



Resolution Foundation

BRIEFING

A problem shared?

What can we learn from past recessions about the impact of the next across the income distribution?

Cara Pacitti & James Smith
August 2019

Acknowledgements

We would like to thank the Resolution Foundation's Macroeconomic Policy Unit Associates (Kate Barker, Jason Furman, Richard Hughes, George Magnus, Toby Nangle, Jumana Saleheen, Gregory Thwaites, Gertjan Vlieghe and Tony Yates) for guidance and support. The authors are also grateful for contributions from other members of staff at the Resolution Foundation, particularly Nye Cominetti, Adam Corlett, Laura Gardiner, Fahmida Rahman and Matt Whittaker; and for conversations with a number of academic economists, including Brian Bell and Paul Gregg. All errors remain the sole responsibility of the authors.

Download

This document is available to download as a free PDF at:
resolutionfoundation.org/publications

Citation

If you are using this document in your own writing, our preferred citation is:
C Pacitti & J Smith, A problem shared?:
What can we learn from past recessions about the impact of the next across the income distribution?,
Resolution Foundation, August 2019

Permission to share

This document is published under the [Creative Commons Attribution Non Commercial No Derivatives 3.0 England and Wales Licence](https://creativecommons.org/licenses/by-nc-nd/3.0/). This allows anyone to download, reuse, reprint, distribute, and/or copy Resolution Foundation publications without written permission subject to the conditions set out in the Creative Commons Licence. For commercial use, please contact:
info@resolutionfoundation.org

Summary

Recessions are incontrovertibly bad for living standards, producing some combination of mass unemployment (with the unemployed population jumping by over a million on average across the last four recessions) and damaged household finances (with typical incomes falling by five per cent on average over the same four episodes). But not all parts of society are equally affected of course. In this briefing note we assess the impact recessions have on people across the income distribution, and consider what the nature of the last downturn means for the next one.

Focusing just on the immediate recession period – that is, from the year in which GDP first falls to the year in which it first rises again – the financial crisis-inspired downturn of 2008 looks to have been a relatively good one for lower-income households. Real-terms incomes actually rose in the bottom quartile of the distribution (by 1 per cent), with the biggest falls coming in the top quartile (-3 per cent). That experience stands in direct contrast to the recessions of the early 1980s and early 1990s, when incomes fell furthest at the bottom and least at the top (with incomes growing at the top in the 1980s episode). Distributionally, the 2008 recession was more similar to the one that unfolded over two episodes in the mid-1970s – though in the earlier, much longer, recessionary period incomes fell further and more consistently across the distribution.

Sitting beneath these different distributional experiences is the very different performance of employment over the four recessions. The 1980s and 1990s recessions were unemployment-heavy, with the number of unemployed jumping by 1.9 million over the course of the 1980s episode for instance. And lower-income families were especially affected, with those towards the bottom of the income distribution six times more likely to be unemployed than those towards the top. In contrast, the rise in unemployment in the aftermath of the financial crisis was modest relative to the size of the recession. Unemployment *did* still rise; by around one million people. But a much larger part of the recession adjustment took the form of a real wage squeeze that affected all of the distribution. It was very painful, but it was at least a problem shared.

So, while recessions are always best avoided if possible, might it at least be the case that we've shifted to a place where downturns are relatively less bad for lower-income households than used to be the case? Unfortunately, the answer is almost certainly 'no'. Four key reasons stand out.

First, the wage-squeeze nature of the last recession does not necessarily mark a permanent change in how we adjust to a downturn as a country: we can't count on unemployment-heavy recessions being consigned to history. What determines the pay versus employment trade-off is movements in the value of the pound. Owing to the importance of the financial sector to the UK economy, the financial crisis produced a particularly large drop in the value of sterling. That had the effect of raising inflation, and so allowed employers to adjust to the country being made poorer by cutting real-terms (but not nominal) pay rather than jobs. But there is nothing to suggest that the same set of circumstances has to hold next time around. Because the extent of falls in the exchange rate depends on developments abroad, as well as those at home, they are not under the control of domestic policy makers.

Second, even when a recession produces a relatively modest increase in unemployment, the effects are still disproportionately felt by lower-income groups. This is particularly true for the young and those with fewer formal qualifications. Indeed, during the financial crisis unemployment rates increased by roughly twice as much for these groups as for older workers and those with higher levels of qualifications. And the risk may be even more heightened right now. Given very rapid increases in employment among those from lower-income families in recent years, and the rise in flexible, 'atypical' forms of employment in particular, we might expect these 'last in' workers to be most vulnerable to any spike in unemployment when the next recession hits.

Third, it is not just the employment-pay trade-off that drove the shape of the financial crisis fall-out across the distribution: public policy made a big difference too. In particular, increased benefit generosity played a very important role in supporting the incomes of those towards the bottom of the distribution. Such support has of course been stripped back since then, and there is no guarantee that a future government would be as active in using the tax and benefit system to mitigate the impacts of the next recession.

And fourth, the sluggish recovery in incomes endured over the last decade has likely left low-to-middle income households more exposed to the effects of recession today than they were heading into the 2008 downturn. On the plus side, lower-income households hold lower levels of debt than they did previously, with the average, inflation-adjusted reduction in debt for those in the lower half of the income distribution of around £2,500 between 2006-08 and 2014-16. But, crucially, they also have lower levels of savings: nearly 60 per cent of those on low-to-middle incomes report having no savings at all, up from just over 40 per cent just ahead of the financial crisis in 2007. There also appears to be less opportunity than there was previously for lower-income households to respond to an income shock by cutting back on spending. Consumption spending dropped by £20 a week between 2009 and 2014 on average, but the retrenchment in the lowest quartile of the income distribution was £61 a week. And the proportion of consumption allocated by that lower-income group to 'essentials' was 8 percentage points higher than prior to the financial crisis by 2017, a larger increase than any other group.

When the next recession hits then – as it surely will – there is every chance that it is particularly damaging for those low-to-middle income households that are already close to the edge. The policy response will matter, but so too will the action taken ahead of any future downturn arriving to ensure that policy is able to respond effectively. That's the focus of the Resolution Foundation's new *Macroeconomic Policy Unit (MPU)*, with the Unit's launch paper – to be published in the Autumn – set to provide a comprehensive assessment of the extent to which the existing macroeconomic policy framework is ready to provide that effective response during the next recession.

Recessions are inevitably bad news for living standards, but their impacts tend to vary across the distribution

We have looked previously at the – inevitably negative – impact recessions have on the economy.^[1] Taking the four recessionary periods experienced since the 1970s, we showed that GDP fell by nearly four per cent on average and rarely returned to the pre-recession path thereafter. They also lead to mass unemployment – with an average increase of one million people across the same periods – and damage to household budgets. They are, therefore, best avoided. But recessions are very often triggered by developments abroad, making it impossible for domestic policy makers to fully recession-proof the economy. Policy makers can, however, support the economy and minimise recession damage by introducing effective macroeconomic policy measures – such as cutting interest rates and increasing government spending.

This matters not just at the macro level, but also at the level of the individual household. Recessions are always bad news for living standards, but the effects are rarely evenly felt across society.

Figure 1 makes this point, detailing cumulative changes in inflation-adjusted incomes after housing costs in the aftermath^[2] of the past four recessions. The experience of the financial crisis stands out as being very different from those that came before, with incomes falling furthest at the top of the distribution (by 3 per cent in the top quartile) and actually growing at the bottom (by 1 per cent in the bottom quintile). In contrast, the income hits of the 1980s and 1990s recessions were much more concentrated at the lower end of the distribution. The mid-1970s downturn was different again, with incomes falling fairly uniformly (and further, given the longer period covered) across the distribution.

So does the relatively progressive nature of the financial crisis recession mean we can – from a distributional perspective at least – be sanguine about what happens next time?

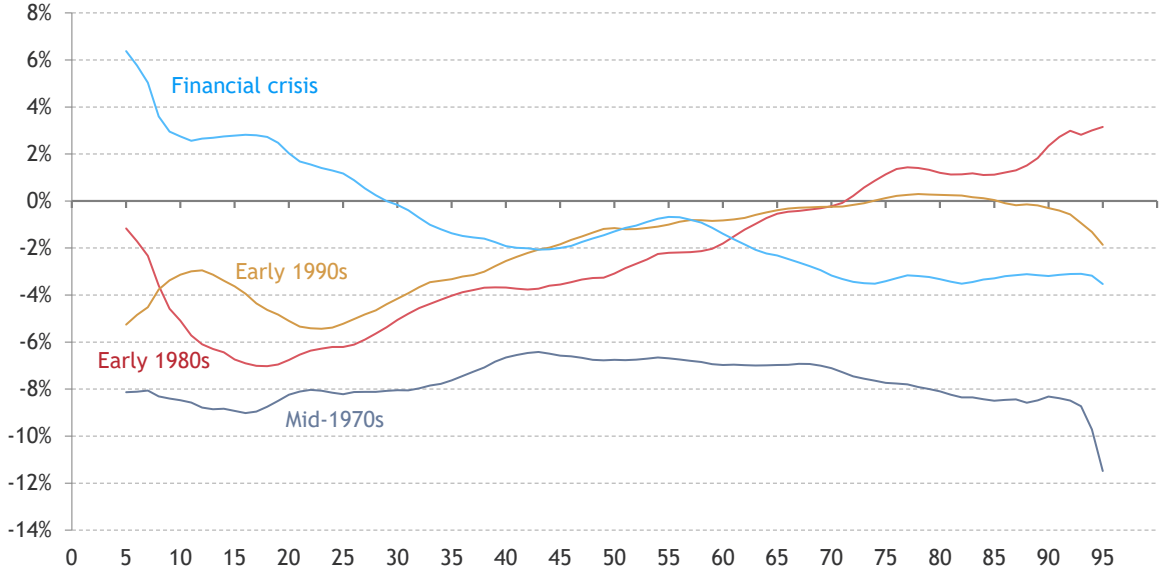
In short the answer is ‘no’. To understand why, it is worth both digging into what drove the unusual shape of the last downturn and exploring what has happened during the subsequent recovery phase. That is the focus of this briefing note, in which we unpick what drives the sharing of pain in recession and consider what the experience of the last downturn can tell us about the possible impact of the next one when it arrives.

[1] See J Smith, *Failing to plan = planning to fail*, Resolution Foundation, July 2019

[2] In each instance our analysis covers the period from the year in which GDP first falls to the year in which it first rises again. For the mid-1970s, this covers two separate technical recessions.

Figure 1: The distribution of income adjustment after the financial crisis differed markedly from that which prevailed in earlier recessions

Proportional change in income (adjusted for inflation and housing costs) by percentile of the income distribution: UK



Notes: Percentiles 1-4 and 96-100 excluded due to noise. Income change in recession calculated as difference between average incomes by percentile from the first year of negative GDP growth to the first year of positive GDP growth. Incomes are five percentile rolling averages of annual real equivalised disposable income after (direct) taxes and benefits and after housing costs, UK. Data taken from FES-HBAI for 1961-91 and FRS-HBAI for 1994-2017 (FRS-HBAI), with a GB/UK adjustment.

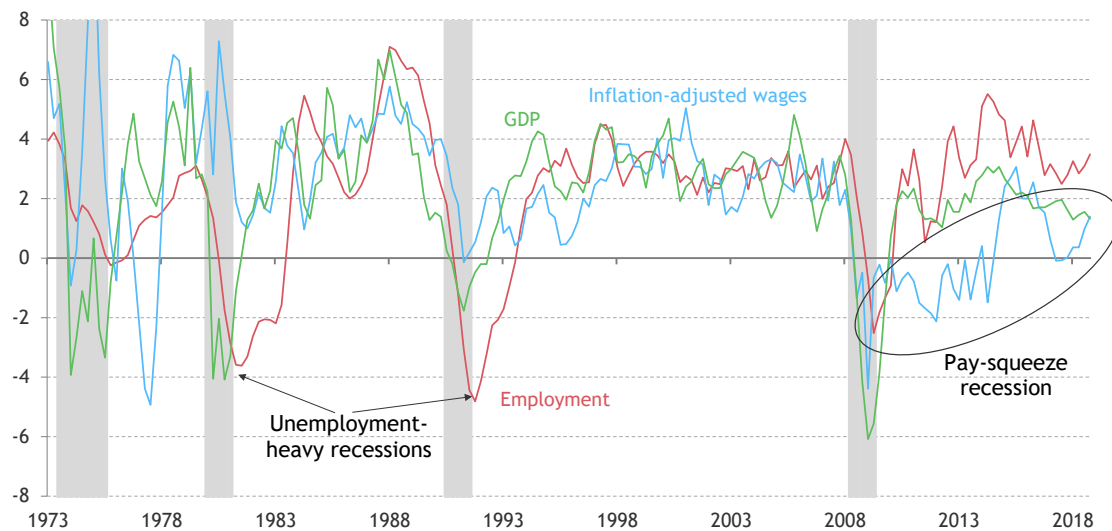
Source: RF analysis of ONS *Households Below Average Income*, *Family Expenditure Survey* and *Family Resources Survey*

The distributional ‘bite’ rests in some part on the nature of the downturn and in particular on exchange rate movements

The difference in experience at the lower end of the income distribution in the 2008 recession versus the 1980s and 1990s ones stems in part from very different labour market responses. Figure 2 highlights the much sharper falls in employment recorded in the first two episodes relative to the most recent one – especially when compared with the varying depths of the drops in GDP. Unemployment still rose after 2008 – by around one million – but by much less than had occurred in the previous two downturns. Instead, a much larger part of the post-crisis recession strain was taken by falling pay – something that was absent from both the 1980s and 1990s recessions.

Figure 2: Falls in employment and inflation-adjusted incomes vary from recession to recession

Four-quarter growth in GDP, employment and inflation-adjusted weekly earnings (growth in employment and wages is mean-variance adjusted to match GDP growth): UK



Source: ONS; RF calculations

In thinking about what determines whether a recession primarily effects unemployment or pay, a number of factors will of course be at play here - not least the size of the recession. But movement in the value of the pound is a key factor.

When a recession is accompanied by a particularly large fall in sterling, as occurred during the 1970s recession and following the financial crisis, inflation tends to spike. Firms' labour costs then fall relative to the price of the goods and services they produce, meaning their adjustment to the country becoming poorer can occur via a slowdown in real wage growth rather than via laying people off. In the absence of this devaluation effect, firms find themselves unable to adjust pay (thanks to nominal pay rigidities) and unemployment instead rises.^[3] Crucially, this has very different distributional implications.

Unemployment-heavy recessions always hit those at the lower end of the income distribution hard, making them especially painful

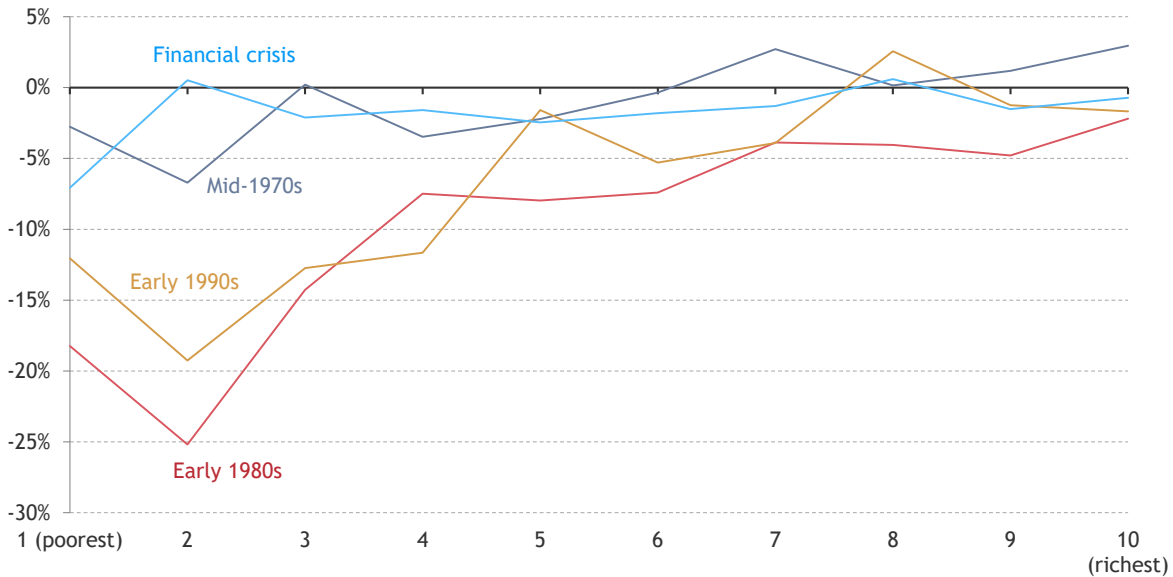
Unemployment-heavy recessions tend to hit lower income households especially hard – reflecting their higher propensity to be at the sharp end of this adjustment. In contrast, pay-squeeze recessions are typically more evenly spread, with all workers suffering some slowdown in pay growth.

[3] There are a number of studies on the importance downward rigidities in money wages, for example see: T F Bewley, *Why Wages Don't Fall during a Recession?*, Harvard University Press, 1999.

Figure 3 illustrates this point by setting out the impact of recessions on employment across the income distribution.^[4] In all instances employment rates fell furthest among lower-income households. But the effect is most marked in the very high-unemployment 1980s and 1990s recessions: for example, in the 1980s recession, the fall in employment in decile two was six times as large as the fall at decile eight.

Figure 3: Employment falls were more concentrated at the lower end of the distribution during the 1980s and 1990s recessions

Change in employment rate by working-age equivalised household income decile (after housing costs), UK



Notes: Employment rates are for non-pensioner family units (ages 16-64)
Source: RF analysis of DWP, *Households Below Average Income*; ONS, *Family Expenditure Survey*

Crucially, there is nothing to suggest that the nature of the financial crisis downturn will be repeated when the next recession hits. Sterling devalued sharply because of the importance of the financial sector to the UK economy; but the next recession could have very different roots. It would be wrong therefore, to assume that we have shifted to some new recession model whereby all future downturns will have the same benign distribution.

And there are in any case plenty of reasons for being concerned about how lower-income households will weather the next downturn, even if it is a wage-squeeze rather than an unemployment-heavy one.

[4] Again we define ‘recessions’ here as covering the year from which GDP first falls to the year in which it first rises again. The early 1990s recession is measured between 1990 and 1991 rather than 1990 and 1992 however, due to missing data for 1992.

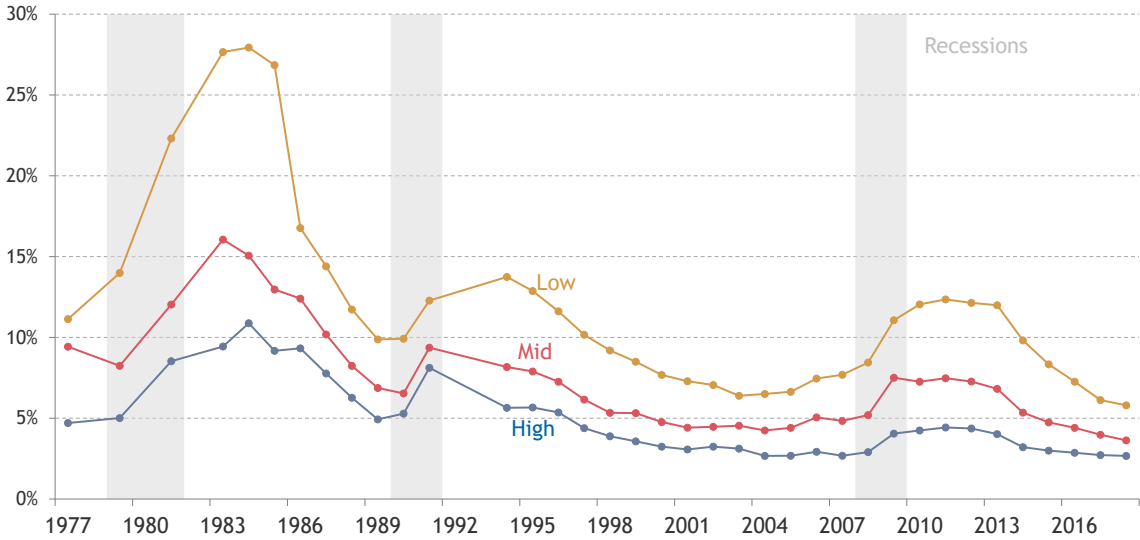
Whatever the nature of the next downturn, unemployment is likely to rise most for those in lower-income households

In part, that’s because – as we’ve already seen – lower-income households are *always* harder hit by unemployment during a recession, even when the effect is more modest.

Figure 4 details unemployment trends for different qualification groups. It shows that the group with the lowest level of qualifications, a proxy for lower incomes, was the only one to reach an unemployment rate in double figures in the aftermath of the financial crisis (with the rate peaking at 12.4 per cent in 2011). In contrast, the highest-qualification cohort only experienced a 1.5 percentage point rise in unemployment. Indeed, the trends for the low- and mid-qualification groups were broadly similar in both the 1990s and 2008 recessions – it is primarily the improved performance of the high-qualification group that held the overall average down in the latter period.^[5]

Figure 4: Those with lower levels of formal qualifications facing the steepest rises in unemployment in recessions

Unemployment rate by level of formal qualifications, ages 16-64: UK



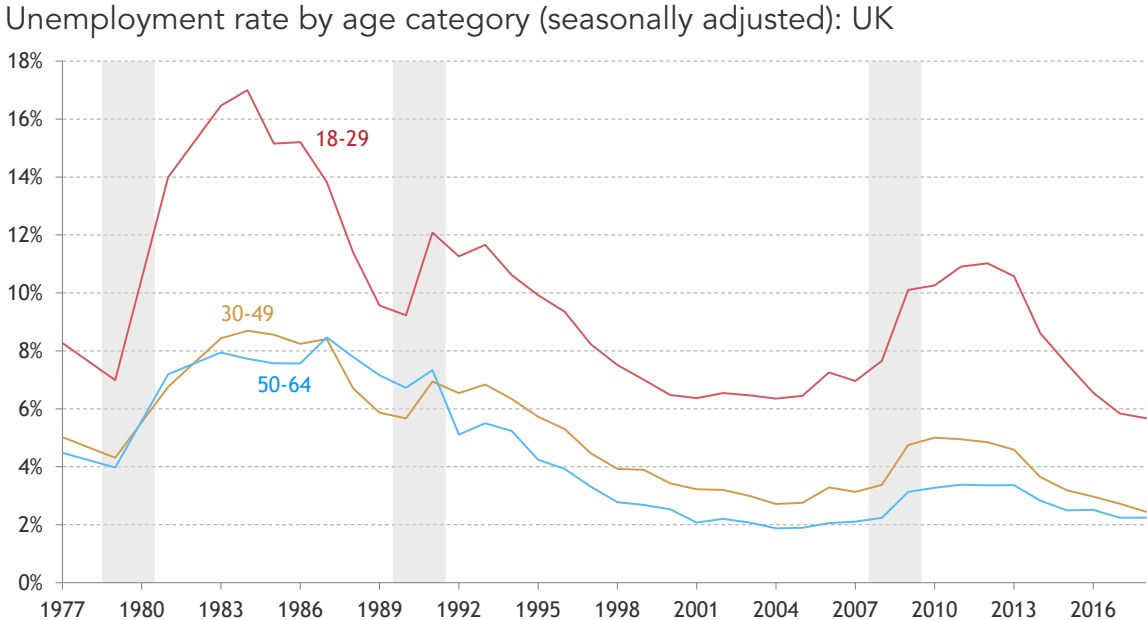
Notes: Population split into groups by highest formal qualifications attained, randomly ranked within these groupings, then split into the top, middle and bottom thirds by this ranking. This controls for changes in proportion of population attaining formal qualifications over the time period covered e.g. increase in degree attainment.
Source: RF analysis of ONS, *Labour Force Survey*

Those graduating during or immediately after the financial crisis faced different problems however, relating to the type of work they secured. Members of the group were 30 per cent more likely to work in a low-paid occupation than previous cohorts had been.^[6]

[5] Work on the impact of recessions in the US finds similarly large rises for those with lower levels of qualification during recessions with evidence that this reflects the mix of industries in which this group works. See: H Hoynes, D L Miller and J Schaller, 'Who Suffers during Recessions?', *Journal of Economic Perspectives*, vol. 26, pages 27-48.
[6] S Clarke, *Growing Pains: The impact of leaving education during a recession on earnings and employment*, Resolution Foundation, May 2019.

The young also disproportionately suffer during recessions, likely reflecting the fact they are often more junior employees with fewer years of experience and also less job-specific skills, making them more likely to face redundancy during recessions. As Figure 5 shows, unemployment levels are typically higher for younger groups, but so too are the proportional increases in unemployment faced in successive downturns. In 2012 for instance, the unemployment rate for those aged 18-29 was 3 percentage points higher than the average for all age groups, and more than double the rate for those aged 30-49. And it had risen by 4 percentage points between 2007 and 2011 among 18-29-year-olds, as opposed to only 2 percentage points among the 30-49-year-old cohort.

Figure 5: Youth unemployment increases by more than older groups in the aftermath of a recession



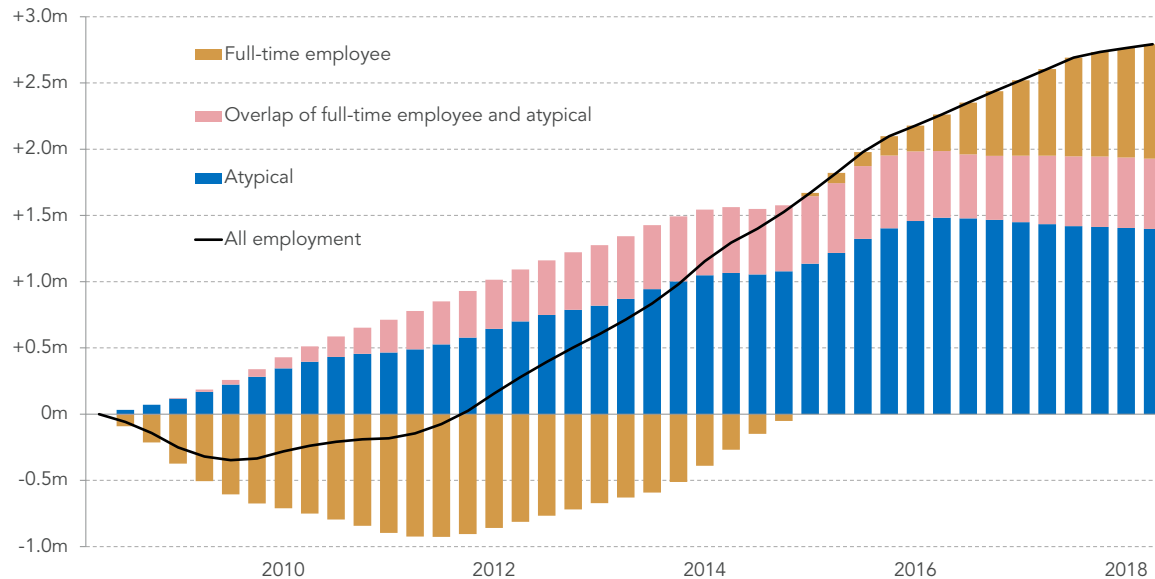
Source: RF analysis of ONS, *Labour Force Survey*

Moving beyond the immediate post-crisis recession period, we know that the employment recovery of the last decade has been very impressive. And we’ve shown before that this growth has been progressive, with employment rates rising most among people from lower-income households and from groups that are typically under-represented in the labour market. And, as shows, there has also been a sizeable increase in atypical working arrangements over the last decade, leaving many towards the bottom of the income distribution with less secure jobs and more unpredictable hours.^[7] Strong employment growth over recent years is undoubtedly good news, but it does raise the prospect that it is this same ‘last in’ group that will be most exposed to redundancy once a fresh downturn arrives.

[7] For more on the rise of atypical working arrangements, see: S Clarke and N Cominetti, *Setting the record straight: how record employment has changed the UK*, Resolution Foundation, January 2019.

Figure 6: There has been a significant rise in atypical working arrangements over the last decade

Net employment growth since 2008, by types of job: UK



Source: RF analysis of ONS, *Labour Force Survey*

And government policy will again play a key role in determining the distribution of recession pain, with no guarantee that it will play the same role as it did in 2008

There is a further question mark that hangs over the extent to which lower-income households can expect the next recession to play out like the last one did which relates to government policy. While, as we have seen, developments in the labour market are a key determinant of what happens to incomes across the distribution, so too are developments in the tax and benefit system.

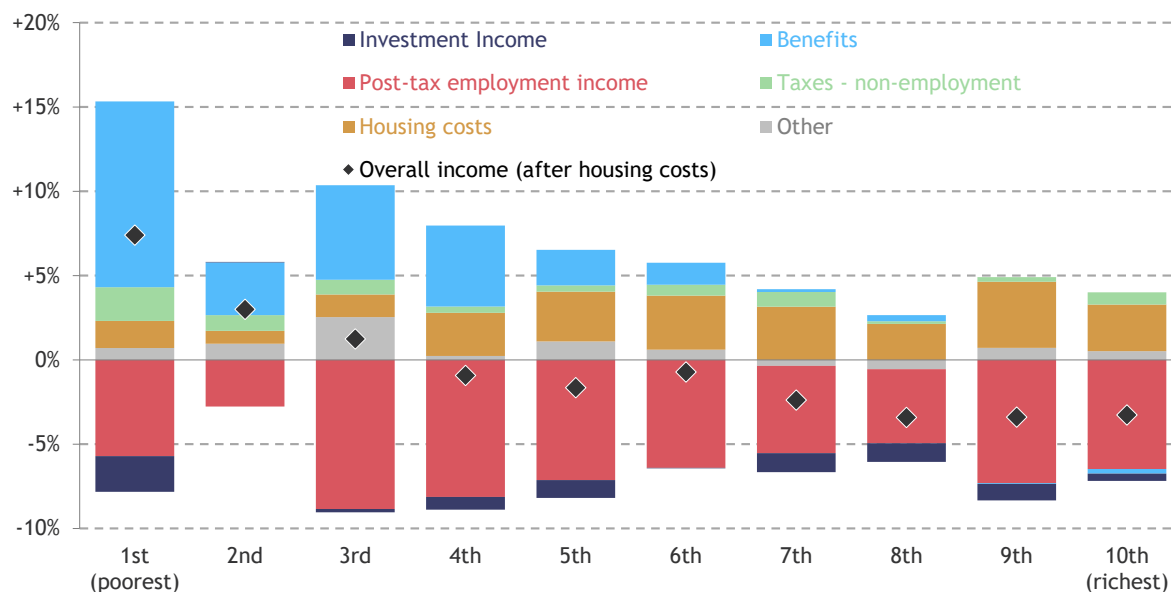
Figure 7 draws out this point. It decomposes the income changes experienced across the distribution in the immediate post-crisis recession (as previously set out in Figure 1) into their various components. It shows that the proportional hit associated with falling employment income varied relatively little across the distribution, with the stronger performance of incomes at the very bottom instead owing much to the contribution made by increasing benefits – which more than offset falling employment income in both decile one and decile two.

The large rise in the contribution of benefits in this period in part reflects the significant increase in the numbers claiming them. For example, there was a rise in the numbers claiming housing benefit, as people moved below qualifying thresholds.^[8] However, discretionary policy decisions – such as the increase in Child Tax Credit by £75 above earnings in April 2009 – also played a part in boosting the incomes of the lowest deciles.

[8] D Diacon, B Pattison, J Strutt and J Vine, *Support with Housing Costs Developing a simplified and sustainable system*, British Social Housing Foundation, , 2010.

Figure 7: Policy responses played a key role in supporting lower income households in the immediate post-crisis recession period

Contribution to the change in real (CPI-adjusted) equivalised disposable household income (after housing costs) for working-age households by income decile between 2008-09 and 2010-11: GB



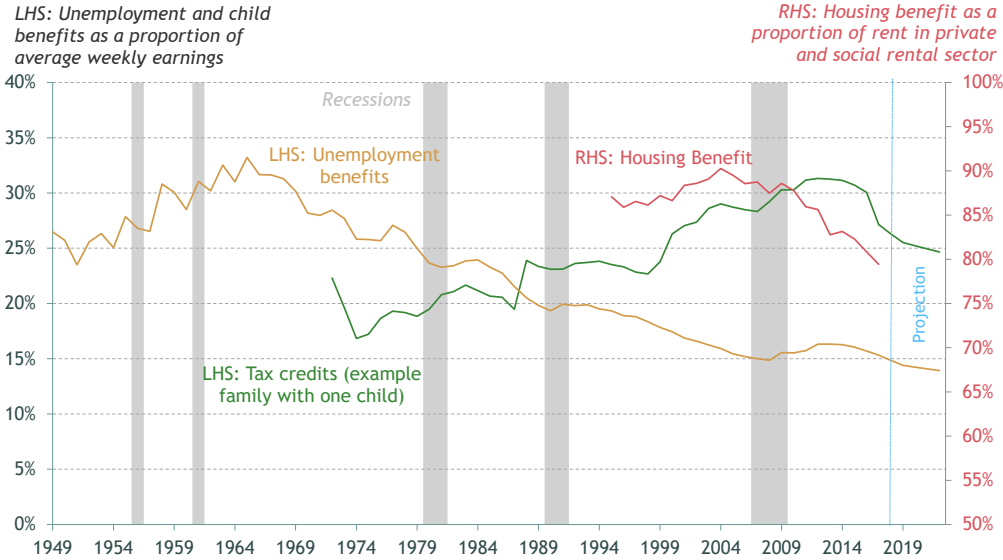
Notes: Real equivalised disposable household income including housing costs. Percentiles 1-4 and 96-100 excluded due to noise. Post-tax employment income includes all employment income net of all employment-related tax, income from investment includes pensions and benefits includes all benefits including housing benefit, as well as p: GB
Source: RF analysis of DWP, *Households Below Average Income*

Looking ahead, the reduction in the generosity of the benefits system raises questions about the extent to which it can support those on lower incomes in the next recession. As shown, the value of benefits relative to average earnings has declined markedly since the financial crisis. And it is on course to decline further. In particular, Jobseekers Allowance will reach its lowest value ever in 2019-20, at 14.5 per cent of average weekly earnings.^[9] Similarly, family tax credits for working couples are projected to fall to 25.6 per cent of average weekly earnings, a fall of nearly 5 percentage points since 2009-10. This is largely due to the abolishment of the 'family element' in tax credits (and the Universal Credit equivalent), costing families up to £545 a year each.

[9] For a discussion of the outlook for benefit generosity, see: A Corlett, *The Living Standards Outlook 2019*, Resolution Foundation, February 2019

Figure 8: The benefits system has become less generous since the financial crisis

Unemployment benefits and family tax credits for working-couples as a proportion of average weekly earnings, and housing benefit as a proportion of rent by family unit in both private and social rental sector: UK



Notes: 'Example family with one child' represents total value of family tax credits plus per-child tax credits. 'Unemployment benefits' refers to Jobseekers Allowance. Years refer to the main year in the financial year, e.g. 2017 is 2017-18 financial year. Source: RF analysis of IFS, *Fiscal Facts*; ONS; Bank of England; and OBR, *Economic and Fiscal Outlook*. Housing benefit from RF analysis of DWP, *Family Resources Survey*

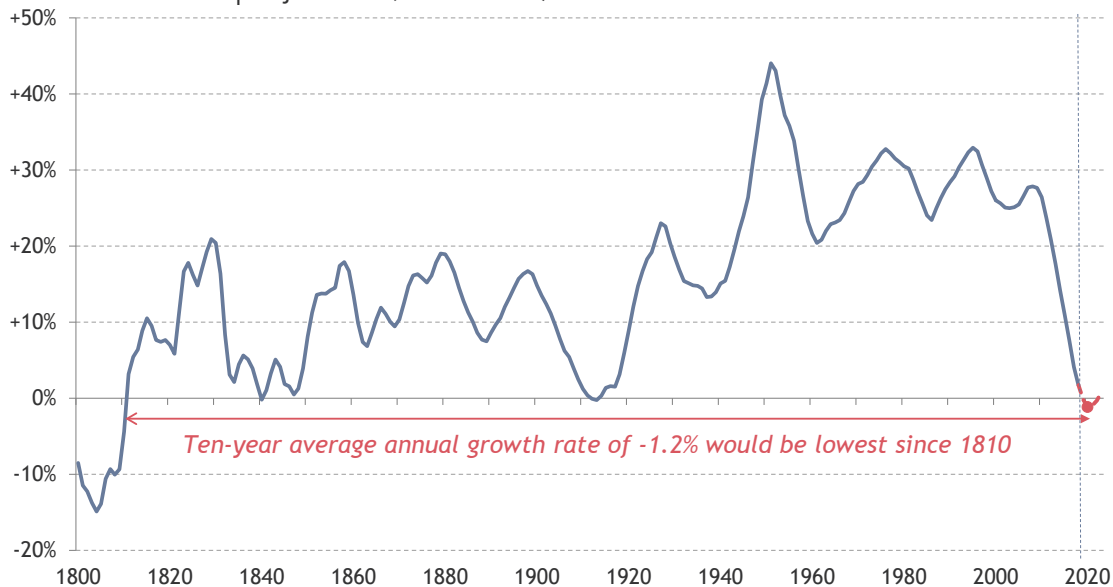
The prolonged post-crisis income squeeze also means that the household balance sheet positions of lower income households look especially vulnerable to any new income shock

While Figure 1 showed that lower-income households fared relatively well in the immediate post-crisis recession period, the prolonged nature of the subsequent income squeeze has taken its toll on the group.

Figure 9 shows just how unusual a period this has been. It sets out real weekly wage growth for the entirety of the period since 1800 and shows that wages have tended to grow much more rapidly than seen in recent years. Indeed, wage growth is currently on course to complete its weakest decade since 1810 having fallen by £32 per week on average between 2008 and 2014.

Figure 9: The past decade of wage growth has been the weakest since 1810

10-year rolling average of annual growth in real-terms average weekly pay: outturn and OBR projection (smoothed): UK



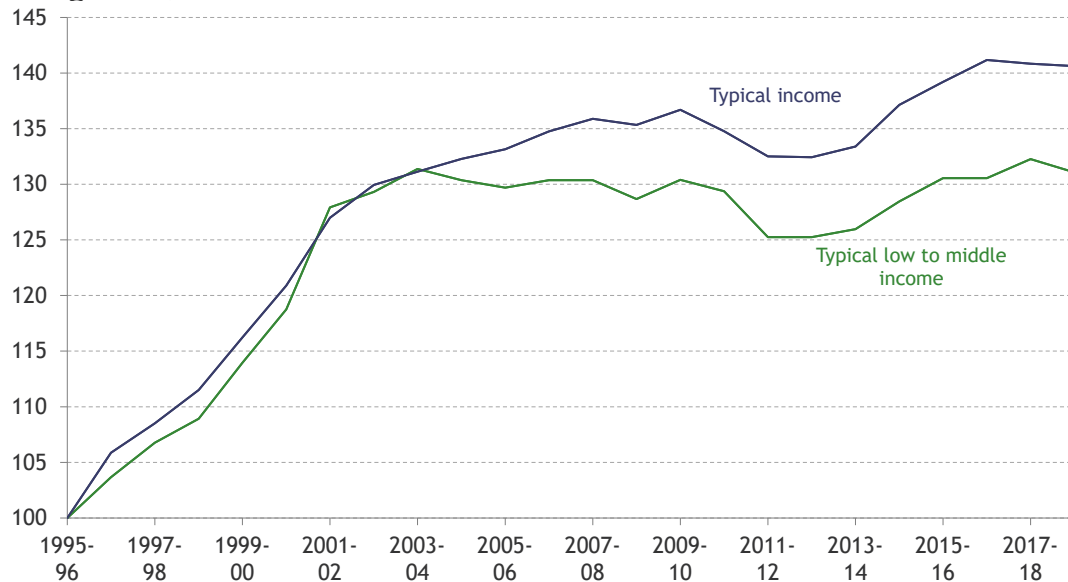
Source: RF analysis of Bank of England, ONS and OBR

Focusing on income, rather than just earnings (adding in the impact of the tax and benefits system and the effect of housing costs), we can see that the post-crisis squeeze has been particularly tight for low to middle income households – especially as it followed on from a marked slowdown in growth even before the financial crisis arrived. Figure 10 makes the point. It shows that low to middle income growth broadly matched median income growth between 1995-96 and 2003-04, but subsequently fell well below it. As a result, incomes among low to middle income households were no higher in 2018-19 than they had been in 2003-04. In contrast, median income rose by 7.2 per cent over this period.

All of this matters for living standards in the here and now of course, but it also matters because of its impact on the ability of households to build up their financial buffers ahead of the next income shock. Whether or not a given household can smooth through a loss of income or a reduction in spending power depends on their income and savings, and the ‘headroom’ they have in their household budget to deal with unexpected costs: weak income growth has meant that those on lower incomes have been able to make little progress in repairing their balance sheets over the last decade.

Figure 10: Incomes among low to middle income households are no higher today than they were in the early 2000s

Indices of inflation-adjusted equivalised disposable household income (after housing costs): UK

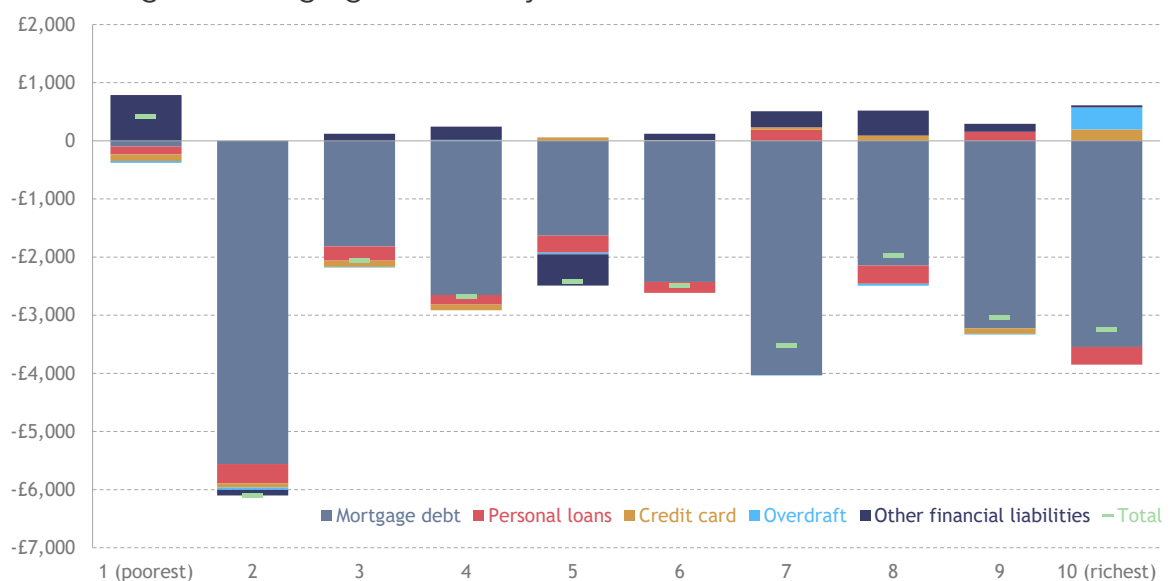


Source: RF analysis of DWP, *Households Below Average Income*

The good news for lower income households is that they hold lower levels of debt today than was the case heading into the financial crisis. Indeed, the inflation-adjusted reduction in debt for those in the lower half of the income distribution was around £2,500 between 2006-08 and 2014-16. Almost all of this was accounted for by falls in the real value of mortgage debt.

Figure 11: There has been a reduction in debt since the financial crisis

Real change in average gross debt by net income decile (2006-08 to 2014-16)



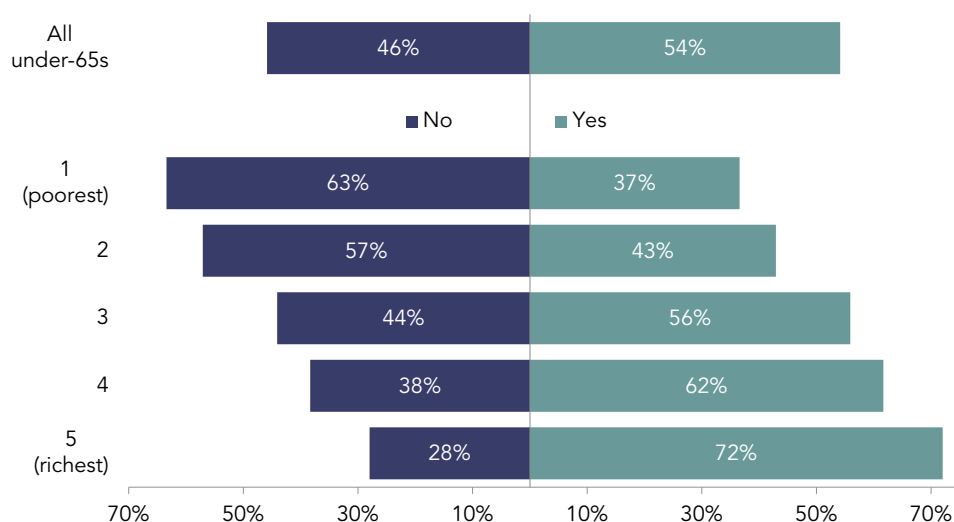
Notes: Changes in gross debt are for an average adult within a family unit (defined as a single adult or couple and any dependent children). Family units are allocated to net income deciles based on their net household income in 2014-16 and the chart shows real values as at start of 2019.

Source: RF analysis of ONS, *Wealth and Assets survey*

But financial resilience crucially also depends on the assets that households own. Here the developments have not been as positive. Figure 12 provides subjective evidence on this from the Bank of England's NMG survey. It shows that households at the bottom of the income distribution in 2018 felt they would be unable to cope with the impact of a financial emergency. While 52 per cent of all households surveyed felt they had enough savings to deal with such an emergency, the same is not true for lower income households. A majority of the bottom 10 per cent and 20 per cent of households by income stated that they didn't have enough savings to deal with such a situation. At the very least, the *perception* of low to middle income households is that they would not currently be able to weather a financial crisis that reduced their real income substantially.

Figure 12: Most low to middle income households don't think they have enough savings to deal with an emergency

Perceptions of having enough savings to deal with an emergency, by equivalised working-age household income quintile: GB, 2018



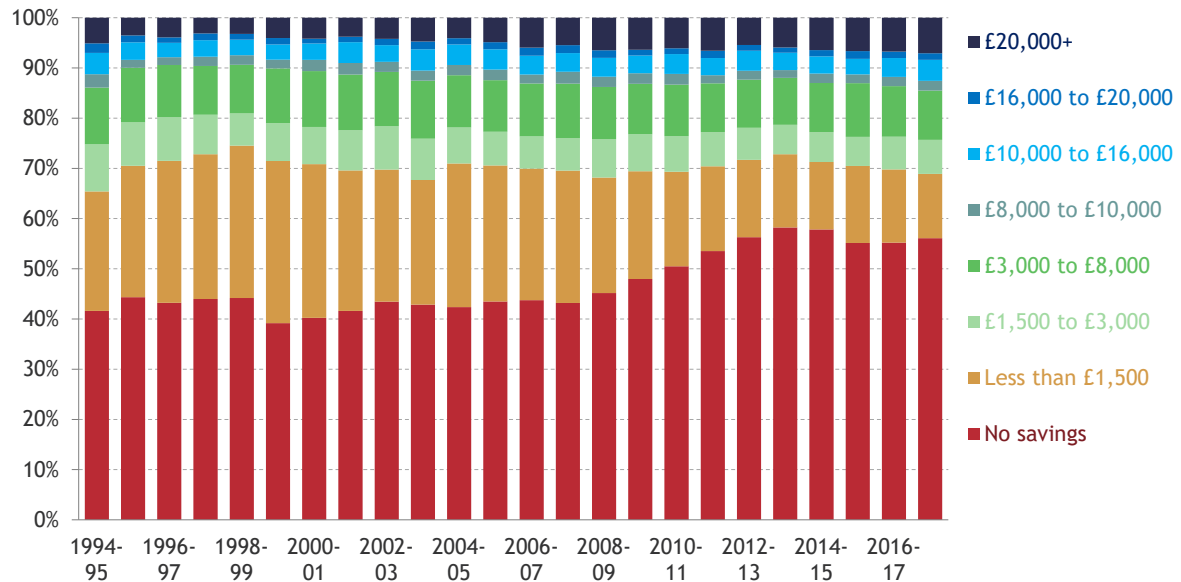
Notes: Results exclude those survey respondents who declined to answer or said they didn't know. 'All under-65s' figures exclude those not providing income information. Survey conducted September 2018.

Source: RF analysis of Bank of England, NMG Survey 2018

Other data back up this gloomy perception. Figure 13 shows that the proportion of low to middle income families that report having no savings or investments rose by 15 percentage points in the aftermath of the financial crisis, peaking at 58 per cent in 2013.

Figure 13: The proportion of low to middle income households with no savings has spiked since the financial crisis

Savings and investments of adults in the family (nominal) for low to middle income households: UK

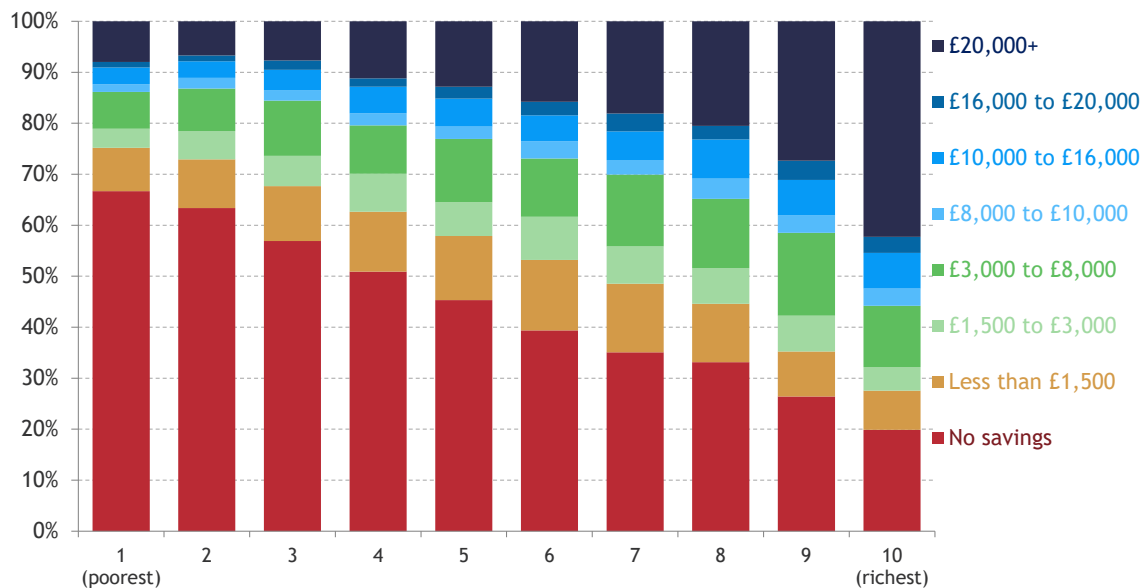


Notes: UK from 2002-3, GB before. Savings figures are not adjusted for inflation.
Source: RF analysis of DWP, *Households Below Average Income*

Figure 14 completes this picture, showing the particular vulnerability of the lowest deciles of the population by income. Here, two-thirds of households in the poorest tenth of the population reported having no savings or investments in 2017.

Figure 14: Lower-income households currently have significantly lower levels of savings than other income brackets

Savings and investments of adults in the family (nominal) by income decile: UK, 2017-18

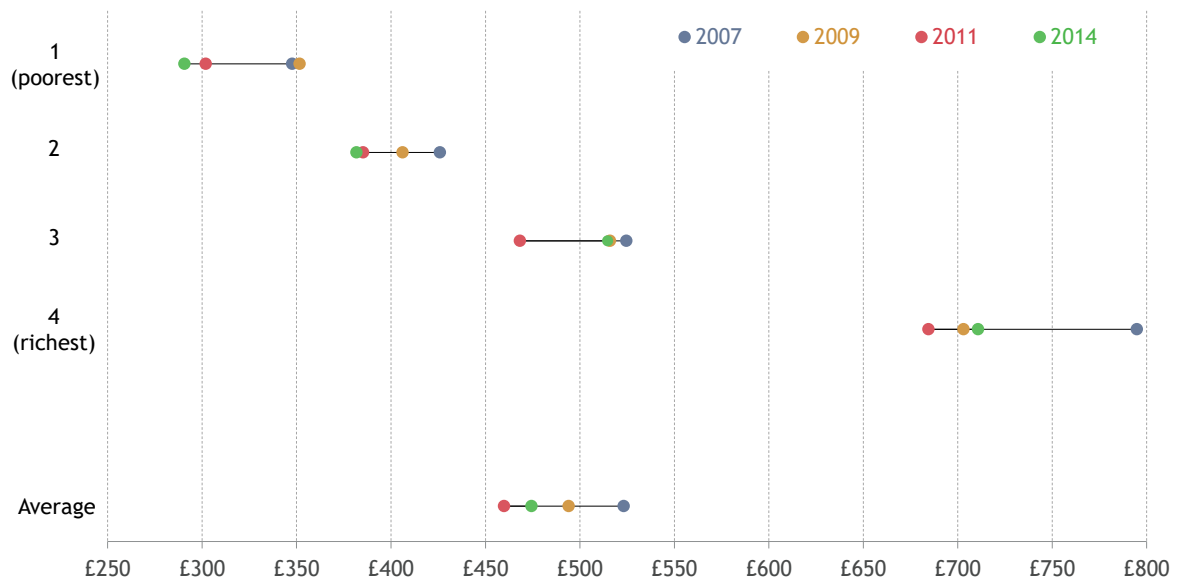


Notes: Savings figures are not adjusted for inflation.
Source: RF analysis of DWP, *Households Below Average Income*

There is also evidence to suggest that lower-income households have very little scope for cutting back on spending in response to any future income shock. Figure 15 shows – in money terms – how the weekly consumption of each household income quartile evolved between 2007 and 2014. It highlights a retrenchment across the income distribution, reflecting the generalised nature of the post-crisis income squeeze. The cash change between 2007 and 2014 is greatest for the top income quartile, but what really stands out is the limited amount of spending being undertaken at the bottom end of the distribution – and therefore the restricted scope for further decreases. The average decrease in consumption spending between 2009 and 2014 was £20 per week, but for those in the lowest quartile of the income distribution it was £61 per week.

Figure 15: Post-crisis retrenchment has left lower-income groups with little scope for further cutbacks

Median equivalised weekly non-housing household consumption (CPIH-adjusted to 2017-18 prices) by income quartile: UK



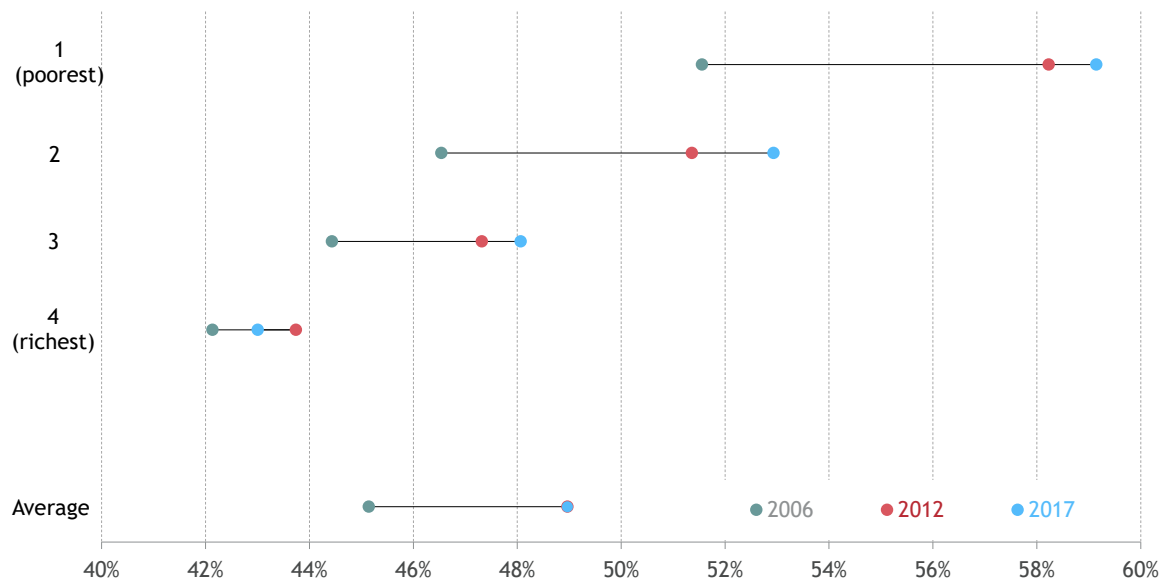
Notes: Consumption in each detailed spending category in each year is reweighted to match figures from the National Accounts (on a per-household, per week basis), in order to correct for growing under-recording of consumption expenditure in surveys. Consumption is deflated using deflators specific to each spending category. We present trends in consumption for each individual, rather than just for the head of the household.

Source: RF analysis of ONS, *Living Costs & Food Survey*

This constriction is reflected in how much of the weekly budget of lower income households is being directed towards categories of expenditure that we can consider to be ‘essential’ – which includes food, fuel, clothing and transport. Spending on such ‘essentials’ rose to 59 per cent of the bottom quartile’s total consumption in 2017-18, up from 52 per cent ahead of the financial crisis and significantly higher than recorded by any other income group. Given this backdrop, there is a clear question about the extent to which households at the bottom of the income distribution could feasibly retrench further in the next recession.

Figure 16: 'Essential' forms of spending account for a significantly higher share of lower-income households' total consumption than was the case pre-crisis

Proportion of equivalised non-housing household consumption spent on 'essentials', by income quartile: UK



Notes: We present trends in consumption for each individual, rather than just for the head of the household. This figure is derived from raw survey-based consumption data. 'Essentials' category includes consumption of fuel & power, food & non-alcoholic beverages, clothing & footwear and transport.

Source: RF analysis of ONS, *Living Costs & Food Survey*

Conclusion

Following the 1980s and 1990s recessions, the received wisdom was that the impacts of economic downturns were disproportionately felt by those on lower incomes. Consistent with that, we have shown evidence that those at the bottom of the distribution have indeed borne the brunt in unemployment-heavy recessions. But the experience of the financial crisis challenged that view. In its aftermath, there was a pay squeeze which affected the whole distribution and a targeted benefits policy that supported the poorest groups. The recession was undeniably painful, but it was one which had most impact at the top end of the distribution.

However, it would be wrong to conclude that this is a trick that can be easily repeated when the next downturn arrives – for four key reasons. First, there is no guarantee that the next downturn will look like the last – with a sterling-related pay adjustment rather than an unemployment one. Second, even if the next recession does play out like the last, lower-income groups look especially exposed to even a relatively modest unemployment rise. Third, we can't rely on the application of the same level of government support for lower-income households in the next downturn – particularly given the nature of the benefits squeeze that continues to be delivered as part of the austerity package. And fourth, the persistence of the post-crisis income squeeze appears to have damaged lower income household's financial resilience, leaving them more exposed to an income shock than they were just ahead of 2008.

This briefing note provides context for the first report from the Resolution Foundation's new Macroeconomic Policy Unit, established to play a part in encouraging a better-informed and more inclusive macroeconomic policy debate. That report will assess the ability of the current framework to provide effective support to the economy in the next recession. It will set out the broad direction that a reform agenda based on this framework assessment should follow. Each element of that agenda will be returned to in detailed papers in the months ahead.

Resolution Foundation

The Resolution Foundation is an independent research and policy organisation. Our goal is to improve the lives of people with low to middle incomes by delivering change in areas where they are currently disadvantaged. We do this by:

- undertaking research and economic analysis to understand the challenges facing people on a low to middle income;
- developing practical and effective policy proposals; and
- engaging with policy makers and stakeholders to influence decision-making and bring about change.

For more information on this report, contact:

James Smith

Research Director

james.smith@resolutionfoundation.org

0203 372 2956