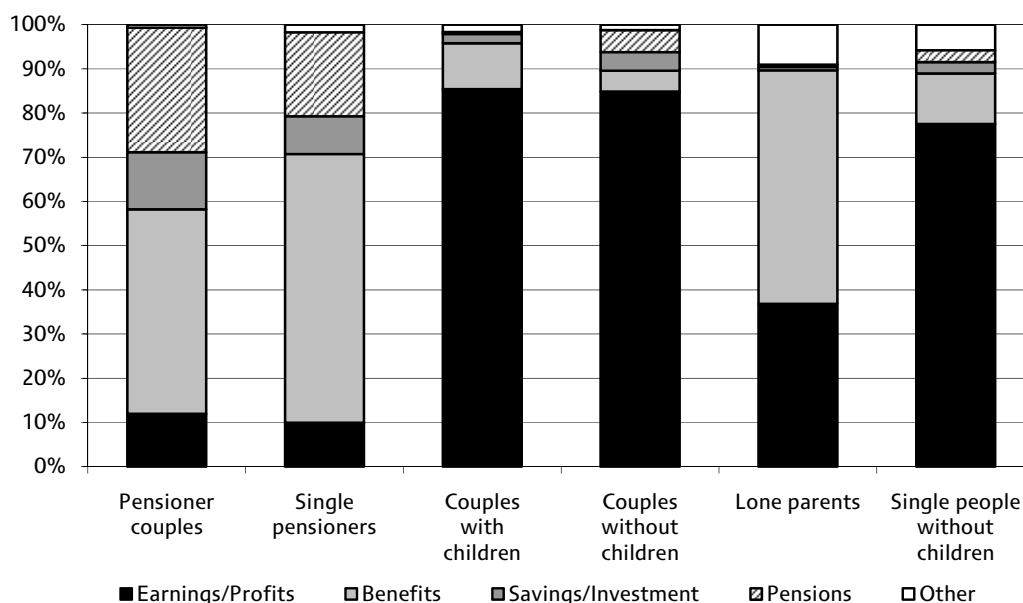
**b) Single people without children, and couples with and without children**



*Notes:* Incomes have been measured before housing costs have been deducted and are given in pounds per week at 2007–08 prices. Figures are for Great Britain only.

*Source:* Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

**Figure 11. Income sources by family type, 2006–07**



*Notes:* Incomes have been measured before housing costs have been deducted. Figures are for Great Britain only.

*Source:* Authors' calculations using Family Resources Survey, 2006–07.

To illustrate this point, Figure 11 shows the percentage of each family type's overall net income coming from different sources in the latest year of available data, 2006–07 (this year is chosen as an example, but the picture would be little different for other recent years). The different income sources we examine are: earnings or self-employment profits; state benefits and tax credits; savings and investment income; occupational and private pensions; and other income. We see that the main difference between the two groups is that the first type of families (those with strongly cyclical income growth) receive the vast majority of their income from earnings or self-employment profits, at over 75%.

The second group of families (with income growth seemingly unrelated to economic growth) receive much less of their income from earnings or self-employment profits – around 35% for lone parents and around 10% for pensioners. These groups receive a majority of their income from state benefits – though, as one would expect, pensioners also receive a large proportion from occupational and private pensions and around a tenth from savings and investment income.

Given these income sources, the pattern of these family types' income growth during periods of high and low economic growth are unsurprising.

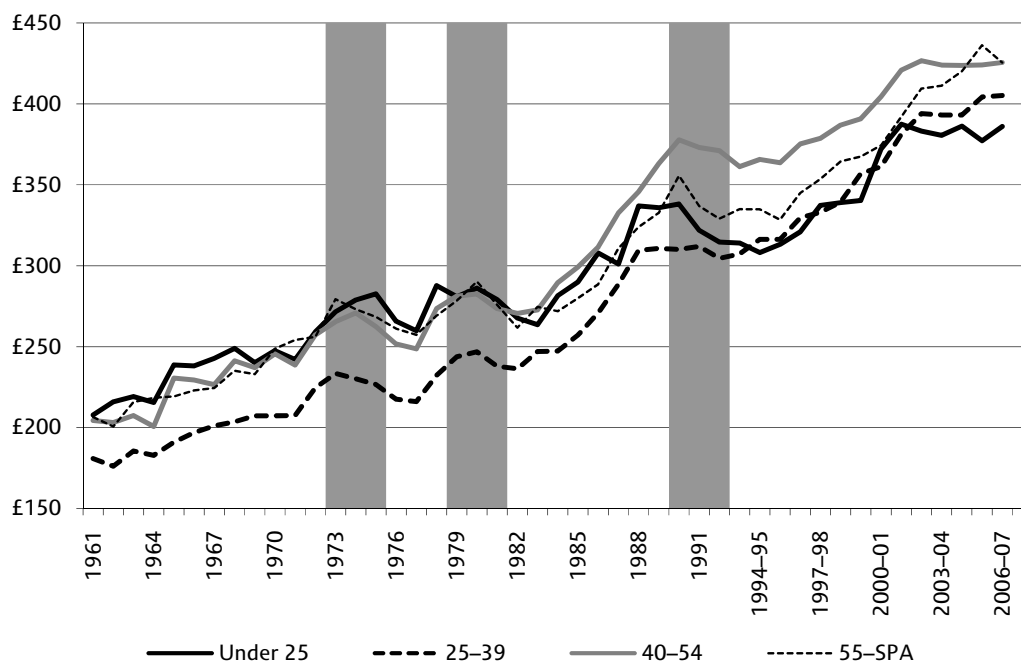
Families dependent on the labour market for their income see their incomes go up and down with the state of the economy and the labour market. Families not so dependent on the labour market do not see such fluctuations and are thus not as affected by periods of recession.

### 4.3 Average incomes by age

Figure 12 shows average, or median, income levels by age group of the head of household between 1961 and 2006–07 (with values presented in 2007–08 prices). There are four age groups: under 25, 25–39, 40–54 and from 55 to state pension age (SPA). Those above state pension age are excluded as the average incomes of single and couple pensioners have already been shown in Figure 10.

Currently, the households of individuals aged between 40 and state pension age have the highest average incomes, though this was not always the case. During the 1960s and early 1970s, the incomes of the two groups over 40 and the under-25s were all quite similar and grew at broadly similar rates. These three groups then suffered falls in their real incomes

**Figure 12. Median real income by age group of head of household (recessions shaded in grey)**



*Notes:* Incomes have been measured before housing costs have been deducted and are given in pounds per week at 2007–08 prices. Figures are for Great Britain only.

*Source:* Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

during the recessions of the mid-1970s and early 1980s. Those aged 25–39 had lower average incomes over this period, but saw a similar pattern of growth over this period.

Over the rest of the 1980s, all groups of working age saw substantial increases in their average incomes, with those aged 25–39 catching up slightly with the other three age groups. Then, during the recession of the early 1990s, those under 25 saw noticeable falls in their average incomes, as did those over 55 but less than state pension age. The middle two age groups saw smaller falls in their average incomes. Since the early 1990s, those aged over 40 have seen relatively strong growth in their average incomes, such that they currently have the highest incomes on average. Those aged 25–39 now have the next-highest incomes, on average, followed by the under-25s, who have seen less robust growth since the early 1990s.

Just focusing on the experience of these age groups during recessions, it appears as though all of them experienced relatively large falls in their incomes during the mid-1970s and early 1980s recessions. However, falls in average incomes were much larger for younger ages and for those over 55 (but under state pension age) during the recession of the early 1990s, as opposed to the small falls or stagnation experienced by those between the ages of 25 and 55.

#### *4.4 Average incomes by level of education*

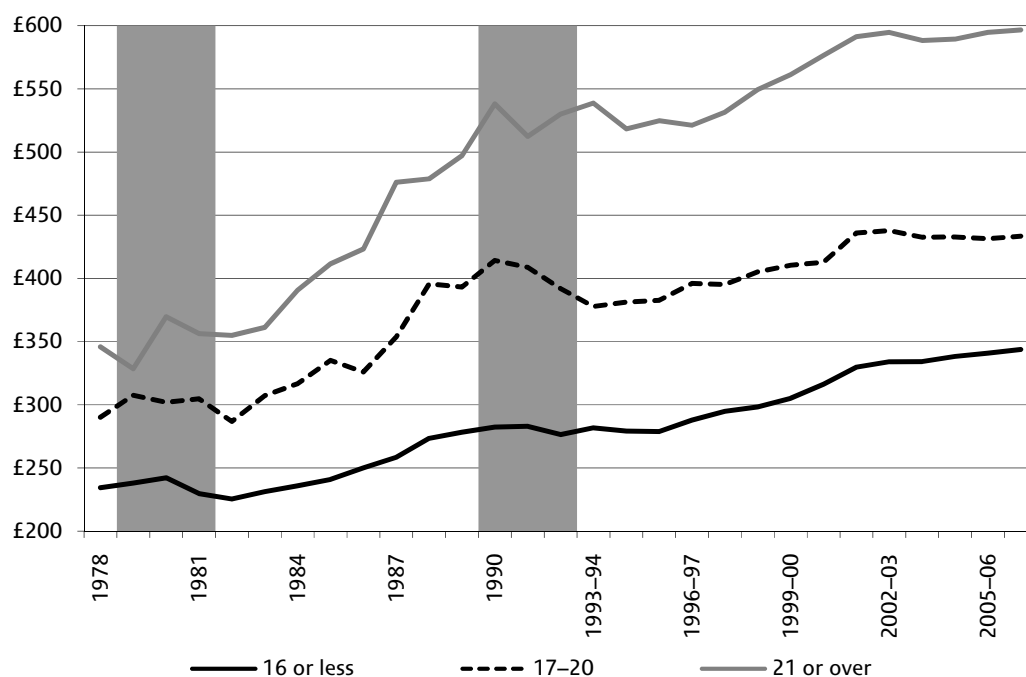
Figure 13 shows average, or median, income levels between 1978 and 2006–07 by levels of education, again defined by the head of household. There are three groups: those who left education at 16 or earlier; those who left between the ages of 17 and 20 inclusive; and those who left aged 21 or later.

As one might expect, those with greater levels of formal education tend to have higher average incomes. However, the gap between those who left at 16 or before and those who left at 21 or later increased rapidly during the 1980s. In 2006–07, the group with the most education had average incomes 1.75 times greater than those who left at 16 or before, which compares with a ratio of just less than 1.5 in 1978. A number of academic studies have suggested that the 1980s were a period of ‘skill-biased technological change’, when firms’ demand for lower-skilled workers fell dramatically while the wage premium they paid higher-skilled workers

increased.<sup>15</sup> This process may go some way towards explaining the increased gap between the average incomes of those with different levels of education.

Focusing on the two recessions over this period, we see that those who left education at 21 or later saw their incomes stagnate or increase very slightly over the course of each recession. However, those who left education earlier saw their incomes fall or stagnate during these two recessions, falling most during the recession of the early 1990s for those who left after 16 but before 21. Those with less education thus appear to have suffered slightly more during previous recessions.

**Figure 13. Median real income by age at leaving education for head of household (recessions shaded in grey)**



*Notes:* Incomes have been measured before housing costs have been deducted and are given in pounds per week at 2007–08 prices. Figures are for Great Britain only.

*Source:* Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

<sup>15</sup> See, for example, the summary in E. Berman, J. Bound and S. Machin, 'Implications of skill-biased technological change: international evidence', *Quarterly Journal of Economics*, 1998, vol. 113, pp. 1245–79.

#### *4.5 Summary of changes in average incomes*

Unsurprisingly, periods of recession are also periods during which average household incomes fall in real terms. Across family types, we observe that family types more dependent on the labour market for their income (for example, single people without children, and couples with and without children) seem to have seen a much more cyclical pattern of income growth in recent times. However, those less dependent on the labour market (pensioners and lone parents) have observed higher income growth during periods of low economic growth than they have during periods of high economic growth.

Across levels of education, those who left formal education at 21 or later (i.e. graduates) saw their incomes stagnate or rise very slightly during previous recessions. However, those who left education earlier appear to have seen their incomes fall or stagnate during previous recessions. Except for younger adults during the early 1990s recession, no one age group seems to have suffered much more than others during previous recessions.

### **5. Inequality during previous recessions**

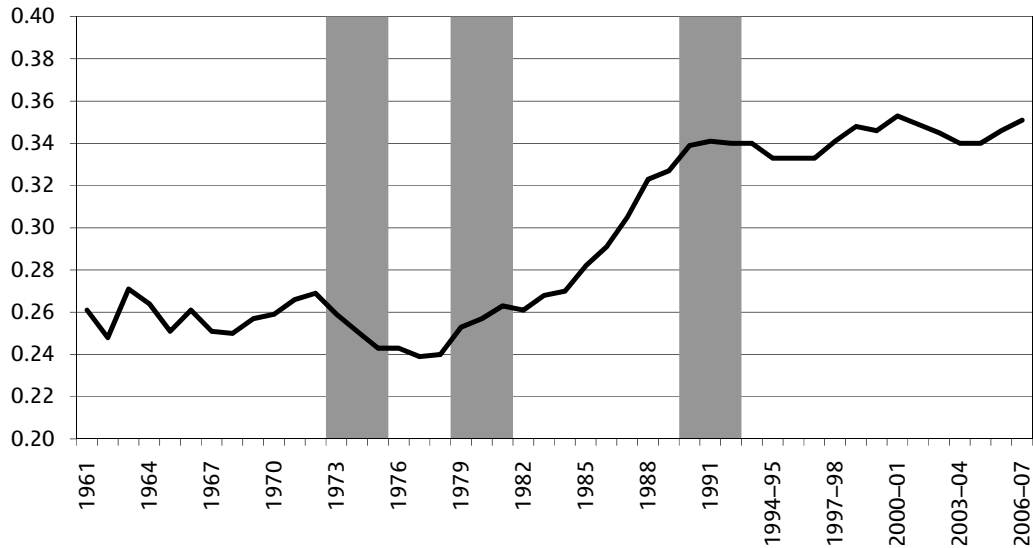
Having shown the falls in average incomes during past recessions, we now turn to discussing trends in inequality. Figure 14 shows the level of income inequality, as measured by the Gini coefficient, between 1961 and 2006–07. Taking the period as a whole, we see that income inequality remained largely constant between the 1960s and the early 1980s, after which it rose substantially during the 1980s. It has remained at a historically high level ever since.

Just focusing on the three periods of recession, income inequality did not evolve uniformly over each recession. During the mid-1970s recession, it fell slightly, having been constant beforehand. Then during the early 1980s recession it rose, though this seems to be part of a rising trend throughout the 1980s. During the early 1990s recession, income inequality was flat, having risen substantially during the late 1980s. Having fallen, risen and stayed constant during these recessions, income inequality has clearly not moved in one single direction during recessions in the past.

As already noted in Box 1, the recessions of the 1970s and 1980s also included some fairly substantial changes in top rates of income tax, which might have been expected to change the level of income inequality – higher



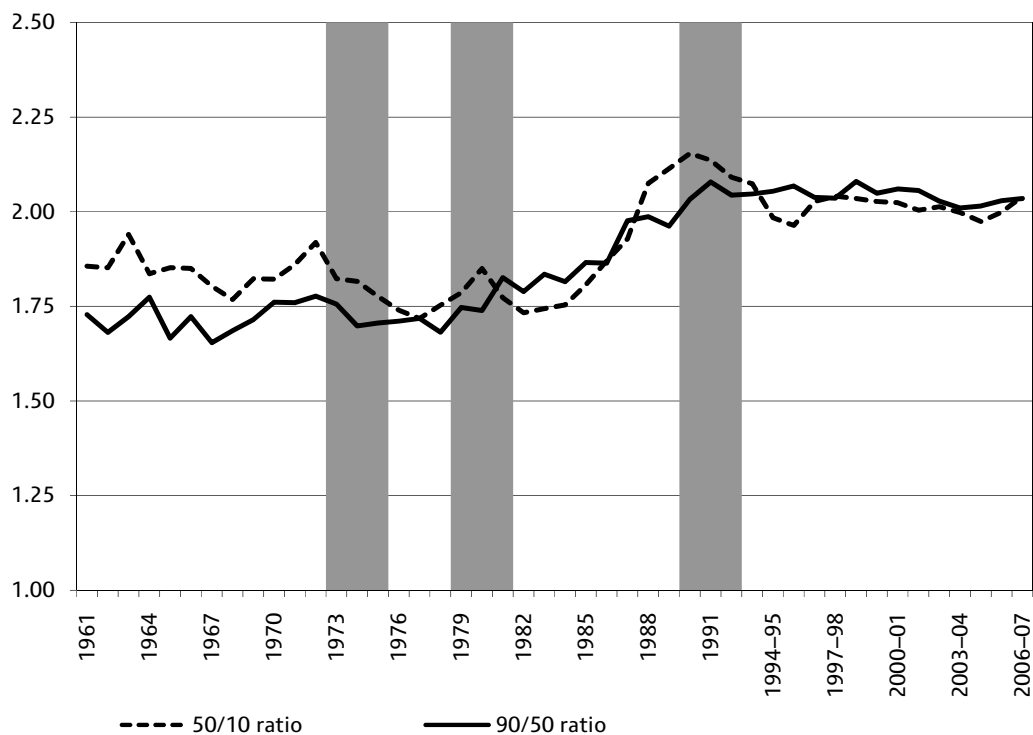
**Figure 14. Income inequality, Gini coefficient (recessions shaded in grey)**



*Notes:* Incomes have been measured before housing costs have been deducted. Figures are for Great Britain only.

*Source:* Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

**Figure 15. Income inequality, decile ratios (recessions shaded in grey)**



*Notes:* Incomes have been measured before housing costs have been deducted. Figures are for Great Britain only.

*Source:* Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

top rates of income tax to reduce income inequality (mid-1970s) and lower top rates of income tax to increase it (early 1980s). The only period of recession that did not include large changes in top rates of income tax was the early 1990s (though it did include a cut in the basic rate of income tax).

Another way to present income inequality is to use the ratio of different points in the income distribution. Figure 15 shows the ratio of the 90<sup>th</sup> percentile to the 50<sup>th</sup> percentile or the top to the middle (solid line), together with the ratio of the 50<sup>th</sup> percentile to the 10<sup>th</sup> percentile or the middle to the bottom (dotted line). Both of these ratios show similar trends to the Gini coefficient over the period as a whole, except that the rise during the 1980s is slightly less dramatic.

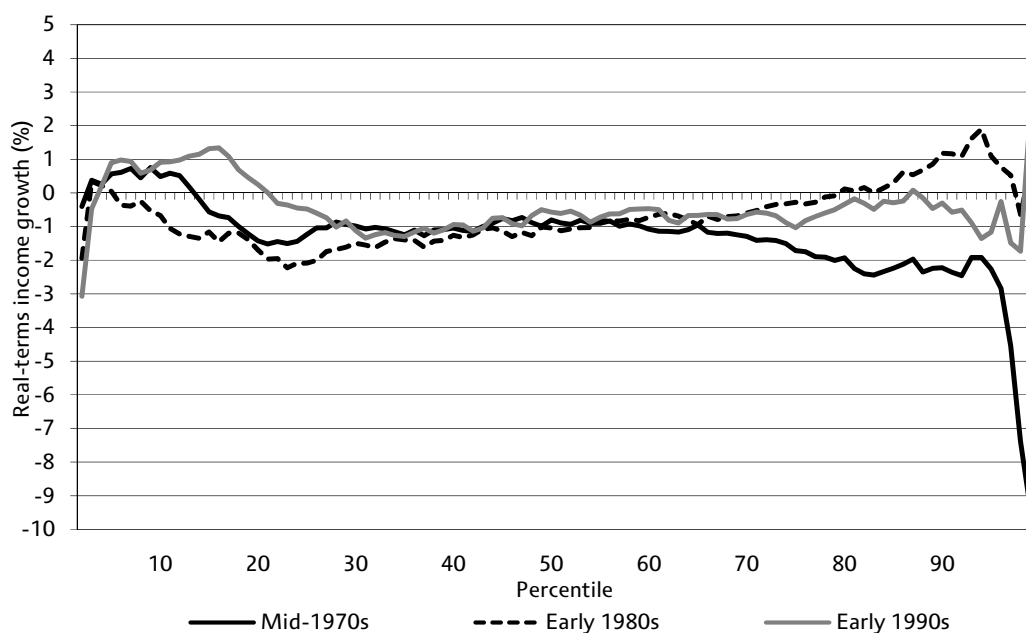
During the periods of recession, we observe a slight fall (mid-1970s) and two rises (early 1980s and early 1990s) in the 90/50 or top to middle ratio. However, we observe falls in the 50/10 (middle to bottom) ratio in all three recessions. There thus appears to be some weak evidence that those on lower incomes (around the 10<sup>th</sup> percentile) may have caught up with those on middle incomes (around the 50<sup>th</sup> percentile) during previous recessions.

We can go further than this by showing growth across different points in the income distribution during past recessions. Figure 16 shows the total real-terms change in each percentile point across the income distribution over the course of each of the three recessions experienced by the UK economy in the last 40 years.

The graph shows that between the 30<sup>th</sup> and 70<sup>th</sup> percentiles, the total percentage fall in household income was relatively constant across all three recessions, at around 1% (plus or minus 0.5 percentage points). Below the 30<sup>th</sup> percentile, total income growth becomes less negative, with positive income growth in some parts of the bottom quintile in the mid-1970s and early 1990s recessions. It should, however, be stated that there is likely to be significant sampling variation around these point estimates, such that most estimates are not significantly different from zero or from each other.

Income changes at the top of the distribution are much more diverse. This is not surprising given that the mid-1970s recession was accompanied by large increases in top rates of income tax, which could partly account for

**Figure 16. Real income growth across the income distribution during previous recessions**



*Notes:* Incomes have been measured before housing costs have been deducted. Figures are for Great Britain only. Mid-1970s refers to 1973–75, early 1980s refers to 1979–81 and early 1990s refers to 1990–92.

*Source:* Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

the substantial falls in top incomes. Cuts in top rates of income tax could account for some of the rise in top incomes during the early 1980s recession. During the 1990s recession, income changes in the top third of the income distribution are not radically different from those observed in the middle of the income distribution – except at the very top percentile of the income distribution, where there was real-terms growth in excess of 2%. However, it would be unwise to place too much weight on observations from a single recession – particularly for a group (those with top incomes) whose incomes are notoriously difficult to measure accurately and given likely sampling error.

### *Summary of inequality during previous recessions*

There is no 'rule' for the behaviour of inequality during recessions. Inequality fell during the recession of the mid-1970s, rose during the recession of the early 1980s and was more or less unchanged during the recession of the early 1990s. However, it does appear that incomes in the

middle of the income distribution fell by more than incomes at the bottom of the income distribution during previous recessions. We might thus expect to see falls in overall levels of relative poverty, which the next section goes on to discuss.

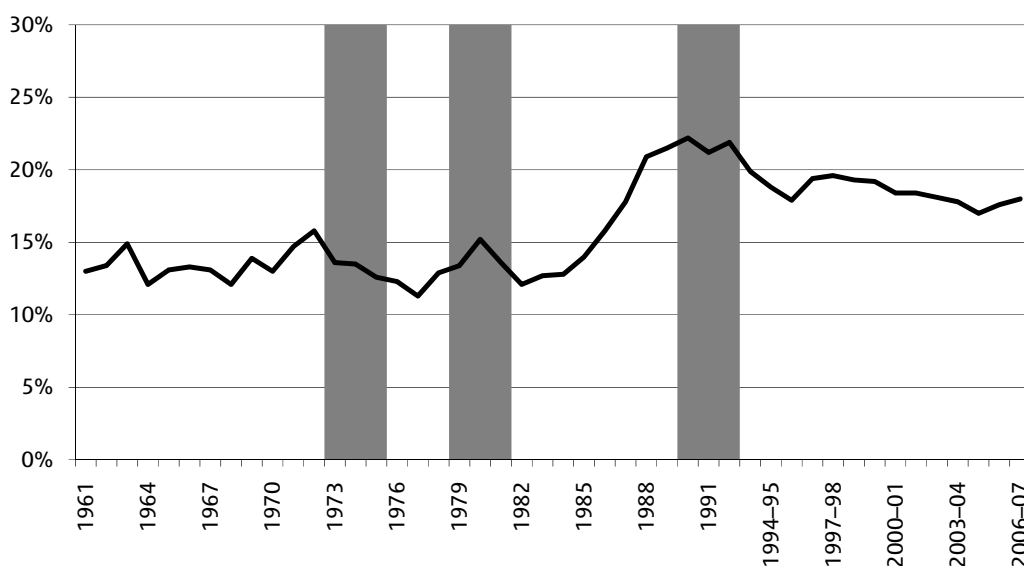
## 6. Poverty during previous recessions

This section discusses the course of poverty during previous recessions, both for the population as a whole and for particular subgroups (children, pensioners and working-age adults without dependent children).

### 6.1 Poverty in the whole population

Figure 17 charts the proportion of all individuals classed as living in relative poverty between 1961 and 2006–07, where relative poverty is defined as living in a household with an equivalised income less than 60% of the contemporary median, before housing costs have been deducted (BHC). Recessions are again shaded in grey. The graph shows that over all three recessions, relative poverty was lower at the end of the recession

**Figure 17. Relative income poverty (recessions shaded in grey)**



*Notes:* Incomes have been measured before housing costs have been deducted. Figures are for Great Britain only up until 2001–02 and for the UK from 2002–03 onwards. Individuals are classed as living in relative income poverty if they live in a household with an equivalised disposable income less than 60% of the contemporary median, before housing costs have been deducted.

*Source:* Authors' calculations using Family Expenditure Survey and Family Resources Survey, various years.

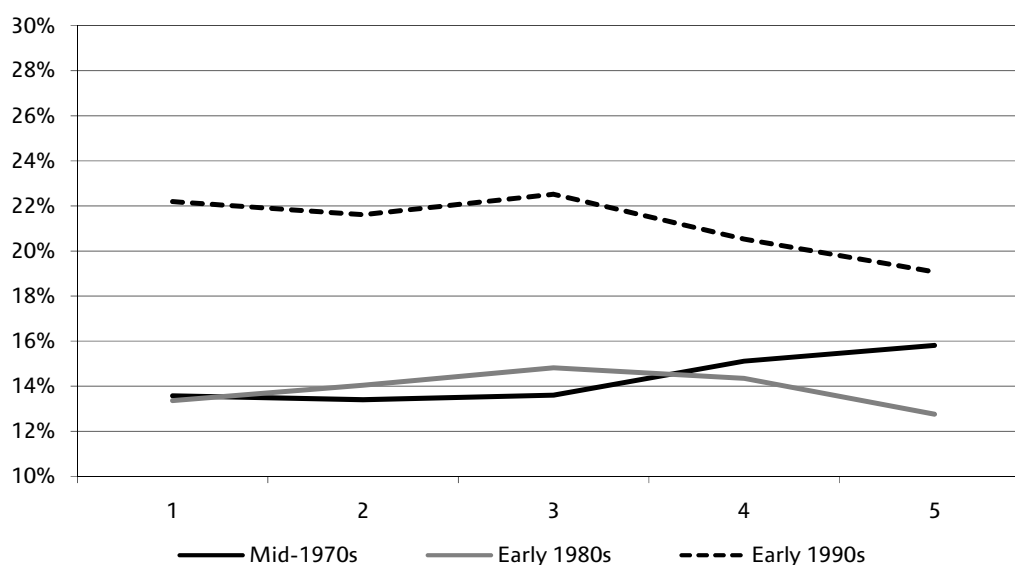
than it was prior to the start of the recession. However, it is also notable that relative poverty continued to fall after the end of all three recessions (though only for one year in the case of the early 1980s recession), during which time unemployment carried on rising (see Figure 4).

As we stated earlier, though, part of the effect of a recession on relative poverty might simply be due to falling average incomes reducing the relative poverty threshold. We now therefore examine an absolute measure of poverty – where the poverty line is fixed in real terms over time. However, it would not be appropriate to use the same threshold over time. This is because such absolute measures of poverty tend to lose their relevance over long time frames. Real income growth over time would lead to an increasingly small number of individuals being classed as living in absolute poverty and there are well-known problems with using families with the lowest recorded incomes as a guide to the number or characteristics of families with the lowest living standards. These families could well be temporarily poor or have their incomes mismeasured, given that the families with the lowest incomes often have living standards similar to those much higher up the income distribution. Therefore absolute indicators need to be rebased so that they do not lose their value over time.

We choose to define a measure of absolute poverty where the threshold is fixed at 60% of median income in the first year of a recession, which is then only updated in line with inflation, not changes in median incomes. For example, the black line in Figure 18 shows the proportion of all individuals living in households with incomes below 60% of the median in 1973 for year 1 of the recession through to year 3 of that recession and then the two years that followed (labelled 4 and 5). The grey line shows the same but for the early 1980s recession with the poverty threshold fixed at 60% of the median in 1979, and the dashed line for the early 1990s recession with the poverty line fixed at 60% of the 1990 median.

As can be seen, these indicators of absolute poverty stayed fairly constant during the 1970s recession, increased slightly during the early 1980s recession and stayed fairly constant during the early 1990s recession. After the end of the recessions of the early 1980s and 1990s, these absolute poverty indicators began to decline, but in the mid-1970s recession the measure actually started to increase.

**Figure 18. Absolute income poverty indicators defined at the start of a recession**



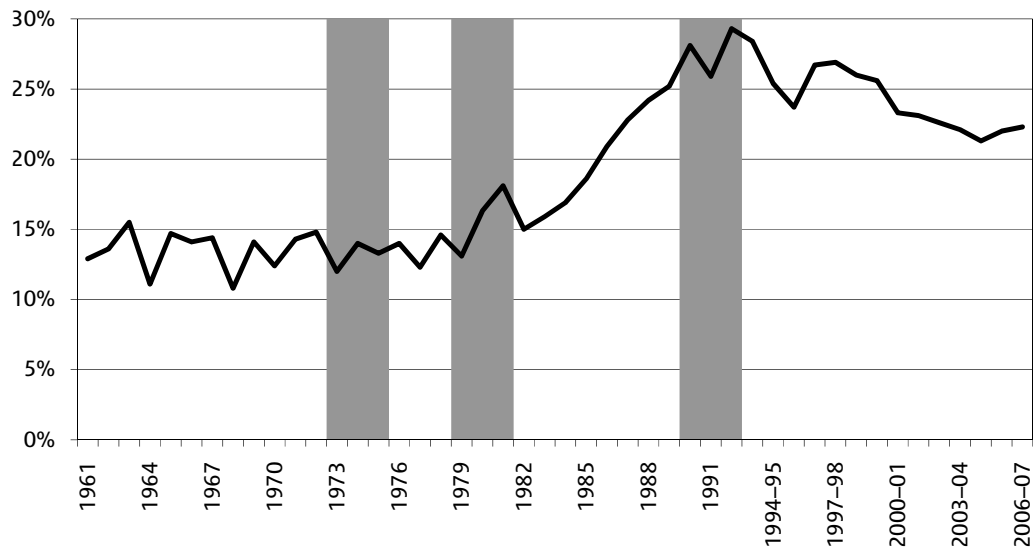
*Notes:* Incomes have been measured before housing costs have been deducted. Figures are for Great Britain only up until 2001–02 and for the UK from 2002–03 onwards. Individuals are classed as living in absolute income poverty if they live in a household with an equivalised disposable income less than 60% of the median in the first year of each recession (held constant in real terms), before housing costs have been deducted. *Source:* Authors’ calculations using Family Expenditure Survey and Family Resources Survey, various years.

Therefore, though relative poverty has fallen slightly during previous recessions, absolute poverty has tended to rise or stay constant. This suggests that during recessions, those towards the bottom of the income distribution may see falls in their real incomes, but those towards the middle of the income distribution see still larger falls, such that the bottom of the distribution catches up with the middle. This is something that was also suggested by Section 5, which examined inequality during recessions.

### *6.2 Poverty amongst children*

We now investigate trends in relative and absolute poverty amongst different demographic subgroups. Figure 19 shows trends in relative child poverty from 1961 to 2006–07, with recessions shaded in grey. The level of relative child poverty hovered between 10% and 15% during the 1970s, before rising to nearly 30% by 1992. Since then, it has fallen to around 22% by 2006–07. The recessionary periods do not appear to represent aberrations to this pattern over time.

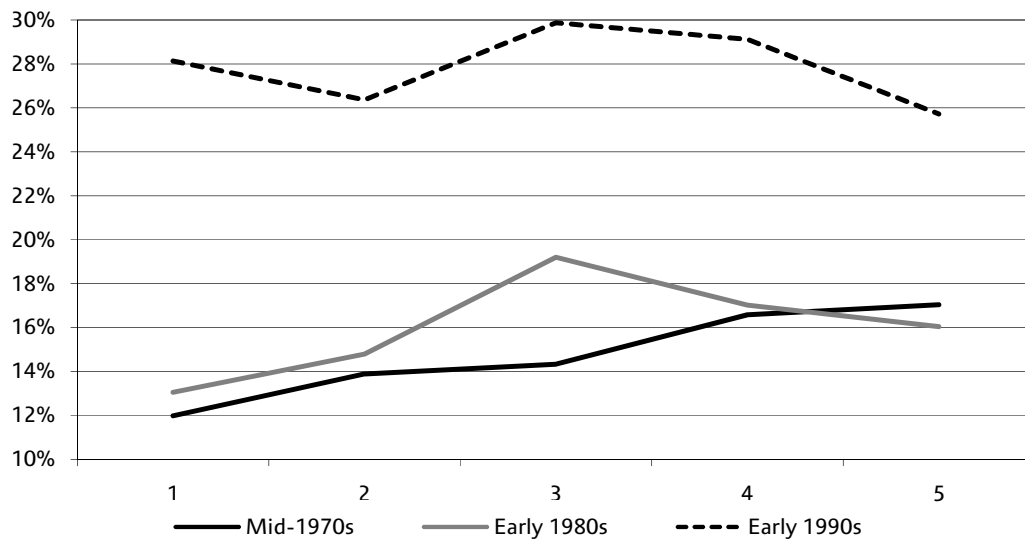
**Figure 19. Relative income poverty amongst children (recessions shaded in grey)**



*Notes:* See Notes to Figure 17.

*Source:* See Source to Figure 17.

**Figure 20. Absolute income poverty amongst children defined at the start of a recession**



*Notes:* See Notes to Figure 18.

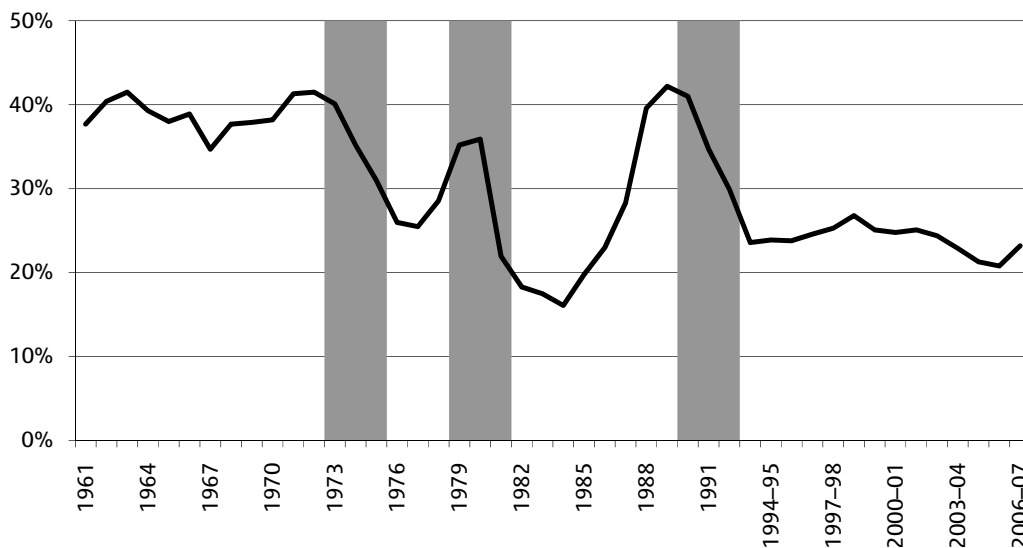
*Source:* See Source to Figure 18.

Figure 20 shows the level of absolute child poverty for each recession, where the poverty line is fixed at the start of each recession as in Figure 18. It shows a rise in absolute child poverty during the 1970s recession (which continued after the end of the recession). Absolute child poverty also increased during the early 1980s recession and was higher at the end of the early 1990s recession than it was at the start of it. In these two later recessions, the indicator declined after the economy began to recover.

### 6.3 Poverty amongst pensioners

In contrast to trends for children, relative poverty amongst pensioners appears to exhibit quite a strong cyclical pattern, which is not surprising given that we have seen falls in average incomes during recessions and secular growth in incomes for pensioners over time. As can be seen in Figure 21, during the 1960s, pensioner poverty fluctuated around 40%. However, during the recession of the mid-1970s, it fell substantially, falling from over 40% before the recession to close to 25% after the recession. In the late 1970s, pensioner poverty began to rise, before falling substantially during the early 1980s recession, dropping from close to 35% to under 20% after the recession had ended. During the rest of the 1980s, pensioner poverty began to rise again, reaching over 40% before the start of the early 1990s recession. However, it again fell during that recession, falling by nearly 20 percentage points.

**Figure 21. Relative income poverty amongst pensioners (recessions shaded in grey)**

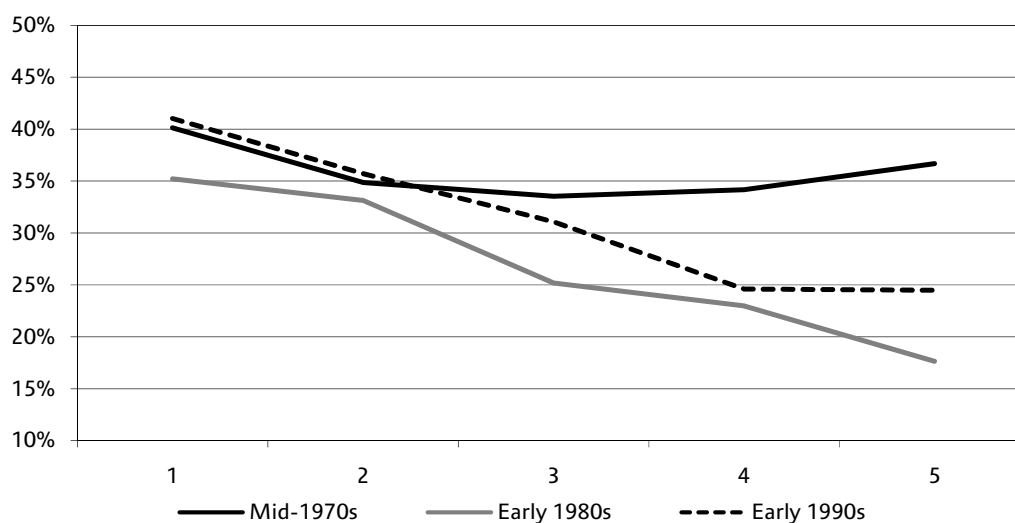


Notes: See Notes to Figure 17.

Source: See Source to Figure 17.



**Figure 22. Absolute income poverty amongst pensioners defined at the start of a recession**



*Notes:* See Notes to Figure 18.

*Source:* See Source to Figure 18.

Figure 22 show that absolute poverty amongst pensioners also declined during each recession, using a poverty threshold that is fixed in the first year of a recession. This is in contrast to absolute poverty amongst children, which experienced slight rises during previous recessions.

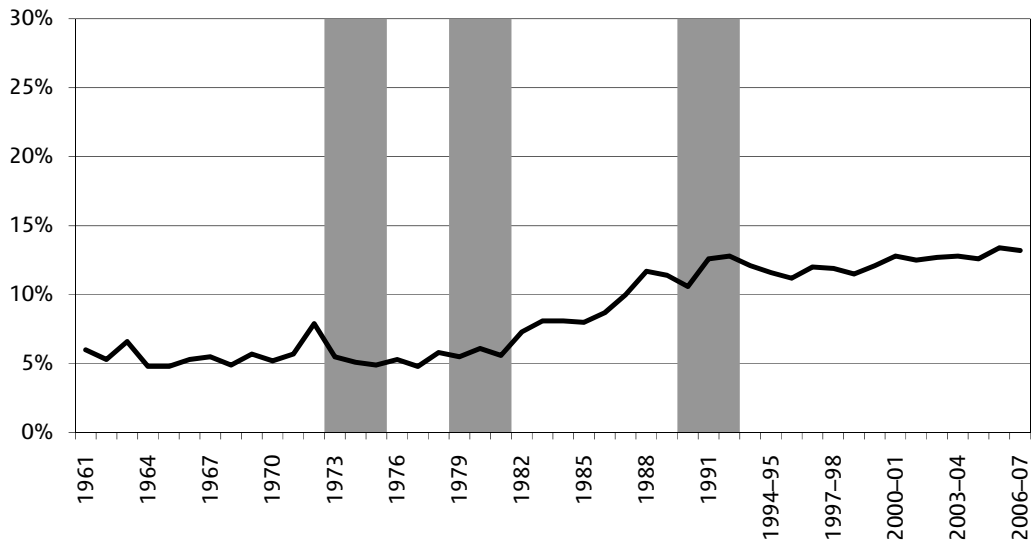
Therefore, it appears that pensioner poverty, when using a relative income threshold, has exhibited a strong cyclical pattern in the past, falling by over 15 percentage points in each of the three recessionary episodes of the past 40 years. However, these falls were from quite high bases; it is unlikely that pensioner poverty would fall so rapidly during the current recession, given that its level is a little over 20% at present.

#### *6.4 Poverty amongst working-age adults without dependent children*

The last demographic group we examine is working-age adults with no dependent children. We focus on those without dependent children because the trends amongst working-age adults with children will be very similar to those seen for children.

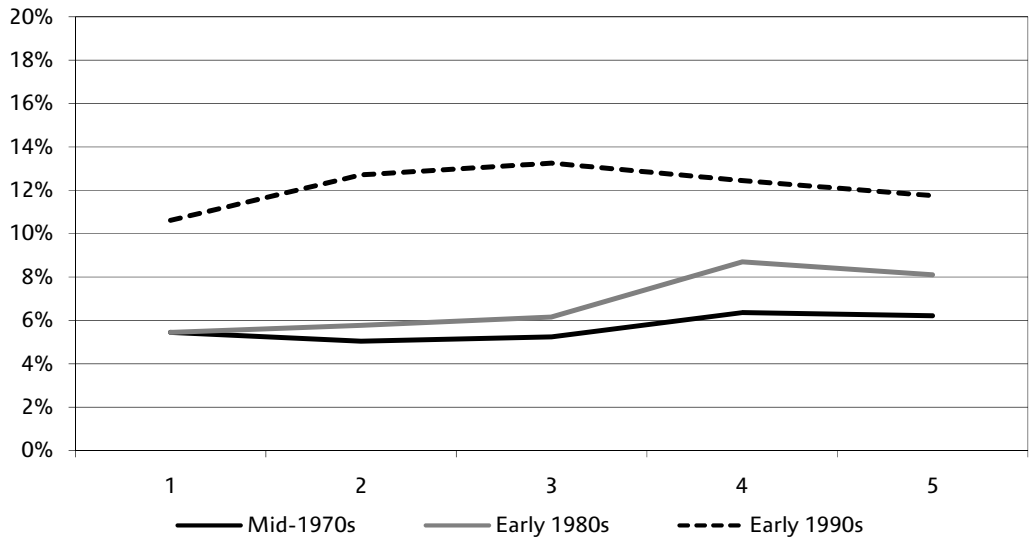
Figure 23 shows that relative poverty amongst this group of working-age adults hovered around 5% during the 1960s and 1970s, but then increased to around 12% during the 1980s. Since then, it has remained relatively constant, in contrast to the falls in pensioner and child poverty.

**Figure 23. Relative income poverty amongst working-age adults with no dependent children (recessions shaded in grey)**



*Notes:* See Notes to Figure 17.  
*Source:* See Source to Figure 17.

**Figure 24. Absolute income poverty amongst working-age adults with no dependent children defined at the start of a recession**



*Notes:* See Notes to Figure 18.  
*Source:* See Source to Figure 18.

However, as with children, there appears to be no obvious difference in the trend in relative poverty amongst working-age adults without dependent children during recessions.

When it comes to the indicator of absolute poverty defined at the start of each recession (shown in Figure 24), this group saw no change in absolute poverty during the recessions of the mid-1970s and early 1980s, but it increased a little in the years immediately after the recessions. In the early 1990s, absolute poverty amongst this group increased, but it then declined in the following years.

### *6.5 Summary of poverty during previous recessions*

During previous recessions, there were falls in levels of relative poverty for the population overall, driven by large reductions in pensioner poverty. The fact that pensioner poverty has fallen during recessions should come as no surprise, as this group is much less likely to be affected by rising levels of unemployment or lower earnings growth than other groups.

During previous recessions, relative poverty remained largely unchanged for children and working-age adults without dependent children. However, indicators of absolute poverty (i.e. using a poverty threshold that does not decline with average incomes, but is just updated with inflation) did increase, particularly for children.

## **7. The current recession**

With the current recession far from over, we have only a limited amount of data available about its effects on measures of living standards. As mentioned in Section 2, the HBAI data (on which our previous sections have been based) covering the start of the recession will not be available until Spring 2010 at the earliest, and unemployment statistics are also only available with a lag (albeit a much shorter one). In this section, we use the latest data available and set out some characteristics of the current recession, and of the current tax and benefit system, which may be relevant to living standards.

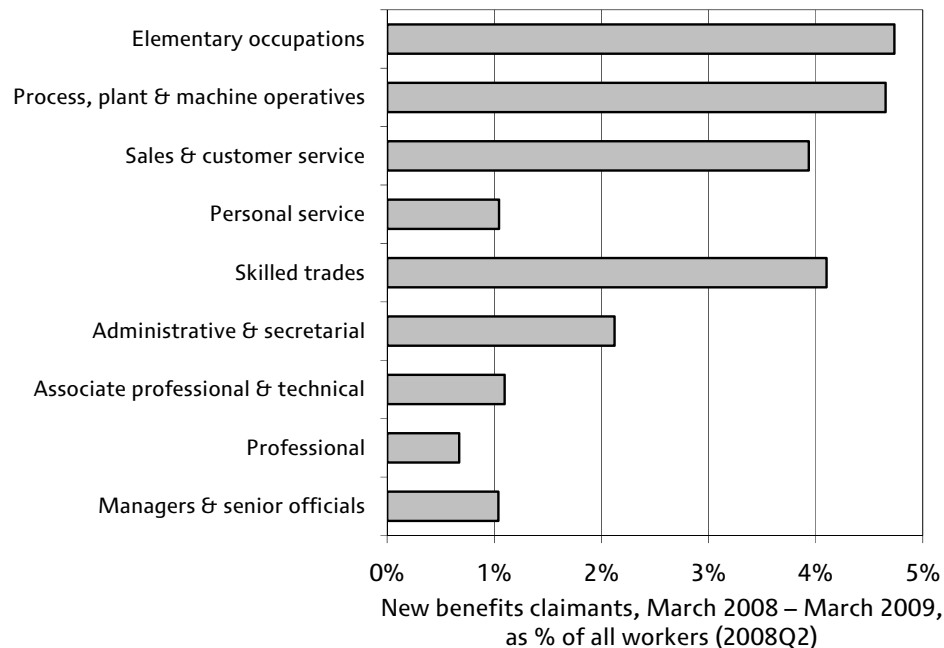
### *7.1 A 'middle-class' recession?*

In the early stages of the current recession, it was suggested by some commentators that we might be entering 'middle-class' or 'white-collar'

recession, unlike anything seen in the past.<sup>16</sup> Because the recession started in the financial sector (which also saw the first mass layoffs of the current downturn), it was argued that skilled, university-educated workers would suffer more than their semi-skilled and manufacturing counterparts. This would stand in stark contrast to previous recessions, in which low-skilled, low-educated workers have been hardest hit.

These predictions do not appear to be borne out by the latest unemployment data. Figure 25 shows unemployment growth by occupation, between March 2008 and March 2009 (the latest available data). We can see that low-skilled ‘elementary’ occupations (such as shelf fillers and cleaners) and process, plant and machine operatives have been hit hardest since 2008 – with an increase in unemployment amounting to nearly 5% of the 2008 workforce in these occupations.

**Figure 25. Unemployment growth (claimant count) by occupation, March 2008 to March 2009**



*Note:* Denominator for each occupation is the number of individuals working in that occupation in 2008Q2.

*Source:* Authors’ calculations using claimant count data and the Annual Population Survey data made available by the Office for National Statistics (NOMIS).

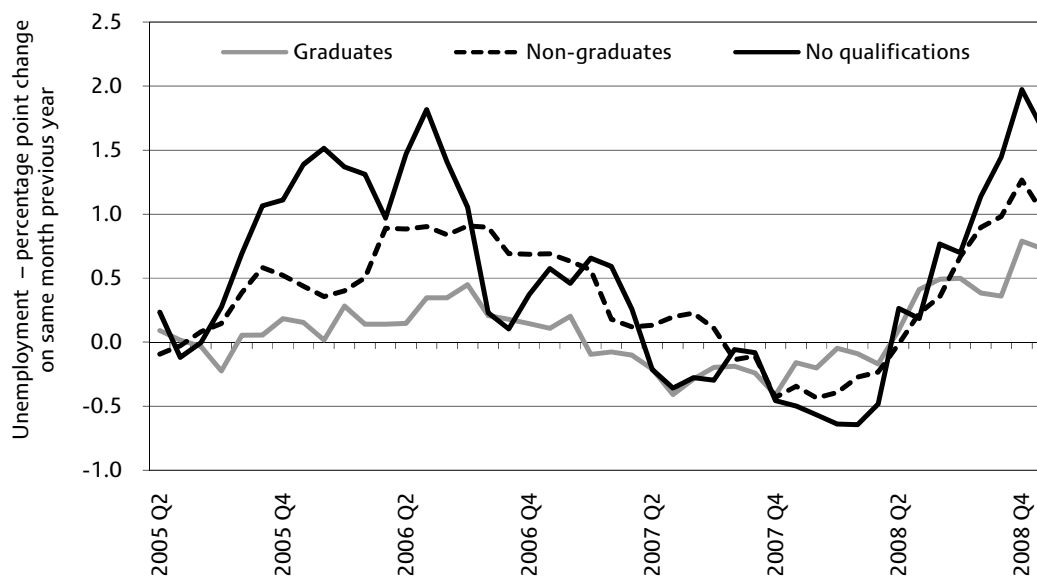
<sup>16</sup> See, for example, “Middle class recession” to hit Britain’s white-collar workers, top economist warns’, <http://www.dailymail.co.uk/news/article-1079754/Middle-class-recession-hit-Britains-white-collar-workers-economist-warns.html>.

Skilled trades (such as plumbers and motor mechanics) and sales occupations (such as shop assistants) have also suffered, with their unemployment rate rising by around 4%. In contrast, managers and senior officials have seen their unemployment increase by only 1%, and ‘white collar’ professional unemployment has increased by just 0.7%.

One worry we might have about Figure 25 is that it uses a ‘claimant count’ measure of unemployment (the number of people claiming unemployment benefits), which may understate unemployment among white-collar workers, since they are less likely to claim benefits. In Figure 26, therefore, we use a broader measure of unemployment (the International Labour Organisation definition) and ask a related question – ‘has unemployment grown fastest for workers who are university graduates or for workers with lower educational qualifications?’. The graph shows the change in unemployment for workers with different levels of education (graduates, workers with qualifications below graduate level and workers with no qualifications). Unfortunately, the data are only available to the end of 2008, but this still allows us to examine the first few months of the current recession.

We can see that unemployment started to increase for all education groups in the second quarter of 2008, with unemployment growth accelerating through to the fourth quarter of 2008. However, it is the lowest-educated

**Figure 26. Unemployment growth by education group**



*Note:* ILO unemployment measure.

*Source:* Authors' calculations using the Labour Force Survey.

workers who have seen their unemployment rate increase fastest. In October 2008, unemployment for the lowest-educated workers was 2 percentage points higher than it was in October the previous year. For graduates, the rate of unemployment growth was less than half as fast (their unemployment level was less than 1 percentage point higher in October 2008 than it was in October 2007).

Bank layoffs notwithstanding, then, the data suggest that it is the low-educated, low-skilled workers whose employment prospects have suffered most as the recession worsened. This is very much in line with the findings of Hines et al.<sup>17</sup> – that labour market outcomes for the low-skilled are particularly affected by the economic cycle. Many commentators have also voiced a fear that younger workers will be particularly hard hit by this recession,<sup>18</sup> as they have been in previous recessions, because they are more likely to be entering the labour force for the first time (finding fewer vacancies) and more likely to be on temporary contracts (which may be the first to be cut by companies seeking to reduce costs).

Figure 27 suggests that this fear is well-founded. The graph shows the changes in unemployment (from the same month in the previous year) for 18- to 24-year-olds, 25-to 49-year-olds and workers aged 50 and over. As in Figure 26, we can see unemployment start to rise for all groups in the second quarter of 2008 – albeit slightly later for workers over 50 than for the younger age groups.

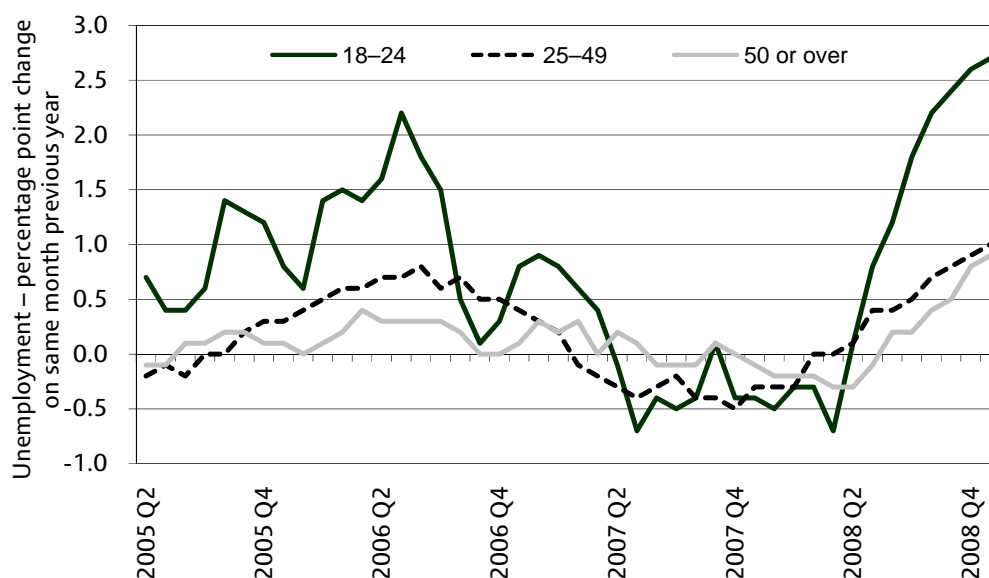
Unemployment is most volatile for 18- to 24-year-old workers, whose unemployment level has been growing at a rapidly accelerating rate over the course of 2008. In October 2008, their unemployment level was more than 2.5 percentage points higher than it was in October the previous year. For older workers (25–49 and 50-plus), unemployment was around 1 percentage point higher in October 2008 than it was a year earlier.

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<sup>17</sup> J. Hines, H. Hoynes and A. Krueger, 'Another look at whether a rising tide lifts all boats', NBER Working Paper no. 8412, 2001 (<http://www.nber.org/papers/w8412>).

<sup>18</sup> See, for example, 'Young victims of recession', [http://www.bbc.co.uk/blogs/thereporters/markeaston/2009/04/map\\_of\\_the\\_week\\_young\\_victims.html](http://www.bbc.co.uk/blogs/thereporters/markeaston/2009/04/map_of_the_week_young_victims.html).

**Figure 27. Unemployment growth by age group**



Note: ILO unemployment measure.

Source: Authors' calculations using data made available by the Office for National Statistics in *Economic & Labour Market Review* (<http://www.statistics.gov.uk/elmr>).

In summary, then, a recession affecting mostly 'middle-class' and 'white-collar' workers has not materialised. The data suggest that it is low-skilled, low-educated and younger workers whose labour market prospects have suffered most as the UK entered recession in 2008. These are very much the groups whose labour market outcomes suffered most in previous UK recessions.

### 7.2 Levels of out-of-work benefits

Levels of entitlement to out-of-work benefits are naturally a crucial determinant of whether individuals who lose their job are likely to find themselves in poverty, and of the depth of any poverty.

Hills et al.<sup>19</sup> show that, since 1997, income support levels for families with children have maintained their level relative to the poverty line,<sup>20</sup> after housing costs have been deducted (AHC), and in some cases have

<sup>19</sup> J. Hills, T. Sefton and K. Stewart, *Towards a More Equal Society? Poverty, Inequality and Policy since 1997*, Policy Press, Bristol, 2009.

<sup>20</sup> Defined as 60% of contemporary median income after housing costs have been deducted.

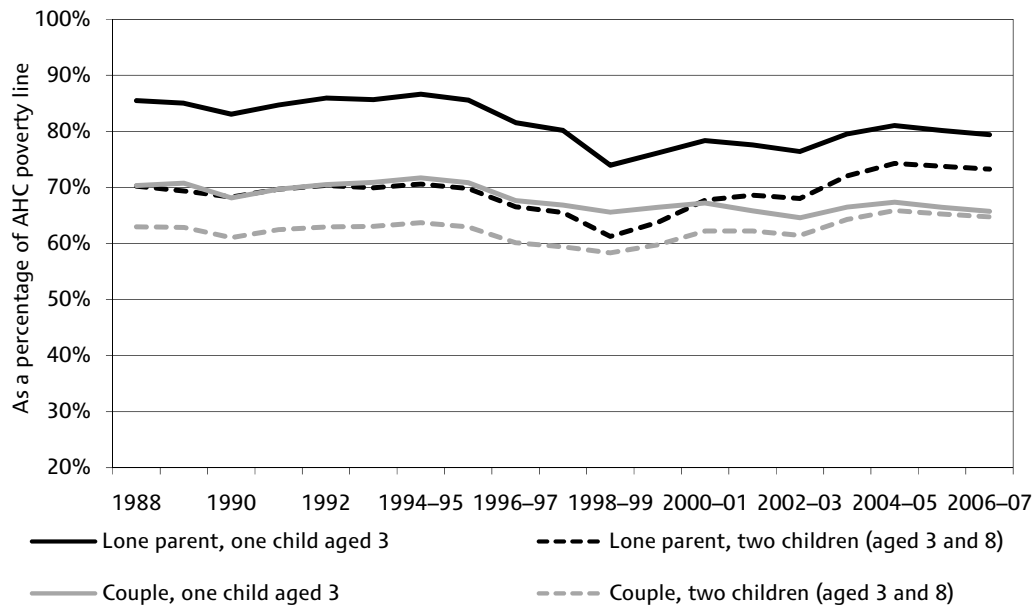
increased. In contrast, income support levels for those without dependent children have fallen substantially. This is important because income support levels are generally the same as the levels of jobseekers' allowance (JSA), the main benefit for unemployed people. Below, we extend these series for some example family types back to 1988. We do this in order to see whether or not the levels of out-of-work benefits relative to the poverty line have changed substantially since the last time the UK experienced a sharp rise in unemployment, in the early 1990s.

Figure 28 shows the level of entitlement to out-of-work benefits for various example families with children relative to the poverty line (AHC) for years from 1988 to 2006–07. These assume zero income from other sources, such that these entitlements represent floors to potential out-of-work income levels. There are differences across these family types, a lone parent with one young child being entitled to the most over the period and a couple with two children entitled to the least. However, the main point to note is that the levels of entitlement relative to the poverty line are largely unchanged since the recession of the early 1990s for families with children – around 80% for a lone parent with a young child and 65% for the couple family types. This is not surprising, given that from the late 1990s onwards, most of the relevant child-contingent benefits were increased in line with earnings, or more in some years, though most were increased in line with prices during the first part of the 1990s.

Figure 29 shows the same information as Figure 28, but for some example family types without dependent children. Again, there are differences across these family types, with single people over 25 entitled to the most. However, in contrast to families with children, the entitlement to out-of-work benefits for these families without children has fallen over time, relative to the poverty line. During the early 1990s, single people over 25 were entitled to out-of-work benefits equal to about 70% of the poverty line (AHC); this figure is now around 50%. There have been equally large falls for single people under 25 and for couples. Again, this is unsurprising given that most relevant benefits were increased in line with prices over the period.

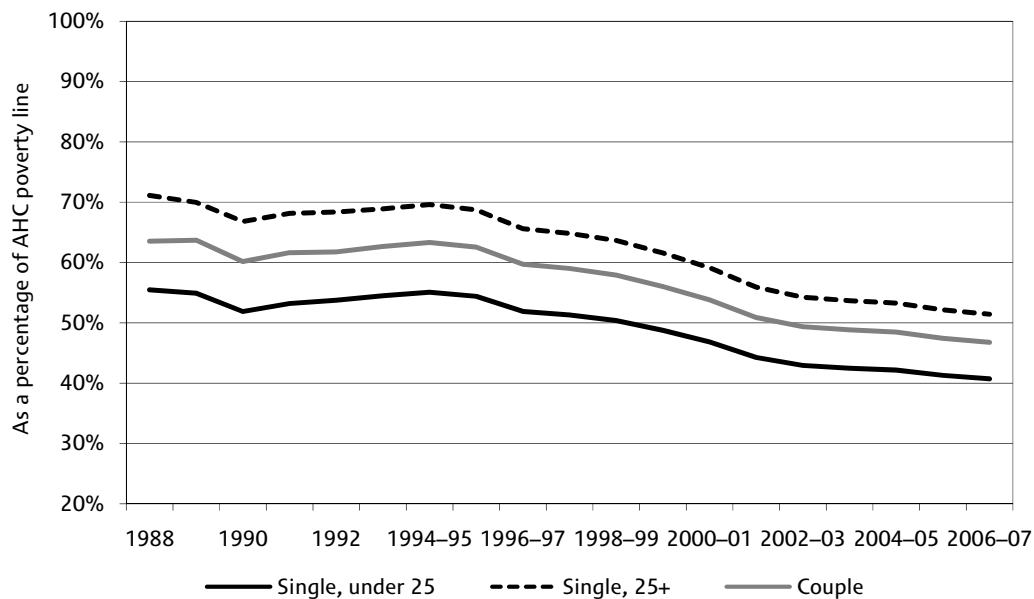


**Figure 28. Out-of-work benefits for families with dependent children relative to poverty line (AHC)**



Source: Authors' calculations using Family Expenditure Survey, Family Resources Survey and benefit rates available at <http://www.ifs.org.uk/fiscalFacts/benefitTables>.

**Figure 29. Out-of-work benefits for working-age adults without dependent children relative to poverty line (AHC)**



Source: Authors' calculations using Family Expenditure Survey, Family Resources Survey and benefit rates available at <http://www.ifs.org.uk/fiscalFacts/benefitTables>.

Examining the adequacy of current levels of unemployment benefits, a recent report by Peter Kenway for the Joseph Rowntree Foundation concludes that ‘the current value of JSA is low, or very low, by any reasonable standard’. This report further discusses arguments for and against raising rates of unemployment benefit, and concludes that they should be raised.<sup>21</sup>

### *7.3 Top incomes and financial markets*

While this recession may affect the employment prospects of skilled, highly-educated workers less than those of other groups, there is another way in which recessions can affect the living standards of the better-off. Brewer et al.<sup>22</sup> note that growth in incomes at the very top of the income distribution tends to be correlated with growth (and contraction) in financial markets. This is not surprising, given that individuals in this group earn a larger fraction of their income from savings and investments than individuals further down the income distribution, and that a significant fraction of top earners work in the financial sector.<sup>23</sup> In particular, Brewer et al. note that top incomes fell in 2002–03 (a time when mean income was still growing) and that this fall coincided with a dramatic fall in share values.

Figure 30 recreates a graph from Brewer et al. (2008, op. cit.), showing the real income levels of the top 1% and the top 0.1% (the very highest incomes) alongside the FTSE 100 index. All three series are shown relative to their level in 1996Q2. The series for the top 0.1% was created by Brewer et al. and has currently only been constructed up to 2004–05 (although data for 2005–06 are now available).

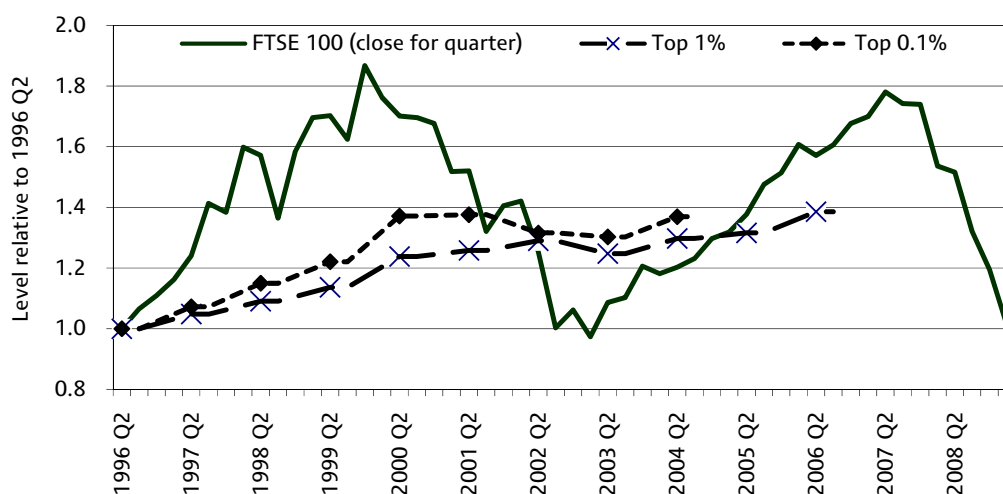
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<sup>21</sup> P. Kenway, *Should Adult Benefit for Unemployment Now Be Raised?*, Joseph Rowntree Foundation, York, 2009 (<http://www.jrf.org.uk/publications/should-adult-benefit-now-be-raised>).

<sup>22</sup> M. Brewer, L. Sibieta and L. Wren-Lewis, *Racing Away? Income Inequality and the Evolution of High Incomes*, Briefing Note no. 76, IFS, London, 2008 (<http://www.ifs.org.uk/publications/4108>).

<sup>23</sup> Brewer et al. (2008, op. cit.) show that at the very top of the earnings distribution (the top 0.1%), 30% of individuals work in ‘financial intermediation’.

**Figure 30. Top incomes and the FTSE 100 index**



*Note:* Incomes have been measured before housing costs have been deducted.

*Sources:* Google Finance; M. Brewer, L. Sibieta and L. Wren-Lewis, *Racing Away? Income Inequality and the Evolution of High Incomes*, Briefing Note no. 76, IFS, London, 2008 (<http://www.ifs.org.uk/publications/4108>); authors' calculations using Family Resources Survey.

We can see that the FTSE 100 index is far more volatile than the top income series, rising dramatically in the late 1990s, 'crashing' from 2000 to 2002, then surging again from 2003 to early 2007, before crashing once more over the course of 2007 and 2008. Top incomes (both the top 1% and the top 0.1%) don't 'crash' to anything like the same extent, but they do stop growing, or grow much more slowly, between 2000 and 2003, as the stock market slides. Given the turmoil in financial markets in recent months, we might well suspect that top-income growth will be somewhat moderated in the near future.

#### 7.4 Summary

While some commentators predicted a 'middle-class' or 'white-collar' recession, hitting skilled and educated workers harder than their low-skilled peers, the reality so far has been altogether less novel. The groups whose labour market outcomes appear to have suffered most – the low-skilled, low-educated and young – are the same groups whose employment prospects were worst affected by previous recessions.

With this in mind, it is important to note that levels of out-of-work benefits are lower for most groups than they were in the recession of the early 1990s. This is particularly true for working-age individuals without dependent children, whose benefits have, for the most part, been increased in line with inflation since the early 1990s, and are now worth around 50% or less of the poverty line (AHC). We might thus expect a sharp rise in unemployment to have a slightly different effect on poverty rates for families without children from that in the last recession, with out-of-work benefits providing a much more modest income.

At the other end of the income distribution, we may expect modest (or negative) growth in top incomes for the next few years, since top incomes appear to be significantly correlated with the performance of financial markets.

## **8. Overall summary and conclusions**

The last recession that the UK experienced was in the early 1990s, and the current one is likely to be the deepest since the end of the Second World War. In this Briefing Note, we have shown how previous recessions have affected measures of average living standards, poverty and inequality. We have seen that family types more dependent on wages and salaries (such as working-age adults without children and couples with children) have been worse affected by downturns than those, such as pensioners and lone parents, who are more dependent on fixed incomes or state benefits. We have shown that inequality can rise or fall during a recession, but that there is some evidence that the bottom of the income distribution has 'caught up' with the middle during previous recessions. And we have seen that poverty (measured in relative terms) fell during previous recessions, largely driven by a fall in pensioner poverty.

With its roots in a financial and banking crisis, the current recession differs from other post-war recessions in many important respects. However, when we consider which groups are likely to be worst affected, the current recession looks far from being 'unique' as some have predicted. In previous recessions, it was low-skilled, low-educated and younger individuals whose labour market prospects suffered most. These groups are also among the worst-equipped to weather an economic storm, since they tend to have lower savings than their better-educated and older peers. The latest available data suggest that it is these same vulnerable

groups – low-skilled, low-educated and young people – who are seeing the fastest increases in unemployment in the current downturn.

It would be wrong, of course, to suggest that individuals at the top of the income distribution will be entirely insulated from economic conditions. We know that these individuals tend to depend on the financial sector for more of their income, in one form or another, than their less well-off peers. However, they are also far better able to maintain their living standards during a downturn, by drawing down their savings until conditions pick up.

Therefore, the main conclusion for policymakers is that the current recession, for all the novelty of its origins, is looking worryingly familiar in its effects on households.