TOUCH STONE EXTRAS

Unfair to Middling

How Middle Income Britain's shrinking wages fuelled the crash and threaten recovery

Contents

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Stewart Lansley is the author of the TUC Touchstone Pamphlets *Do The Super-Rich Matter?* and *Life in the Middle: The Untold Story of Britain's Average Earners*. He is also the co-author of *Londongrad: From Russia With Cash*, 4th Estate.

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Unfair to Middling

In the *Life in the Middle* pamphlet published earlier this year, the TUC showed that the pay and life chances of middle earners had fallen behind wealthier groups in the UK over the last thirty years. This was despite the fact that middle earners had been so central to the electoral victories of successive governments since 1979. This Touchstone Extra looks in more detail at the economic trends that have left middle earners struggling. It is a fascinating and detailed look at how the changing structure of our economy since the 1970s has concentrated earnings amongst the better-off, reduce the share of national income going to wages and destroyed the relatively secure and well paid jobs on which middle earners used to rely.

Touchstone Extra

These new online pamphlets are designed to complement the TUC's influential Touchstone Pamphlets by looking in more detail at specific areas of policy debate raised in the series. Touchstone Extra publications are not statements of TUC policy but instead are designed, like the wider Touchstone Pamphlets series, to inform and stimulate debate. The full series can be downloaded at **www.tuc.org.uk/touchstonepamphlets**.

Executive summary

The TUC Touchstone Pamphlet *Life in the Middle*, published in May, showed how Middle Income Britain, a group that was one of the main winners from post-war trends, found itself on the losing end of a 30-year long wave of sweeping economic and social change. Since the late 1970s, middle Britain has been left increasingly behind in the battle for the spoils of rising prosperity. Those higher up the income scale have enjoyed a more rapid rise in living standards than those in the bottom 60 per cent of the income distribution, while the super-rich have secured themselves a personal wealth boom on a scale not seen since the end of the nineteenth century.

As middle income Britain has slipped behind the super-rich, the rich and the merely affluent, new income, wealth and opportunity gaps have opened up. As a result, Britain today is a society increasingly divided between the top 40 and the bottom 60 per cent. In the immediate post-war years British society resembled a 'pyramid' with a small and privileged group at the top, a larger but still small and comfortable middle and a large majority at the bottom. By the end of the 1970s, Britain had moved closer to a 'diamond' shape with a small group of the rich and the poor and a much fatter middle.

Today the social map has changed again. In just three decades, Britain has moved away from a 'diamond' to an 'onion-shaped' society with a small super-elite of the very rich, a minority group of the affluent and a large bulge below the middle.

This report examines three economic factors that have left middle- and lower-income Britain in the slowlane of rising prosperity.

- First, the profits squeeze that helped to define the 1970s has been replaced by a sustained wage squeeze in which average earnings have been rising more slowly than productivity. In addition, the share of national wealth going to wages has been in sharp decline – peaking at 65 per cent in 1973 but running at 53 per cent today.
- Secondly, this new squeeze has been compounded in its impact by another long-term economic trend: the increasing concentration of the earnings pool at the top.
- Thirdly, alongside Britain's increasingly low wage, unequal economy, there lies another important and increasingly entrenched trend – a decline in the employment opportunities open to those on middle and lower earnings.

Moreover, these trends are likely to continue. Despite claims that we are in the throes of a largely middle-class recession, the main losers from the current downturn are middle and lower income groups. This is now being accepted by the Government. As Gordon Brown told the Labour Party conference:

> *When markets falter and banks fail it's the jobs and the homes and the security of the squeezed middle that are hit the hardest. It's the hard pressed, hard working majority – the person with a trade, the small business owner, the self-employed. It's the class room assistant, the worker in the shop, the builder on the site.*

These post-1979 changes have moved the economy from one set of damaging imbalances to another. Although the trends all have their own set of explanations, they are also closely inter-linked. The falling wage share has itself led to widening inequality while driving higher levels of personal debt. The rising earnings gap has, in turn, contributed to declining levels of labour market mobility.

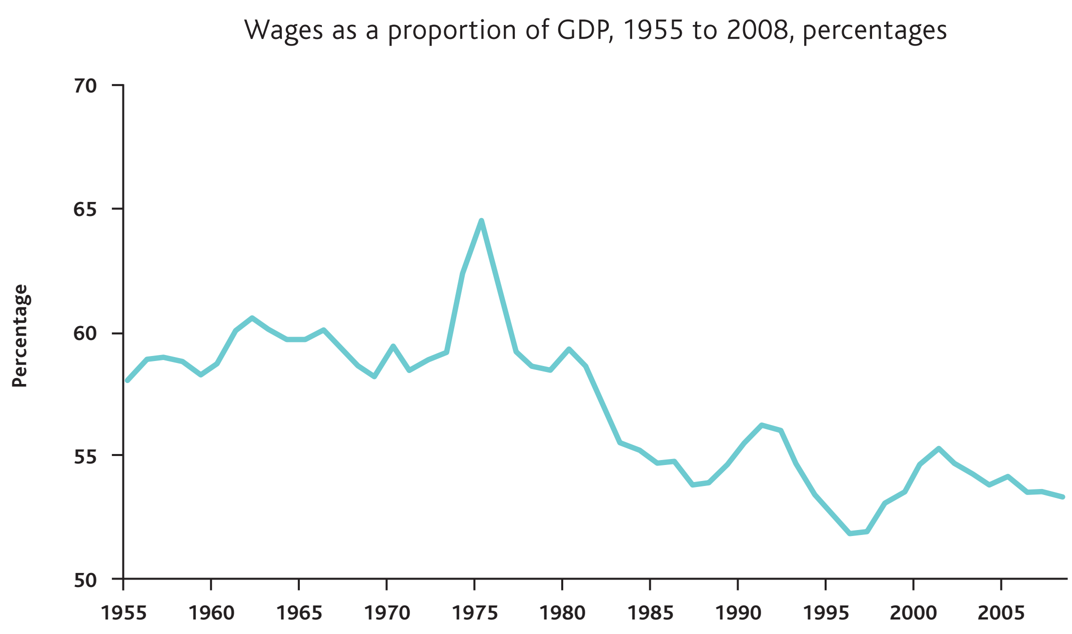
Most significantly, given the current economic crisis, Britain's low-wage, unequal economy has also been an important contributory factor to the financial crash and the subsequent recession. Those whose wages fell behind borrowed more than they could afford, contributing to the credit crunch. Average household debt was 45 per cent in 1980 but rose to 157 per cent in 2005. And the decline in wages was made up by increased profits – much of which was used for financial speculation rather than productive business investment, helping drive the UK's heavy reliance on finance and encouraging the over-investment that led to the crash.

1 The wage squeeze

In the last three decades, middle- and lower-income households have found themselves slipping steadily behind higher income groups in the prosperity stakes. One of the central factors behind these dividing fortunes has been the long-term trend in the pattern of earnings. In the last three decades, the proportion of national income going to wage-earners has fallen, while the proportion going to profits has risen.

Central to these shifts has been the role of the wage-share. Figure 1 reveals two distinct characteristics of the post-war behaviour of the proportion of national income going to wage-earners. First, there is a link to the economic cycle with the share first rising and then falling, with a lag, during recessions. For example, it rose slightly in both 1974–5 and in 1990–91 before falling back. This may be because at the onset, profits are more sharply affected than wages. Eventually however, the wage share falls as unemployment continues to rise, firms continue to cut costs and profits recover.

Figure 1: How the profits squeeze gave way to the wage squeeze

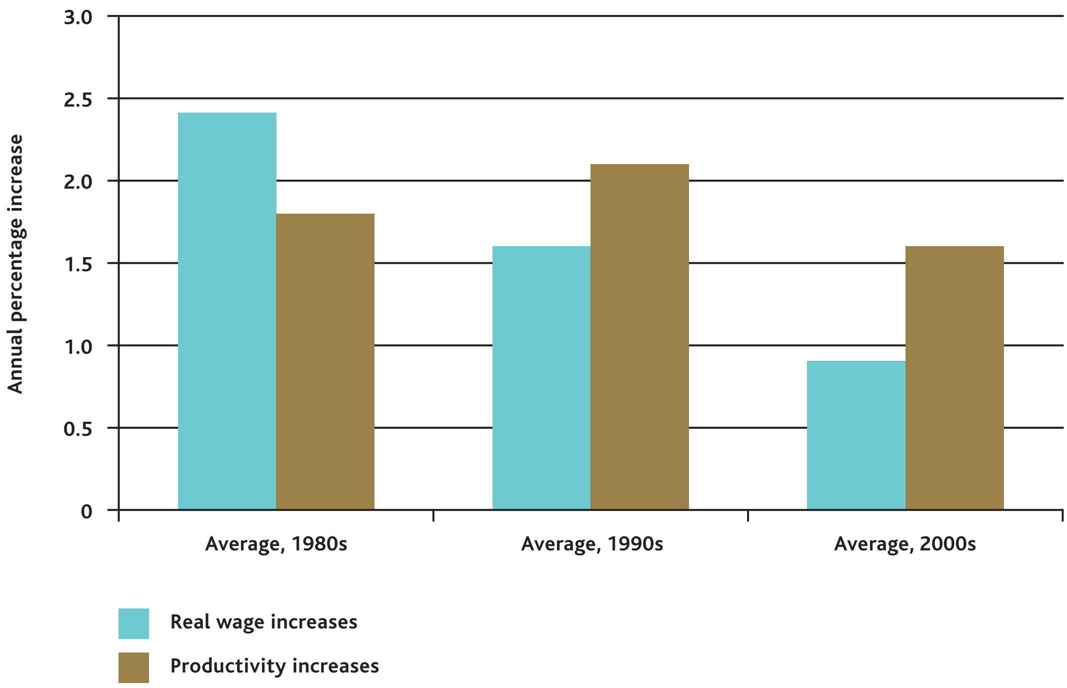


Source: Office for National Statistics

The second and most significant trend is of a sustained decline since the mid-to-late 1970s. The wage share held its post-war level at between 58–60 per cent until the early 1970s and then rose to a high of 64.5 per cent in 1975. It then started drifting downwards reaching a post-war low of 51.7 per cent in 1996, largely as a result of the rise in unemployment in the slump at the beginning of that decade. From then it recovered slightly to reach 55.2 per cent in 2001 before slipping back to 53.2 per cent in 2008 – close to its post-war low in 1996.

The peak for the share of wages – close to 65 per cent in the mid-1970s – turned out to be a temporary phase, the product of an exceptional set of circumstances including the oil price shock. The 'profits squeeze' which accompanied the sharp rise in wage share is now widely accepted to have been detrimental in its economic impact, contributing to inflationary pressure, a squeezing of business investment and the weakening of Britain's productivity and growth rate.

Figure 2: How real wages have lagged productivity, 1980 to 2008



Source: Oxford Economics

Steadily, however, the 'profits squeeze' of the 1970s has given way to the much more sustained 'wage squeeze' of the last three decades. During this period, as shown in Figure 2, real wages have been rising more slowly than productivity, with the gap widening since 1990. Since 1980, real wages have risen by 1.6 per cent per annum while productivity has been rising at 1.9 per cent per annum. In the post-millennium years, the gap has opened with real wages rising by a mere 0.9 per cent while productivity has averaged 1.6 per cent.

The declining wage share has been driven by the introduction of flexible labour markets since the 1980s (with the paring back of employment protection rules); economic liberalisation (including privatisation); the increasing constraints on collective bargaining; a reduction in the demand for unskilled labour resulting from technical change; and the global transfer of jobs triggered by globalisation. These factors have all greatly increased the bargaining advantage of employers and the share of GDP going to profits.[1]

The rising share of profits and falling share of wages have had significant consequences for the economy.

They have increased the concentration of income and wealth

Profits are much more unevenly distributed than wages. Although some of the extra profits funded higher levels of investment, most of the beneficiaries of the swelling profits pool have been those at the top of the income and wealth distribution. As shown in Section 5, private pension levels and share ownership where access is linked to the profit share are much more unequally distributed than wages.

Higher profits have also been used to justify the explosion of corporate, executive and financial remuneration, fuelled the rise in business values and brought record dividend payments in private companies. The rising profit share has thus allowed the rich to prosper by driving the greater concentration of wealth and income at the top. Indeed, the wage share would have fallen even more sharply if allowance was made for the rise in the share of the very top earners including company executives and chief executives. As Andrew Glyn has argued, these are "really part of profit incomes masquerading as wages'.[2]

The emergence of a new wealthy elite has also brought what Citigroup global strategist Ajay Kapur has called "favourable treatment by market-friendly governments'.[3] Over the last decade this economic and financial elite has used their growing political muscle to ensure weak financial regulation by the state and lower taxes on the wealthy. Simon Johnson, former chief economist at the IMF, has argued in an article in *The Atlantic* that what he calls a dominant 'financial oligarchy':

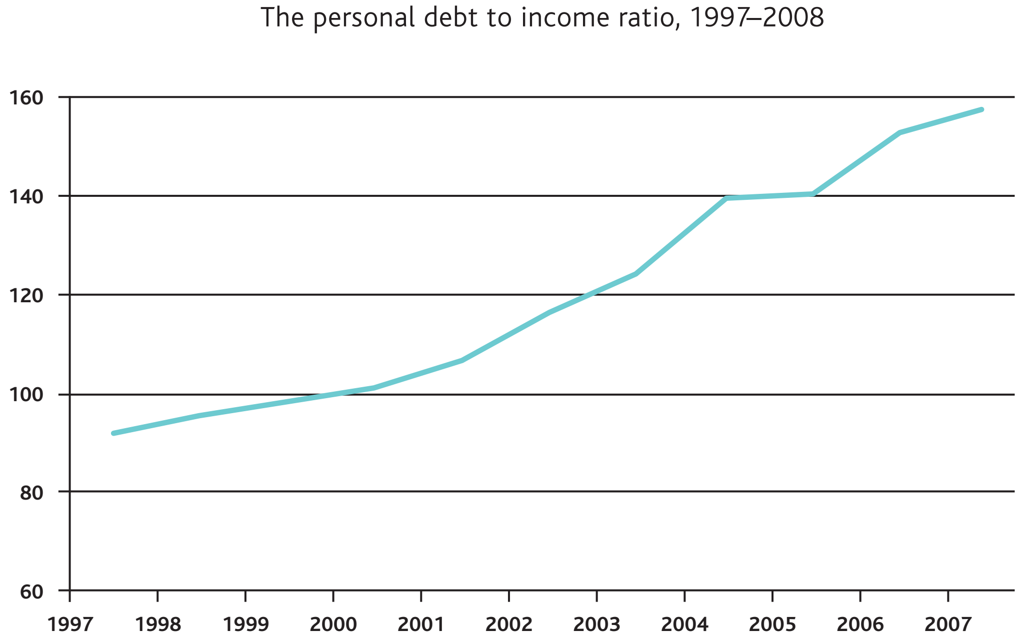
> *played a central role in creating the crisis, making ever-larger gambles… until the inevitable collapse. More alarming, they are now using their influence to prevent precisely the sorts of reforms that are needed, and fast, to pull the economy out of its nosedive. The government seems helpless, or unwilling, to act against them.*[4]

They have contributed to the rise of personal debt

The falling wage share has contributed to the sharp rise in private debt of the last decade. To maintain spending power, wage-earners turned increasingly to credit. As shown in Figure 3, the debt/income ratio rose from 91.1 in 1997 to 157.4 in 2007. In 1980 it stood at 45 per cent.

But it is not just lower and middle earners who have turned to borrowing. Higher profits fuelled returns on financial investment and encouraged the wealthy to borrow more not to finance consumption but to take speculative bets on financial assets. This was because rates of return – at historic highs – greatly exceeded the cost of borrowing which stood at historic lows from the recession. Money poured into hedge funds, private equity, takeovers, commercial property and luxury housing.

Figure 3: The rise in debt



Source: Office for National Statistics

At the height of the boom in 2006 and 2007, for example, top end house prices increased much more sharply than on average. According to Savills, prices for prime central London properties costing over £5m grew by 50 per cent in the year to March 2007, six times faster than for houses in general. As this helped to increase prices across the housing sector, those on middle and lower incomes have borrowed beyond their means, adding further to rising personal debt and the asset bubble which triggered the ensuing credit crunch and the current recession.

They have fuelled the expansion of the financial services sector

While the importance of manufacturing has been falling, the financial services sector grew from some 6.6 per cent of national economic activity in 1996 to over 10 per cent by 2007.[5] This is in part because the rise in the profits share has not been evenly distributed between sectors. In the last twenty years, the financial sector has secured an increasing share of national profits. This is mainly because as rates of return on financial engineering came to exceed those available in other parts of the economy such as new businesses and manufacturing, funding for long-term growth gave way to short-term, fast-buck deal making with money moving at speed chasing rapid return. The rising returns on offer helped to encourage the much higher levels of leveraging and risk-taking in financial institutions that eventually led to the credit crisis.

It is City workers who have been one of the main beneficiaries of the boom in profits, enjoying soaring salaries and bonuses. This has been made possible by the scale of fees enjoyed in the City for advisory and underwriting activities.

Although financial services appear to have a competitive rather than a monopolistic structure, the excess fees on most financial transactions are not competed away.[6] The fee structures applying in the case of hedge funds and private equity (the '2 + 20' arrangement whereby partners charge an annual management fee of 2 per cent plus 20 per cent of profits) are uniform. Arguably such excess fees have helped to create artificially high short-term returns on activities such as mergers and acquisitions and private equity, in excess of those available elsewhere in the economy, thus contributing to a deeply unbalanced pattern of investment and encouraging the expansion of high risk financial instruments. This distortion has been recognised by the chairman of the FSA, Lord Turner, who has warned that much of the City's role has been "socially useless" and may have risen "beyond a socially useful size".[7]

They have been a key factor in rising poverty levels and the steady expansion of the scale and cost of the social welfare function of the state

In the UK, a half of children living in poverty have at least one parent in work, but earning too little to take them above the poverty line, while the risk of poverty amongst working families has increased over time.[8] The rise in the level of working-related poverty is at least in part a product of the falling wage share. Because of this, government policies have had to work much harder than in the past to reduce the level of poverty and to check the extent of final income inequality. The cost of spending on income support for families (such as child benefit and working family tax credit) increased from £18.3bn in 1996/7 to £30.6bn in 2006/7 (at 2006/7 prices).[9]

In turn, the benefit system has become increasingly complex and expensive to administer and increasingly difficult for recipients to understand, while the extent of income redistribution has increased just to prevent inequality rising to unacceptable levels. In the process there has been both an extension of means-testing affecting middle as well as lower income households and an intensification of the poverty trap. The low wage economy means that those on benefit can often be little better off financially by moving into work.

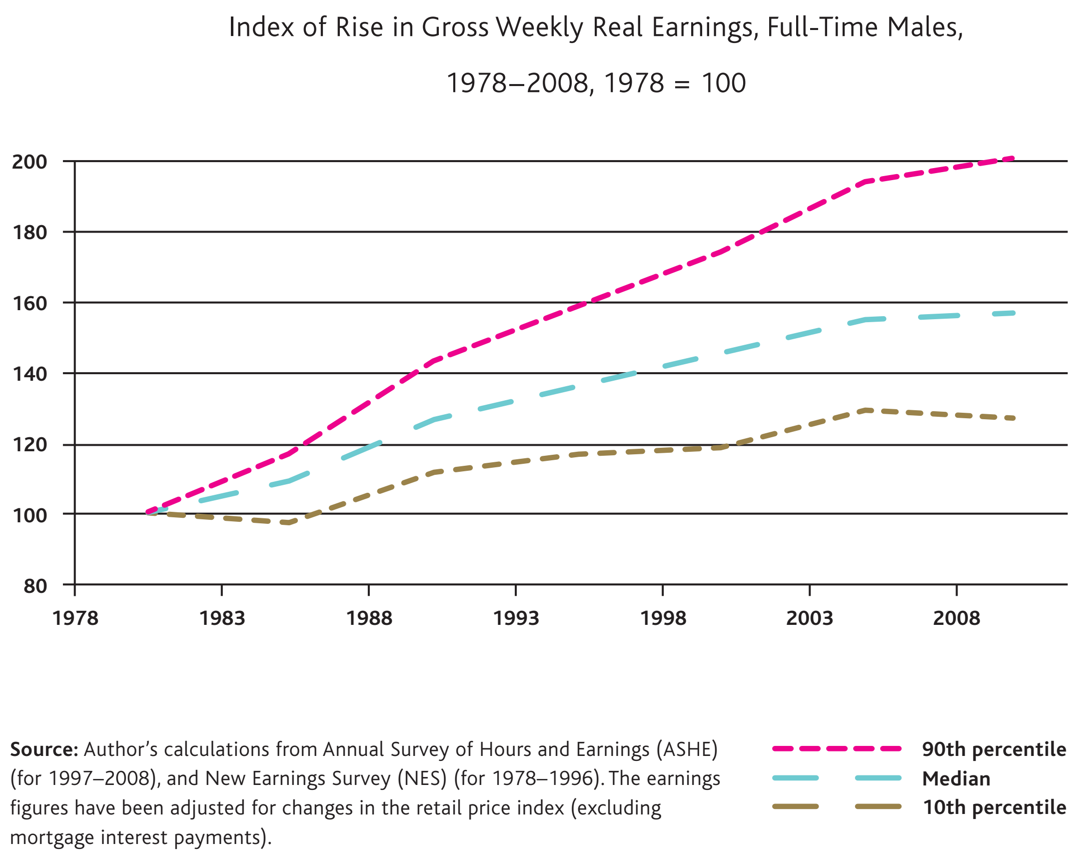
The wage-squeeze is only part of the story behind the slipping in the relative living standards of middle Britain and the nation's changing social shape. The impact of falling average wages has been compounded by another apparently systemic economic trend – the increasing concentration of earnings amongst the highest paid.

2 *Rising wage inequality*

The last three decades has seen another significant long-term move – a steady rise in the inequality of earnings. As a result, the falling wage share has not been evenly distributed across the earnings range but has been borne almost entirely by middle and lower paid employees. Because of this, the bottom 60 per cent of earners have been faced with a declining share of a diminishing pool.

Figure 4 shows the index for the rise in earnings (for full time males) for the 10th percentile, the median and the 90th percentile from 1978 to 2008 (1978 = 100). The figures have been adjusted for inflation. While real earnings at the 90th percentile doubled over the three decades, real median earnings were 56 per cent higher and real earnings at the 10th percentile only 27 per cent higher. The earnings structure has thus become increasingly skewed towards the top end, with the gap widening sharply between the middle and the top.

Figure 4: How earnings have become more unequal over the last 30 years



Source: Author's calculations from Annual Survey of Hours and Earnings (ASHE) (for 1997–2008), and New Earnings Survey (NES) (for 1978–1996). The earnings figures have been adjusted for changes in the retail price index (excluding mortgage interest payments).

Notes: The NES covers GB and ASHE covers the UK.

Most of this rise in inequality took place through the 1980s with the rise slowing in the 1990s. Since the late 1990s, the gap between the 10th percentile and the median has remained roughly constant while top earners have continued to pull away from the rest of the population.

This rise in earnings inequality over the last 30 years has been driven by two main factors.

First, by a change in the structure of the workforce.

The number of jobs in manufacturing fell from 7,130,000 in 1978 to 3,154,000 in the first quarter of 2008 before the onset of the recession – that's a fall of 3.5 per cent a year. In contrast the number of jobs in finance and business services rose from 2,795,000 in 1978 to 6,669,000 at the beginning of 2008.[10]

This industrial shift has been accompanied by important shifts in job patterns. Notably, there has been a significant rise in the number of people working in well-paid professional and managerial jobs; a decline in the number of middle-skill jobs requiring moderate levels of education and paying moderate salaries; and a rise in the number of routine low paid jobs. In the 12 years from 1997 to 2009 alone, the proportion of the working population employed in managerial and professional occupations rose from 34.7 per cent of the employed population to 43.5 per cent, while the proportion working as plant and machine operatives fell from 9.8 per cent to 6.6 per cent.[11] This has led to a steady polarisation of the jobs market with the emergence of what some labour market economists have called the 'hollowing out of the middle' – the steady loss of jobs once paying middle levels of pay.[12]

Second, by an increase in earnings relativities between jobs.

Earnings in high paying jobs have been creeping up over time more quickly than those in middle and low paying jobs. The most high profile examples are those at the very top. As noted above, the last three decades has seen very sharp rises in remuneration levels amongst financiers, bankers and company executives (roughly the top 0.1 per cent). Over the last decade, remuneration packages for the chief executives of FTSE100 companies have risen nine times faster than those of the median earner.[13]

Increasingly Britain's home-grown super-rich are drawn from financiers rather than traditional entrepreneurs. According to the *Sunday Times*, 16 per cent of the richest 1,000 in 2009 obtained their wealth from hedge funds, financial speculation, private equity and other financial activity. A mere 11 per cent made their money from industry and engineering and 4 per cent in construction and housebuilding.

But growing pay inequality is not just a product of runaway pay amongst a few hundred top executives. According to a survey by *The Guardian*, the best paid employees in September 2009 were those working for City-based firms. The average pay at money broker ICAP, which employs 4,330 staff, was more than £200,000. Average pay amongst the 1,776 staff at hedge fund group Man was £198,000. This was the double the average of five years earlier.[14]

Earnings amongst those working in well paid, white collar professions outside of the corporate super-elite and City financiers have also been rising faster than non-professional salaries. Winners from the changing earnings structure include corporate lawyers, accountants, senior civil servants and top local government officials. All these jobs command salaries that are much higher in relation to the median than their counterparts 30 years ago.

Table 1 compares real earnings levels for a range of jobs in 1978 and 2008. The jobs are ranked by their median earnings in 1978, with, for example, medical practitioners the highest paid and plasterers the lowest paid of the jobs indicated in that year. The second column shows the rise in real median earnings (after adjusting for inflation) for each job category over the 30-year period, with 1978 = 100.

Table 1: Rise in real earnings, 1978–2008, Full-Time Male Employees

1978 = 1, figures have been adjusted by the rise in the index of retail prices

	Ratio of earnings in 1978 to median earnings in that year	2008 Index 1978=1
Medical practitioners	1.8	2.53
Mechanical engineers	1.42	1.34
Electrical, electronic engineers	1.39	1.55
Architects, town planners	1.33	1.36
Judges, barristers, solicitors	1.24	2.14
Accountants	1.23	1.60
Quantity surveyors	1.15	1.65
Secondary school teachers	1.14	1.67
Toolmakers/ tool fitters	1.05	1.21
Heavy goods vehicle drivers	1.04	1.19
Sheet metal workers	0.99	1.08
Fork lift truck drivers	0.97	0.95
Welfare/social workers	0.96	1.60
Bus and coach drivers	0.96	1.11
Carpenters & joiners	0.92	1.30
Skilled motor mechanics	0.90	1.34
Bricklayers	0.89	1.37
Packers, bottlers, fillers, canners	0.88	0.97
Bakers	0.86	0.99
Plasterers	0.81	1.30

Source: New Earnings Survey for 1978; ASHE for 2008.

Notes: 1978 relates to GB while 2008 relates to the UK, while there have also been some definitional changes relating to some individual jobs. These will not alter the broad direction of change.

This shows that those in the best paid jobs in 1978 have ended up in the fast lane of subsequent earnings growth, while those in the bottom half of the earnings distribution have mostly had to follow behind in the slow lane. Most of the featured best paid jobs in 1978 – medical practitioners, barristers and solicitors, accountants and engineers – have enjoyed much higher increases in earnings over the last 30 years than the middle and lower paid jobs in 1978. Thus while the earnings of medics and of judges, solicitors and barristers have more than doubled in real terms since 1978, real earnings in some occupations, including forklift truck driving, packing and bottling, and baking, have actually fallen. These sharp rises in relativities have added to the growth of pay inequality driven by pay rises at the very top.

There is a good deal of evidence about the underlying causes of these changing pay patterns. In part, they reflect the professionalisation of society – a process described by historian Harold Perkin as 'the third revolution' after the agricultural and industrial revolutions.[15] Although this process has been progressive and beneficial in many ways, improving working conditions and broadening opportunities, recruitment to the professions has for the most part been highly elitist as well as being a key source of the widening pay gap. As the Cabinet Task Force on widening access to the professions, chaired by Alan Milburn, argued: "All the evidence suggests that too many bright, able kids from average middle-income families, as well as working-class families, are losing out in the race for professional jobs."[16] Moreover the professionalisation of society is set to continue. The evidence is that job growth in the future is likely to be even more concentrated amongst professional and managerial staff.

The changes have also been reinforced by technology-driven growth in the demand for skills, especially from the increased use of computers. This has led to a rapid increase in demand and pay for more skilled and educated workers relatively to the unskilled and less well educated.[17]

These two key trends – the falling share of wages and the upward skewing of the earnings distribution – have had two significant economic and social consequences.

- First, the economy is now as much out of balance as it was in the 1970s when the wage share rose to almost 65 per cent. In place of the imbalances of the mid-1970s Britain now has built an economy highly dependent on financial services in which the gains from economic growth have gone more heavily to profits than wages, credit has become an increasingly significant source of demand, and the number of middle earning jobs has declined. Britain has moved from a high-wage, low-debt, relatively equal society to a low-wage, high-debt and much more unequal society. The wage share is now down to 53.2 per cent. Personal debt has risen from a figure of some 45 per cent of incomes in 1980 to over 150 per cent today. Over the same period, the level of inequality, however measured, has risen sharply.[18] It is a change that has fundamentally affected the well-being of Middle Income Britain.
- They have been the key factors in the changing social shape of Britain as reported in the TUC Touchstone Pamphlet, *Life in the Middle: The Untold Story of Britain's Average Earners*. In the immediate post-war years British society resembled a 'pyramid' with a small and privileged group at the top, a larger but still small and comfortable middle and a large majority at the bottom. By the end of the 1970s, with the long-term decline of the manual working class and the spreading of affluence, Britain had moved closer to a 'diamond' shape with a small group of the rich and the poor and a much fatter middle. Since then the social map has changed again, the product of first, the rise of a small group of the super-rich; and secondly, a much greater concentration of the population by income in the bottom half of the distribution. In just three decades, Britain has moved away from a 'diamond' to an 'onion-shaped' society with a small super-elite of the very rich, a minority group of the affluent and a large bulge below the middle.

3 Disadvantage in Britain's labour market

The fortunes of Middle Income Britain have also been affected by a third characteristic of the British economy: a bias in work opportunities and progress. While the low paid are especially vulnerable to job insecurity and poor working prospects, the evidence is that although these disadvantages decline as earnings increase, even those on middle earnings are at a significant relative disadvantage compared with the highest earning groups.

Even in the economic boom years immediately before the start of the recession in the second quarter of 2008, when GDP started to fall and unemployment to rise, work opportunities were unevenly shared.

i. Unemployment and occupation

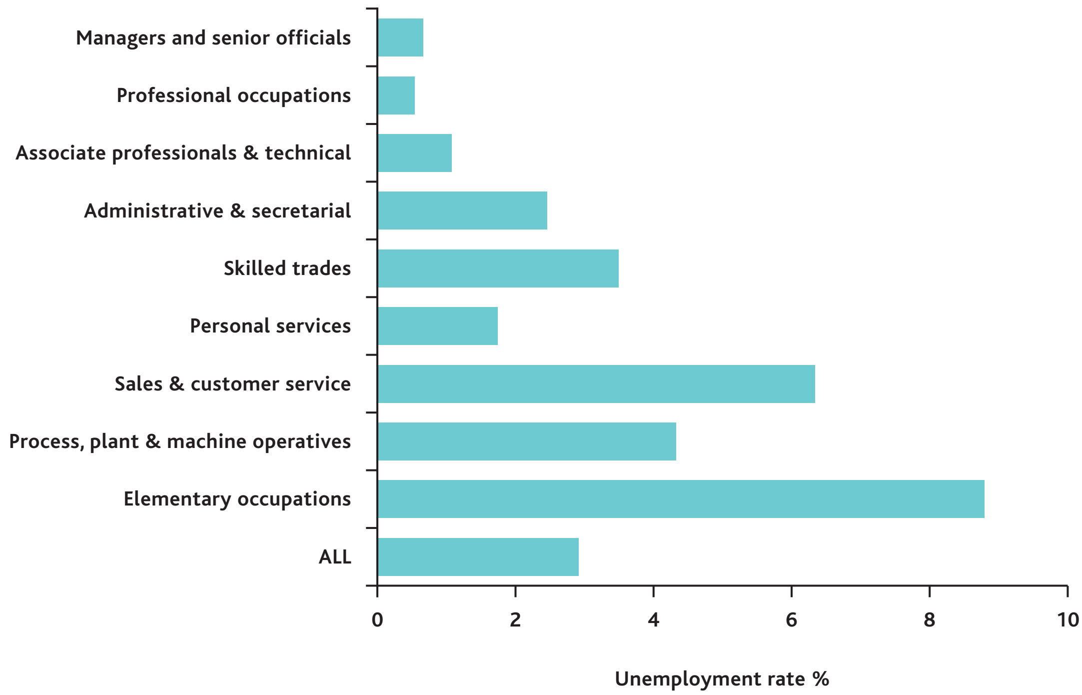
Figure 5 shows that the (claimant count) unemployment rate for March 2008 differed widely by occupation. The highest levels of unemployment were found in traditionally lower paid and lower skilled occupations such as elementary (farm workers, building labourers, factory packers and bottlers, hotel porters, kitchen and catering assistants, shelf-fillers and cleaners) and sales and customer service (call centre agents, market and street traders, shop assistants, merchandisers and window dressers and customer care assistants). The lowest unemployment rates were found in the highest paid professions, including managers and senior officials (such as chief executives, senior officials in national and local government, financial managers, advertising and PR managers, senior officials in the police and NHS).

In the closing month of the long economic boom, those formerly working in the lowest skilled elementary jobs were 16 times more likely to be unemployed than professionals and 13 times as likely as those in top managerial jobs. Those once working in occupational categories with a concentration of middle earners such as skilled trades, sales and customer services and process operatives had much higher unemployment rates than those in higher paid professions. Even during a long period of sustained economic growth that brought rising employment and falling unemployment, employment opportunities were heavily skewed in favour of professional and managerial groups and against the lower paid and unskilled occupations.

ii. Unemployment and education

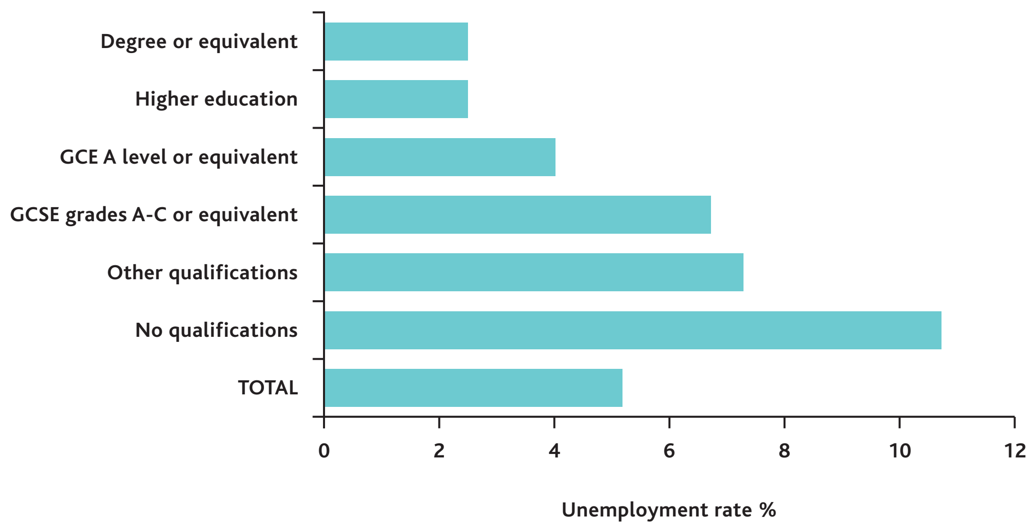
Figure 6 shows that unemployment at the beginning of 2008 was also sharply correlated with educational background. Those with no qualifications were then more than four times as likely to be unemployed as those with degrees, while those with middle level qualifications – A levels and GCSE grades A–C the lowest qualification levels – were also much more likely to end up unemployed.

Figure 5: Unemployment rate by occupation, March 2008



Source: Author's calculations from the Claimant Count Survey (ONS, NOMIS). The denominator used is the average size of the workforce in each occupational category for the period July 2007 to June 2008.

Figure 6: Unemployment rate by qualification level: 1st quarter, 2008



Source: Author's calculations from the Labour Force Survey

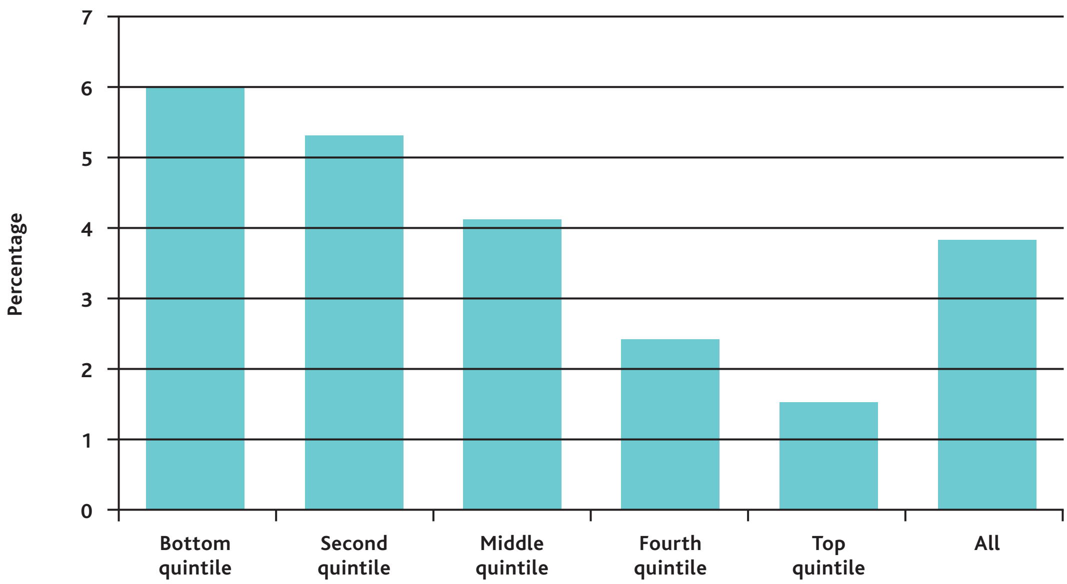
Notes: These figures thus relate to the broader, LFS, definition of unemployment.

iii. Unemployment and pay

What about pay? Earlier studies have shown that the low paid have been particularly vulnerable to unemployment.[19] But how far does such disadvantage extend up the earnings ladder?

Figure 7 shows unemployment rates by previous levels of pay for the first quarter of 2008, just before the onset of the recession. The unemployed have been divided into five earnings groups on the basis of their earnings in their last job, with equal numbers of earners in each group. Each quintile thus represents a fifth of the population. The figure shows that unemployment rates were correlated sharply with earnings paid in their last job. Those with earnings in the bottom fifth when they were in work were four times as likely to be unemployed as those in the highest paying fifth of jobs. Moreover, while the vulnerability of the lowest paid to unemployment has been widely documented, the figure reveals that, although the risk of unemployment falls as earnings rise, it is relatively high amongst middle earners. Those on middle levels of pay in work, for example, were nearly three times as likely to be unemployed as those in the top fifth.

Figure 7: Unemployment rate by earnings level, January–March, 2008



Source: Author's calculations from the Labour Force Survey (LFS) ,Winter 2008 and the Annual Survey of Hours and Earnings, 2008.

Note: The overall level of unemployment shown – 3.8 per cent – is lower than the national LFS unemployment rate – of 5.2 per cent – as all those who have never been employed and those who have not had a job for at least eight years (including, for example, women returning to the labour market after having children as well as the long-term unemployed) have been excluded from the calculations.

4 The impact of the recession

Britain was therefore a highly divided society when it came to access to the labour market even before the start of the recession. So how has the recession affected this pattern of employment disadvantage and opportunity?

Each of Britain's last three major recessions – in the mid-1970s, the early 1980s and the early 1990s – have been predominantly manufacturing recessions, with factories and mines bearing the brunt of rising unemployment. Each of these downturns left the UK with a smaller manufacturing base. They also disproportionately affected lower-skilled occupations, especially in the case of the last two recessions.

It has been widely reported that, in contrast with these earlier downturns and partly because of the rise in the number of professional and managerial jobs noted earlier, the current recession has been a predominantly white-collar one. In October 2008, seven months into the recession, the *Daily Mail* reported the views of the Labour peer and LSE economist, Lord Desai. "It is a middle-class recession in the South, rather than the North, and it will be very different from others we have experienced in the past. It is a dramatic change from the days when workers who lost their jobs were more likely to be 'semi-skilled or manual manufacturing workers." Those most likely to lose their jobs would be "graduates, educated and IT savvy" added the peer.[20]

Six months later the *Financial Times* reported that: "Joblessness is mounting more quickly among professionals than the less-skilled as the recession drives hundreds of thousands of middle-class workers onto the dole".[21] Then in June, *Management Today* argued that it was "white-collar workers who were being hit hardest by recession."[22]

So, in contrast with earlier downturns, is this recession a predominantly middle class, professional recession that has left Middle Income Britons unscathed? It is certainly true that sectors of the economy that have been previously relatively immune from downturns – such as financial services – have been badly affected. Indeed, the recession was triggered in the financial sector with high street banks and the City seeing some of the earliest of the mass lay-offs that were to follow in a number of sectors of the economy. There are plenty of examples of, for example, well paid fund managers, finance directors, architects, PR and advertising executives and marketing and sales managers who have been made redundant and who have not found work months later.

Despite this, it is traditional areas of the economy that have been most severely affected with manufacturing again bearing the brunt of job losses. Table 2 shows that of the 455,000 jobs lost over the year to the first quarter of 2009, manufacturing took the biggest fall of 6.7 per cent. Finance and business services lost 186,000 jobs, a 2.8 per cent fall. Over the same period, the number of jobs in education, health and public administration rose by 168,000. Most of these jobs were in the public sector.

Table 2: Where the jobs have been lost, 1st Quarter 2008 – 1st Quarter 2009

Industry	Fall in number of jobs	Percentage fall in employment
Manufacturing	**212,000**	**-6.7%**
Finance and business services	**186,000**	**-2.8%**
Distribution, hotels and restaurants	**196,000**	**-2.7%**
Transport and communications	**22,000**	**-1.1%**
Construction	**5,000**	**-0.2%**
Other	**18,000**	**-0.4**
Education, health and public administration	**(+ 168,000)**	**(+2.1%)**
ALL	**455,000**	**-1.4%**

Source: UK Workforce Jobs By Industry

Table 3 gives the increase in the numbers unemployed in different occupational groups (based on claimant count data). This shows that in May 2009 there were just over 130,000 more people in receipt of JSA than in March 2008 who previously held skilled middle-class professional jobs (occupational categories 1–3), a rise of nearly 140 per cent. Indeed, the occupational group facing the highest increase in their unemployment rate over this period was 'managers and senior officials', a group which contains the highest paid employees in Britain. It is these figures that led commentators to conclude that we are facing a 'white-collar, middle class' recession.

Nevertheless, these headline figures only tell part of the story. Although the sharpest rises in the rate of unemployment have been amongst higher paid professionals, they still constitute only a tiny proportion of the total number of unemployed. Take those in professional occupations. Their unemployment rate may have risen by 150 per cent over the 14 month period (close to double the average rise of 86 per cent) but it still only stood at 1.3 per cent in May 2009 compared with 0.54 per cent in March 2008. This is a rise of 0.76 percentage points.

Contrast this with those formerly in elementary occupations. Their unemployment rate rose by 56 per cent, around two-thirds of the average. Nevertheless, it stood at 13.7 per cent in May 2009 compared with 8.79 per cent in March 2008, a rise of nearly 5 percentage points. Those in the highest paid professional and managerial occupations (categories 1 to 3) started with very low levels of unemployment (absolutely and relatively) before the recession. Fourteen months in they still exhibit absolutely and relatively low rates of unemployment despite sharp rises in their numbers.

Table 3: Unemployment by occupation, May 2009

	Numbers unemployed March 2008	Numbers unemployed May 2009	Increase/ percentage increase	Unemployment rate May 2009
Previous occupation:				
Managers and senior officials	**30290**	**81475**	**51185 (170%)**	**1.8%**
Professional occupations	**20315**	**50750**	**30435 (150%)**	**1.3%**
Associate professionals & technical	**45270**	**97175**	**51905 (115%)**	**2.3%**
Administrative & secretarial	**82380**	**160450**	**78070 (93%)**	**4.7%**
Skilled trades	**92065**	**213625**	**121560 (132%)**	**8.1%**
Personal services	**41430**	**69320**	**27890 (67%)**	**2.9%**
Sales & customer service	**140515**	**234050**	**93535 (67%)**	**10.5%**
Process, plant & machine operatives	**90570**	**189735**	**99165 (109%)**	**9.0%**
Elementary occupations	**294840**	**459370**	**164530 (56%)**	**13.7%**
ALL*	**839,730**	**1,560,100**	**720370 (86%)**	**5.5%**

Source: Claimant Count data

* The total column includes those for whom the previous occupation was unknown and is therefore higher than the sum of the rows. The overall ILO unemployment rate based on the LFS stood at 7.09 per cent in the first quarter of 2009.

Table 4: Unemployment rate by earnings level, Jan–March 2009

	Bottom quintile	Second quintile	Middle quintile	Fourth quintile	Top quintile	All
Unemployment rate	**9.0%**	**7.2%**	**6.0%**	**3.6%**	**2.3%**	**5.5%**
Ratio of unemployment rate, winter 2009/ winter 2008	**1.5**	**1.35**	**1.46**	**1.5**	**1.53**	**1.45**

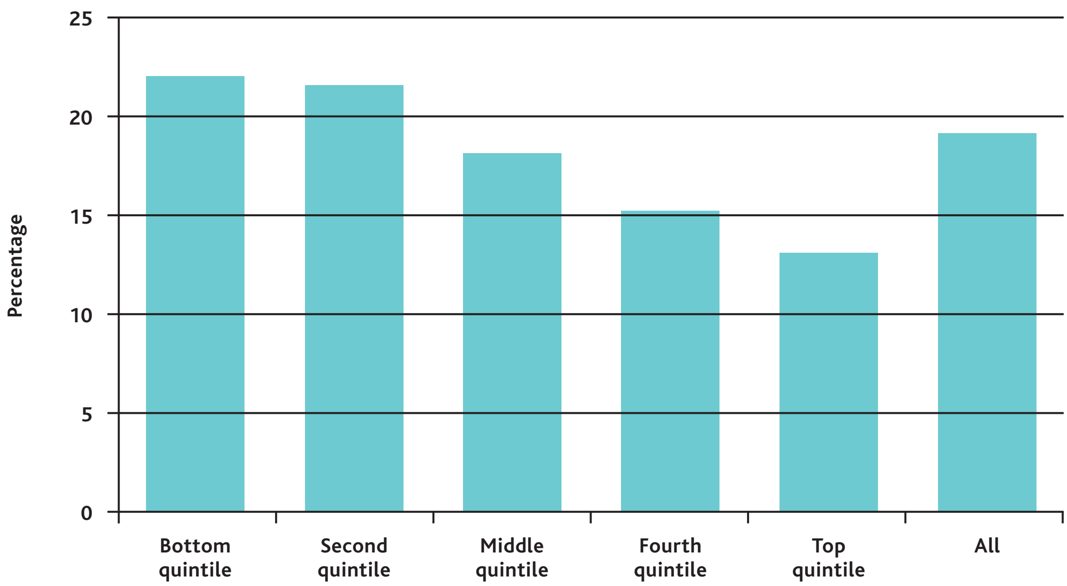
Source: Author's calculations from the Labour Force Survey for the Winter of 2009 and the Annual Survey of Hours and Earnings, 2008.

Notes: The overall level of unemployment shown – 5.5 per cent – is lower than the national unemployment rate – of 7.1 per cent – as all those who have never been employed and those who have not had a job for at least eight years (including, for example, women returning to the labour market after having children as well as the long term unemployed) have been excluded from the calculations.

A similar pattern emerges when it comes to unemployment and earnings. Table 4 shows unemployment rates by earnings brackets for the first quarter of 2009. The second row of the table shows the ratio of the first quarter 2009 rate to that of a year earlier. Again, this shows a sharper rise in the unemployment rate amongst the higher than the lower paid. But because those in the top pay brackets enjoyed very low levels of unemployment before the recession, levels of unemployment at the top remain relatively low and those at the bottom relatively high. The lower and middle paid are still much more likely to be unemployed than the higher paid.

Moreover, the static unemployment level only paints a partial picture of the impact of the recession. It is also important to look at how long those from different backgrounds stay in unemployment and the speed with which they find work. Figure 8 shows that, on average, it is low and middle paying groups who experience the longest bouts of unemployment. Thus 22 per cent of the bottom quintile of earners in the winter of 2009 had been unemployed for more than a year compared with 13 per cent of the unemployed with earnings in the top quintile.

Figure 8: Proportion of Earnings Quintile unemployed for more than 52 weeks, Jan–Mar 2009



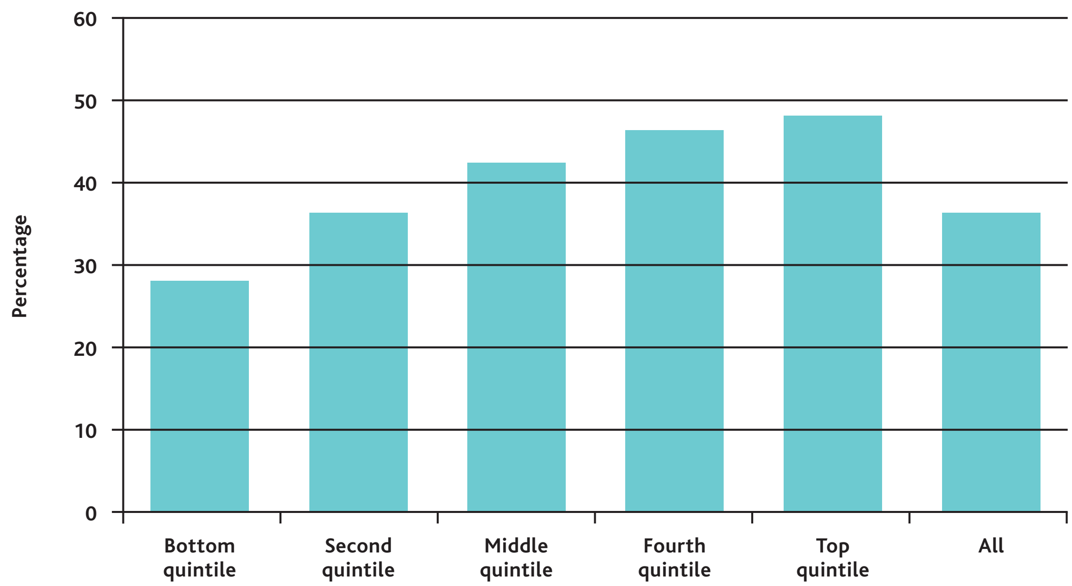
Source: Author's calculations from the Labour Force Survey for the Winter of 2009 and the Annual Survey of Hours and Earnings, 2008.

Further evidence of the impact of the recession can be seen by looking at the experience of those in receipt of Jobseeker's Allowance (JSA), available to those who are economically active and looking for work.

In May 2009, there were 1,560,100 unemployed in receipt of JSA.[23] In the same month, some 354,660 people (23 per cent of the total) left the claimant count. The official figures also show what happens to these 'claimant off-flows'. Some go onto find work or increase their work to more than 16 hours per week, some move onto other benefits, some onto government supported training schemes or approved education and some go abroad while some cease claiming or fail to sign on.[24]

Figure 9 shows the proportion of those in each earnings quintile who leave the claimant count because they have found work. This figure is negatively correlated with the level of pay enjoyed when in work. Thus only 28 per cent of those in the lowest paid quintile left the JSA because they had found work while the comparable figure for those in the highest quintile was 48 per cent.

Figure 9: The proportion leaving the claimant count because thay have found work or increased their work hours to over 16 hours per week, by earnings level, May 2009



Source: Author's calculations from Nomis, Official Labour Market Statistics, ONS and Annual Survey of Hours and Earnings.

These sets of figures suggest that although higher paid groups have been experiencing a rise in unemployment along with lower and middle paid groups, the recessionary labour market favours the better off when it comes to returning to work.

So, although this recession has been caused by a global failure of the financial system, its impact on unemployment patterns has been very similar to the demand-induced recessions of 1974, 1980 and 1990. It is far from the all embracing recession some have claimed. As in those recessions, it is those previously working in skilled trades, as plant and machine operatives, and in elementary occupations who are facing the heaviest rates of unemployment. As the Institute for Fiscal Studies has concluded: "A recession affecting mostly 'middle-class' and 'white-collar' workers has not materialised. The data suggest it is low-skilled, low-educated and younger workers whose labour market prospects have suffered most as the UK entered recession in 2009."[25]

The *Financial Times* has also modified its earlier view. "The burden of rising unemployment in England is falling mainly on the most deprived regions" concluded the paper in a study of the regional impact of the recession. "An analysis of people signing on for the Jobseeker's Allowance in the first four months of 2009 indicates nearly two-thirds of the increase was in areas with above average levels of deprivation. This confirms other data suggesting this downturn, far from being a mainly middle-class recession focused on south-east England, is primarily hitting low-income workers in the traditional industrial heartlands such as the Midlands and northern England."[26]

Far from the brunt of the impact of the recession being born by higher paid professionals, it is the bottom 60 per cent – a mix of the lower and middle paid – who are emerging as the primary losers from the downturn.

5 The disadvantage/ opportunity cycle

The above findings show that disadvantage and opportunity in the labour market are highly correlated with pay and educational qualifications. Those in the bottom 60 per cent of the earnings distribution have not just experienced a declining wage share and a fall in relative wages, they also suffer higher unemployment rates and greater longevity of unemployment. The lower and middle paid are less likely to find work when they come off JSA than the more highly paid.

It is well established that Britain's labour market has a built-in bias against the low paid and unskilled. Successive studies have identified what has become known as a 'low-pay, no-pay cycle'. According to the Treasury, this occurs when "people move between unemployment and low-paid jobs and are not able to use new employment opportunities as a stepping stone up the earnings distribution".[27] This cycle occurs because:

- Low-paid jobs are often short-lived. Men in the bottom of the earnings distribution are nearly three times as likely and women twice as likely to leave work within a year as those at the top.[28] Lower paid jobs tend to be more precarious than higher paid ones.[29] The TUC/YouGov survey for *Life in the Middle* showed that 46 per cent of individuals with household incomes in the lowest quartile and 32 per cent of those on middle incomes had experienced unemployment at some point in the last ten years compared with 21 per cent in the top quintile.
- The low paid who become unemployed are much more likely to return to low paid and often even lower paid work. According to the Treasury, the low paid suffer from 'a scarring effect' which has a negative effect on future earnings.[30]
- The cycle is also most likely to affect people who have few or no formal qualifications. Earnings are strongly correlated with educational qualifications and skill levels while Figure 8 shows that those with lower qualifications are at greater risk of unemployment.

There is also some evidence that the number caught in the 'low-pay, no-pay' cycle may have increased over time. Evidence presented to the Treasury in 1999 showed that the proportion of the working population trapped in this cycle rose from 15 per cent in 1979–83 to 17 per cent in 1990–94.[31]

The figures on the relationship between unemployment, longevity and former earnings suggest that this cycle is not confined to the lowest paid quintile. It extends to the next two earnings quintiles and thus includes middle earners. Take those in the second quintile of earnings. In the first quarter of 2009 they had an average unemployment rate of 7.2 per cent while 21.5 per cent had been out of work for more than a year (Table 4). In the case of the middle quintile, the figures were 6.0 per cent and 18.1 per cent respectively.

This picture of relative disadvantage beyond the lowest income group is reinforced by other individual and household characteristics that help define disadvantage and opportunity and reveal the extent to which Britain remains a society with a deep-seated hierarchy of opportunity and outcome. Most of these characteristics are more unequally distributed than wages. The life chances of those in lower and middle income groups shown in Table 5 are highly circumscribed in a number of important ways. Compared with those in the top two income groups, these groups are:

- less likely to have degrees or any qualifications
- less likely to enjoy a salary-related pension scheme, or indeed any pension scheme
- less likely to have savings
- less likely to hold shares
- more likely to be council or housing association tenants.

Table 5: Disadvantage/opportunity by household income, 2009

	Bottom quintile	Second quintile	Middle quintile	Fourth quintile	Top quintile	All
Proportion with degrees or above	**20**	**17**	**28**	**32**	**61**	**33**
Proportion with salary-related pension scheme	**20**	**35**	**44**	**48**	**58**	**42**
Proportion with no pension scheme	**62**	**42**	**33**	**33**	**18**	**37**
Proportion with no savings	**34**	**26**	**17**	**11**	**5**	**18**
Proportion who own shares	**12**	**18**	**19**	**25**	**43**	**24**
Being a council/housing association tenant	**32**	**24**	**9**	**5**	**3**	**15**

Source: S Lansley, *Life in the Middle*, TUC Touchstone Pamphlet, 2009

Note: These findings are based on individuals by household equivalent income and are therefore not directly comparable with the earlier figures which show characteristics by individual earnings

6 Rebalancing the economy

In the last 15 years, the UK's wider economic and growth strategy has been built around a combination of historically low average real wages, a growing concentration of earnings at the top and a rising dependence on debt.

In the United States – where the wage decline has been greater than in the UK – a number of leading economists have questioned the impact of the low wage model. In 2006, the Nobel-prize winning economist Robert Solow claimed that an economy that doesn't distribute its gain more widely is "poorly performing". In the same year Ben Bernanke, Chairman of the US Federal Reserve, said that corporations should "use some of those [higher] profit margins to meet demands for higher wages from workers".[32] Similar concerns have been echoed in Europe. In 2007 Germany's finance minister called on European companies to "give workers a fairer share of their soaring profits".[33]

The onset of the recession has shown that while Britain's low wage, high debt, financial-services dependent economy was capable of delivering short term economic gains, it was never a sustainable model. The 'wage squeeze' and the increasing concentration of earnings at the top contributed to the factors that led to the recession. Both encouraged greater personal indebtedness. Real wages were not growing fast enough to underpin final demand without excessive borrowing by earners. By contributing to the increased concentration of wealth and income and by raising returns on some forms of financial investment, they encouraged financial speculation and excessive leveraging in financial services and contributed to unsustainable rises in asset prices. The role of inequality has long been an important factor in causing economic instability. In his book, *The Great Crash*, 1929, JK Galbraith identified "the bad distribution of income" as one of five factors causing the stock market crash and the great depression.

Today the recovery itself is threatened by a lack of sustainable demand. Indeed the risk is that, as in previous downturns, the wage share will begin to fall as the economy picks up, accentuating the shortfall in demand created by consumers cutting back on debt and the government's need to reduce spending. The danger now is of a deflationary spiral.

In the UK, the low wage model has also been the subject of growing criticism. In an article in *Prospect* magazine in December 2008, economist Gerald Holtham argued that the way profit growth had outstripped wage growth had contributed to the present crisis. "If profits and output rise persistently faster than wages, who will buy the output?".[34] "In capitalism's last great crisis in the 1970s, the declining share of profits in national income, and the rising share of wages and salaries was the fundamental problem", Tim Lankester, President of Corpus Christi College, Oxford University wrote in the January 2009 edition of the journal *World Economics*. "In the latest crisis, the distribution problem – in so far as it contributed to the crisis – has been different: too large a share of national income has gone to high-income earners and not enough to the lower paid."[35]

More recently, Robert Skidelsky, the biographer of Keynes, has added his voice to the critique. "Keynes argued that excessively unequal income distribution greatly increases the danger of financial instability, leading to economic collapse. He favoured policies of income redistribution to increase what he called the 'marginal propensity to consume'. Instead we have allowed median incomes to stagnate and wealth to pile up in the hands of a financial oligarchy, with growth increasingly reliant on financial speculation and over-borrowing."[36]

So what kind of rebalancing is needed and what impact would it have? This report has argued that a rebalancing of the economy that involved a modest increase in the share of wages and a less unequal distribution of earnings would benefit the wider economy in a number of ways. In particular, it would:

- make the economy less dependent on debt for maintaining demand and produce higher savings ratios
- by creating a more even pattern of returns on investment, lower the premium available on some forms of financial investment that occurred during the boom years and thus limit the level of financial speculation and the unstable cycle of asset prices
- reduce the vulnerability to poverty for those in work and so reduce the scale of compensatory policies needed to tackle poverty in work, thus cutting the rising benefits bill
- increase the incentive to work by reducing the poverty trap.

To measure the actual impact on the economy would require detailed simulations of the changes using a sophisticated model which incorporated the complex economic and financial inter-relationships between wage and profit shares, earnings and wealth inequality and demand, financial activity and asset prices. Such a detailed model does not exist. However, we have been able to undertake a partial analysis of one aspect of the impact.

The TUC commissioned the economic consultants, Oxford Economics, to test the impact of holding the wage share steady at its 2001 level. They produced a projection which holds the share at its at 55.2 per cent rate from 2001 rather than dropping to 53.2 per cent through the middle part of this decade. The consultants then compared the economic impact both on the actual course of the economy from 2001 to 2008 and on its predicted course from 2009 to 2013 (the baseline forecast).

The projection showed that:

- By allowing a slightly higher earnings growth of an extra 0.5 percentage points a year, the initial impact of maintaining the wage share at 55.2 per cent would have been to boost GDP growth through stronger household incomes and consumer spending. Because of higher earnings growth, the model led to a tightening of monetary policy, a slightly higher interest rate than in the baseline forecast, lower company profits and corporate investment.[37]
- Over the twelve year period, the higher wage share leads to consumers running a lower debt-to-income ratio of 143.5, twelve points lower than the 155.4 in the baseline forecast. Consumers take on less debt partly because of greater support from higher incomes and partly because higher interest rates act as a disincentive to borrow and a greater incentive to save.

- Broadly the net effect of holding wages at a slightly higher level is a positive, if mild, boost to consumption and growth, a weaker recession and a slightly faster recovery and lower asset prices and personal debt levels. GDP grows by an average of 0.1 per cent faster in the scenario so that the level of GDP in 2013 is 1.5 percentage points higher than in the baseline.
- Although the UK economy still suffers from a severe recession, this is because the main trigger was the collapse of financial markets and holding wages at a slightly higher level alone would not have prevented the credit crunch. Nevertheless, because consumer balance sheets are less stretched, the peak-to-trough decline in GDP is 5.3 per cent in the scenario compared with 5.8 per cent in the baseline.

If a more sophisticated econometric model had been available, it is likely that a stronger positive impact would have emerged. Moreover, the projection only examines the impact of one element of what needs to be done to rebalance the economy. Because of the nature of such forecasting models it was not possible to examine the impact of a higher wage share on the scale of financial speculation, or the impact of the lessening of the concentration of wealth on asset prices. Because the model cannot adjust for distributional changes, it was also not possible to test the impact of a more equal distribution of earnings.

Tackling the issue of the low wage share is only part of the solution to the lack of sustainability of an economic model built around low wages, high profits, growing inequality and high levels of personal debt. If the rise in the wage share were accompanied by a reduction in the extent of wealth and income inequality, the modest economic gains shown in the scenario analysis would almost certainly be increased. It would lead to increased consumer demand, a lower dependence on borrowing amongst lower and middle income groups, and a more stable pattern of asset prices.

This report has argued that Britain needs a fundamental rethink of its basic economic model, one built on a low and shrinking wage share and one of the world's highest concentrations of earnings. These trends have contributed to wider economic problems from rising personal debt to an over reliance on financial speculation and risk-taking. They have meant that, on average, real living standards have grown more slowly than productive capacity, while rising prosperity has been very unevenly shared. The lion's share of economic progress over the last three decades has been concentrated amongst a small group of winners mostly in the top third of the income distribution. The losers have been a mix of middle and low income households, a majority group that has experienced rises in living standards that fall well short of those enjoyed by the affluent minority.

To rebalance the economy, the trend of an ever declining wage pool needs to be reversed. To avoid a return to the credit fuelled boom of the past, policy needs to shift from a preoccupation with the City and the chasing of ever rising profits. Policy makers need to accept the evidence that declining wages and the soaring earnings gap has contributed to economic instability.

There are some signs of a new recognition of these issues by the Labour leadership. As Ed Milliband put it in the *New Statesman* of 24th September: "Labour at its best has always stood up for lower- and middle-income Britain." Gordon Brown told delegates at Labour's annual conference that "we will not allow those on middle and modest incomes to be buffeted about in a storm not of their making." Despite this, there is no evidence of a strategy designed to stem and reverse the trends that have led to the declining fortunes of these groups. Without such a strategy, middle and lower income groups are likely to continue to lose out when the economy recovers, while the wider risks associated with a continuation of the country's imbalanced economy will simply reappear.

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