



# In-work poverty in the recession

Briefing note

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## Key points

- The growth in unemployment as a result of the recent recession has so far been less than feared, and smaller than in the two previous recessions.
- Part of the explanation for this could be the way in which employers, staff and unions have worked together to avoid lay-offs, by agreeing pay freezes and reductions in working hours.
- Although it is very welcome that unemployment has so far not risen as much as was feared, the downside to this recession is that deals to freeze pay and reduce hours have the effect of lowering earnings, and could push some people into 'in-work poverty'.
- In-work poverty occurs when working families do not have an income that is high enough to lift them over the poverty line.
- In-work poverty has been on the increase over the last decade and this increase has not been dampened by the recession:
  - The proportion of poor children living in working households increased to 61 per cent in 2008/09, up from 50 per cent in 2005/06.
  - There are now 1.7 million poor children in working households compared to 1.1 million in workless households.
  - The number of working-age adults in working households increased by 200,000 in 2008/09 and 60 per cent of poor adults now live in working households.
- Two-thirds of working-poor families are couple families, and 60 per cent of working-poor families have children.
- Couples with children where only one adult is working have a particularly high risk of in-work poverty. Half of working couples with children where neither partner is working part-time are poor; as are one-fifth of lone parents working part-time.
- There are four areas in which action to address in-work poverty can be taken:
  1. **Increasing hourly pay:** raising the minimum wage; campaigning for a 'living wage'; providing in-work support, training and career pathways to low earners; raising performance and productivity in low-paying sectors; and increasing the supply of jobs that pay a decent wage.
  2. **Helping low earners to work longer hours:** a particularly important option for couples where no one is working full-time, this option needs to be balanced against the risk of 'time poverty'; it could be achieved through more flexible and affordable childcare, in-work support and better flexible working opportunities.
  3. **Providing incentives for both partners in a couple to work:** this could be achieved through a Personalised Tax Credit Allowance which would allow a second earner to keep more of their earnings before their entitlement to Working Tax Credit was withdrawn.
  4. **Increasing the value of benefits and tax credits for low earners:** this is a long-term aspiration that is difficult to pursue when cuts to the welfare budget are likely in the near future.

## Introduction

The share of poor households accounted for by working households (as opposed to workless households) has been increasing in the UK over the last decade, with more than half of poor children living in working households before the recession. This note presents new data explaining what has happened to in-work poverty since the recession began, using newly released data covering the period April 2008 to March 2009.<sup>1</sup>

Analysts had thought that the trend towards a greater proportion of poverty being found among working households might be reversed by the recession, as low earners lost their jobs and swapped in-work poverty for workless poverty. However, our analysis shows that this had not happened by March 2009 and that in-work poverty continues to account for a rising share of poverty. This creates a key challenge for the Coalition Government as it sets out its plans for welfare reform and develops its child poverty strategy.

## In-work poverty in the UK

This note updates ippr's 2008 report *Working Out of Poverty: A study of the low-paid and 'working poor'* (Cooke and Lawton 2008). Poor households are defined as those with an income of less than 60 per cent of median household income.<sup>2</sup> The study used data from 2005/06 and preceding years and found that an increasing proportion of poor households contained at least one working adult. Most importantly, it found that half of poor children lived in working households and that the number of children in 'working poor' households had not changed since then-Prime Minister Tony Blair made his pledge in 1999 to end child poverty by 2020. We established that all the progress made in reducing child poverty had been achieved by bringing down poverty among workless households, either by increasing benefit and tax credit payments to these families or by helping these families into work.

While we welcomed the fall in poverty among these households, we were concerned that some families were simply swapping one kind of poverty for another when they moved into work. This meant that the mantra that 'work is the best route out of poverty' was beginning to look increasingly hollow for many families. Government studies have found that a third of families who move into work do not manage to escape poverty, and a significant proportion of those that do subsequently end up back in poverty at some point in the next three years (Browne and Paull 2010).

The fact that the number of children in 'working poor' households had not changed in a decade suggested that the government at that time lacked an effective strategy for tackling in-work poverty. We argued that this risked undermining its anti-child poverty strategy and would make it increasingly difficult to achieve its goal of ending child poverty by 2020. Since the publication of our report in 2008, other studies have demonstrated that the proportion of poor children living in working households has continued to increase and concerns about in-work poverty remain just as important (Kenway 2008; Browne and Paull 2010).

In distinguishing between workless and working poverty, we are not prioritising one kind of poverty over another or suggesting that one kind of poverty is more or less acceptable than the other. Poverty in all its forms is unacceptable in a wealthy nation like the UK and tackling poverty in all its forms should be the focus of government policy. By highlighting the problem of in-work poverty we are seeking to demonstrate the complexity of poverty. Poverty is all too often associated primarily with worklessness, leading to policies that assume getting someone into a job is the end of the story. Our 2008 analysis has showed that this simplistic approach was flawed and that responses to poverty should be based on a more sophisticated understanding of the drivers of poverty.

In its first term, the previous Labour government introduced a number of policies to 'make work pay', most notably the national minimum wage and Working Tax Credits. Although these would be of benefit to the 'working poor', the explicit goal was to increase work incentives for workless adults rather than to address in-work poverty directly. Later, the Labour government began to address in-work poverty more explicitly, through the piloting of in-work advisory support and work-based training for low-skilled workers.

1 This report uses the Households Below Average Income 2008/09 dataset, which is derived from the Family Resources Survey.

2 All figures in this report use income measured before housing costs unless otherwise stated.

The Coalition Government has yet to set out its detailed strategy for tackling child poverty and so we do not yet have a clear sense of whether and how it plans to address the problem of in-work poverty. The 2010 Child Poverty Act enshrines in law the goal of eradicating child poverty by 2020 and requires the Government to publish its child poverty strategy by 25 March 2011. Labour MP Frank Field is currently chairing a Government review into child poverty that will report in autumn 2010 and is likely to include proposals for broadening the definition of poverty and taking a more holistic approach to tackling poverty. This note is designed in part to feed into this review and to highlight the ongoing challenge of in-work poverty among families with children.

Although we do not yet have a detailed anti-poverty strategy from the Coalition Government, there are a number of reforms on the agenda that could have implications for in-work poverty, including the welfare reform plans being developed by the Department for Work and Pensions. Secretary of State Iain Duncan Smith is determined to radically redesign the benefit system so that it provides much stronger financial work incentives to people out of work. While benefit simplification and 'making work pay' is vital, the Secretary of State's strategy paper *21st Century Welfare* (Department for Work and Pensions 2010) makes no mention of in-work poverty and places a great deal of faith in the ability of work to lift families out of poverty. The figures presented in this note pose a challenge to this approach and we hope that our analysis will be taken on board as the Department finalises its welfare reform plans.

### The recession, employment and in-work poverty

The 2008/09 recession was devastating for all those it affected. However, one of its surprising features was the smaller-than-predicted effect on employment. Table 1 shows the percentage point fall in GDP for the 2008/09 recession compared to the previous two UK recessions, together with the increase in unemployment nine quarters after each recession began. In previous recessions, the changes in unemployment and GDP have been comparable. In the 2008/09 recession, GDP fell 6.4 percentage points while unemployment rose by only 2.5 percentage points. Unemployment in the second quarter of 2010 stood at 7.8 per cent, which is high compared to pre-recession levels but lower than at comparable points in the last two economic cycles.

**Table 1**  
Change in GDP  
and unemployment  
during recessions

Recession	Change in GDP (percentage points)	Change in unemployment nine quarters after start of recession (percentage points)	Unemployment rate nine quarters after start of recession
2008/09	-6.4	+2.5	7.8
1990/91	-2.5	+2.8	9.9
1980/81	-4.6	+4.6	10.4

Source: Office for National Statistics (2010a) and Office for National Statistics (2010b)

Note: The first quarters of recession are taken to be Q1 1980 for the 1980/81 recession, Q3 1990 for the 1990/91 recession and Q2 2008 for the 2008/09 recession.

This recession's limited impact on employment (so far) has been widely greeted with relief. Although unemployment now stands at 2.46 million, there is widespread recognition that it could have been much worse. There is much talk of this recession being different: in many workplaces, employers, unions and staff worked together to find alternatives to lay-offs rather than allow the recession to kindle industrial disputes and strike action. Workers accepted offers of reduced hours, pay freezes and voluntary redundancies in order to avoid compulsory mass lay-offs. Redundancies did happen – 1.8 million between the second quarter of 2008 and the second quarter of 2010 (Office for National Statistics 2010b) – but they were less prevalent than feared. This is the 'success story' of the 2008/09 recession (if such a thing is possible): the UK's flexible labour market helped us to cope with the fall in output better than in previous recessions.

However, the possible downsides of this 'success story' have hardly been discussed. Reduced hours and pay freezes translate into lower earnings for workers, many of whom were not on particularly high wages to start with. The number of people working part-time because they cannot find a full-time job has increased by over 400,000 since the start of the recession (Office for National Statistics 2010b). Some of these reductions in pay may have been compensated for by an increase in tax credit entitlement, but not all – many workers affected by pay cuts will be just over the income threshold for working tax credits and others are not claiming it, even if they are entitled. There is a

risk, therefore, that while unemployment did not rise as much as expected, some families could have been placed at greater risk of poverty – specifically, in-work poverty – as a result of the recession.

### Trends in poverty in the UK

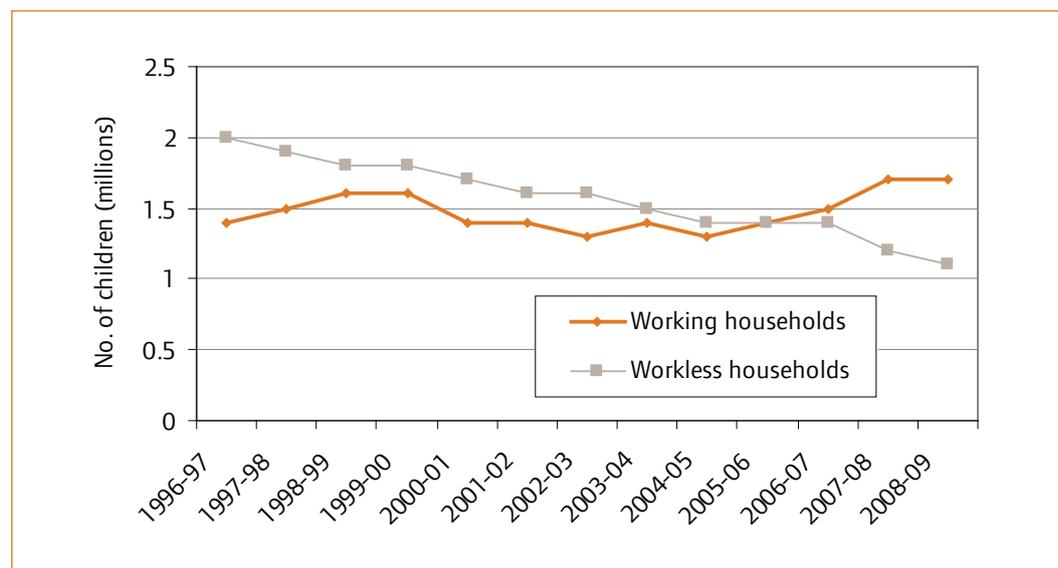
Across the UK, just under 11 million people – equivalent to 18 per cent of the population – were identified as poor in 2008/09, based on their household income before housing costs. This total was made up of 2.8 million children, 5.8 million working-age adults and 2.3 million pensioners. Poverty among these three groups has shown different trends over the last decade, with falls in child and pensioner poverty but a rise in poverty among working-age adults.

Over the last decade, child poverty has received the most policy attention, following the government's pledge to end child poverty by 2020. In 2008/09 child poverty fell for the first time in three years, by 100,000; since 1998/99, the number of poor children has fallen by a total of 600,000.

Figure 1 shows the changing nature of child poverty in the UK. The number of poor children living in workless households has steadily fallen since the mid-1990s, while the number of poor children in working households remained fairly stable up to 2006/07. In that year, the number of poor children in working households (1.5 million) exceeded the number in workless households (1.4 million) for the first time. Between 2006/07 and 2007/08, an additional 200,000 children in working households fell below the poverty line.

The latest figures for 2008/09 show no change in poverty among children in working households, while child poverty in workless households fell by 100,000. This means that during the first part of the recession, workless poverty among children continued its previous decline. Although the trend towards rising in-work poverty was halted in the latest year of data, the recession has not led to a reversal in the trend towards an increasing proportion of poor children living in working households. When Tony Blair pledged to end child poverty within a generation, less than half (47 per cent) of poor children had working parents. Now, that figure stands at 60 per cent.

**Figure 1**  
Trends in child poverty, by household working status



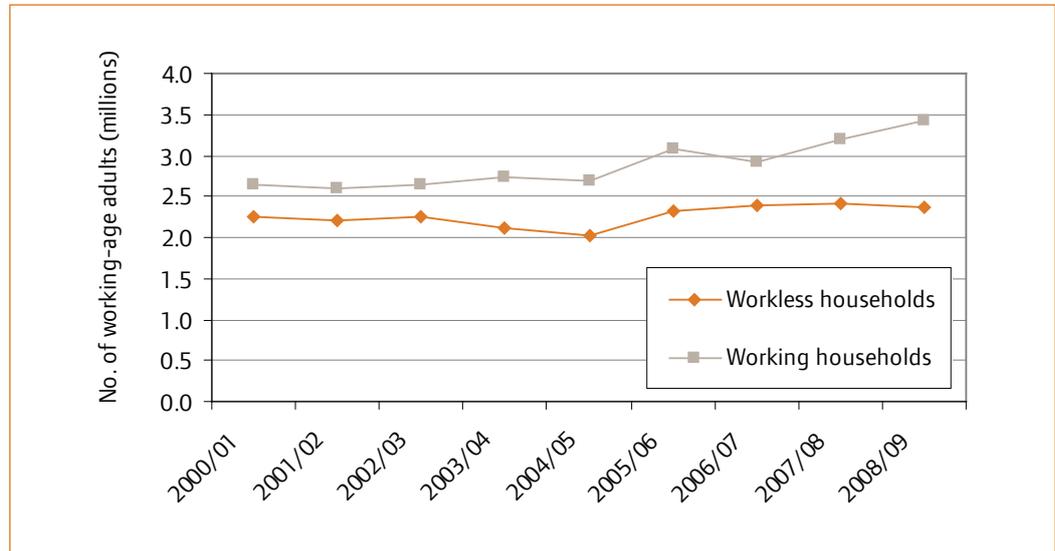
Source: Department for Work and Pensions (2010)

Figure 1 shows that all the progress made in reducing child poverty during Labour's three terms has taken place among workless households. This is largely because of rising employment rates leading up to the recession and an increase in the value of benefits and tax credits paid to workless families. Between 1997 and 2007, the number of workless households overall fell by 200,000 as strong economic growth increased employment rates (Office for National Statistics 2010c). Conversely, no progress has been made on reducing working poverty among households with children, with signs of an increase over the last few years.

Trends in poverty among working-age adults show a different pattern than for children. Figure 2 shows that among this group, there have consistently been a greater number experiencing working poverty than workless poverty during the 2000s. Poverty among working-age adults has increased

by almost 1 million since 2000/01, largely because adults without children have not been the focus of policies designed to reduce poverty. The majority of this increase can be accounted for by an increase in working poverty – up by 800,000 since 2000/01, compared to an increase of 100,000 in workless poverty. Figures for 2008/09 show that the recession has not halted the increase in working poverty among working-age adults, whereas workless poverty among this group remained stable. In 2008/09, 60 per cent of poor adults were in work compared to 55 per cent in 2000/01.

**Figure 2**  
Trends in poverty levels for working-age adults 2000/01–2008/09



Source: Department for Work and Pensions (2010)

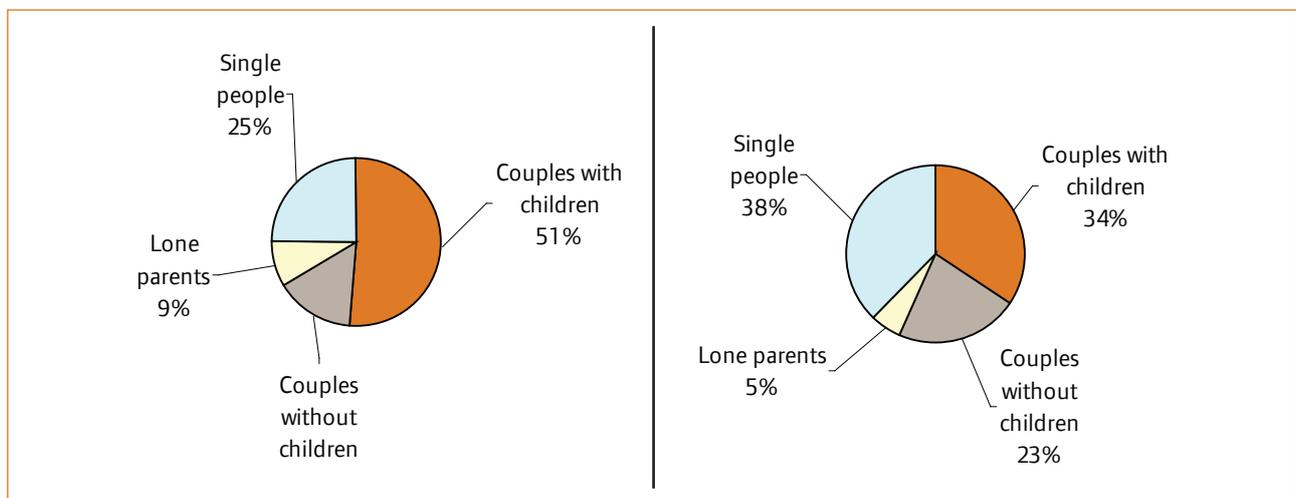
Figures 1 and 2 show, both in numerical and proportional terms, that in-work poverty now accounts for a bigger share of the poverty experienced by children and working-age adults than at the start of the decade. Where progress in tackling poverty has been made – among children – this has been achieved by reducing poverty in workless households. Where poverty has increased – among working-age adults – this has been primarily the result of an increase in in-work poverty. The recession appears to have made little difference to the trends of a growing proportion of poor children and adults being found in working households.

**Figure 3 (left)**  
Composition of all working-poor families

**Who are the working poor?**

**Figure 4 (right)**  
Composition of all working non-poor families

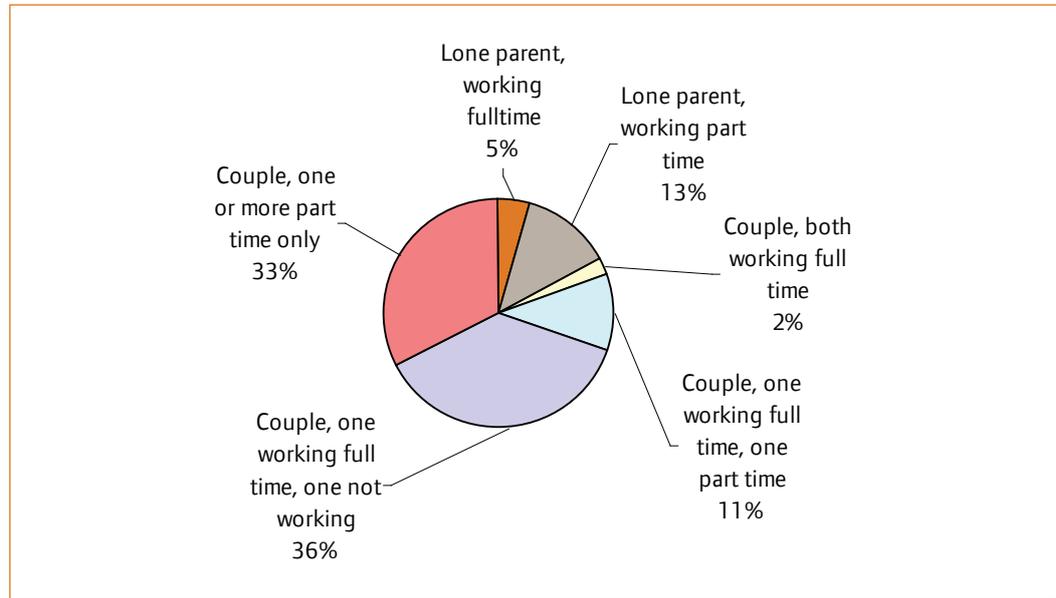
Figures 3 and 4 show the composition of working families who are poor and not poor. As Figure 3 shows, two-thirds of working poor families are couple families, and couples with children make up over half of all working poor families. Overall, 60 per cent of families experiencing in-work poverty have children. Among working non-poor families, 43 per cent are single people or lone parents, and just under 40 per cent are families with children.



Source: Authors' calculations using Households Below Average Income 2008/09 data

Figure 5 focuses on working poor families with children. The most striking feature is that over 80 per cent of these families are couple families, and most are families where only one partner is working or where no one is working full-time. Previous analysis by ippr has indicated that, in approximately nine out of 10 families where no one is working full-time, there is in fact only one earner (Cooke and Lawton 2008). We can therefore estimate that single-earner couples account for around two thirds of working poor families with children.<sup>3</sup>

**Figure 5**  
Composition of working-poor families with children



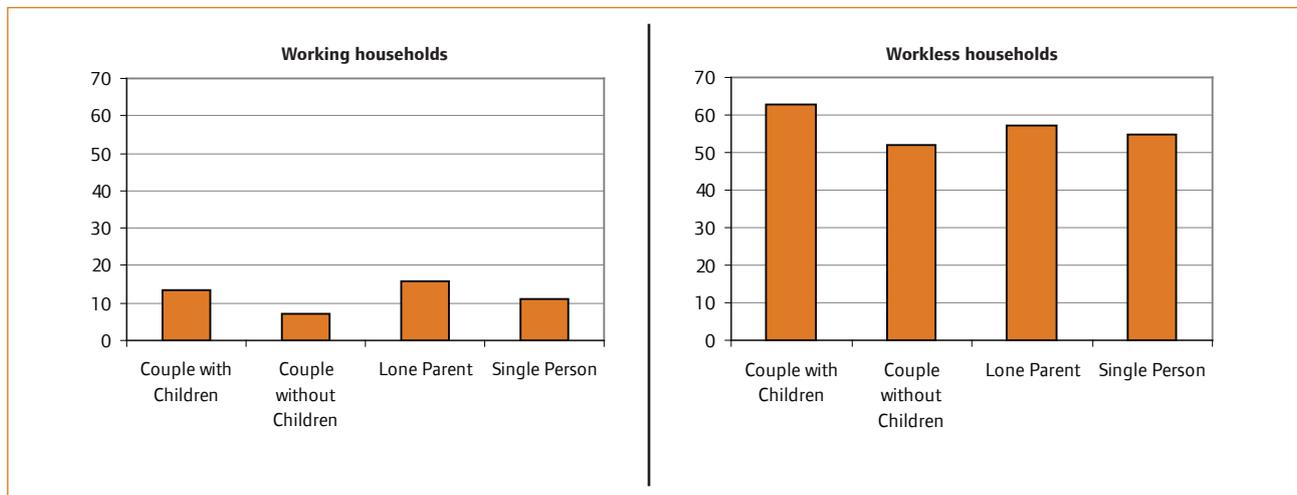
Source: Authors' calculations using Households Below Average Income 2008/09 data

Our analysis shows that to make a serious impact on the challenge of in-work poverty, policies will have to address the needs of couple families in particular. Within this group, couples where only one person is working will need extra support.

**Figure 6**  
Risk of poverty for different family types: working households (left), workless households (right)

**Who is at the greatest risk of in-work poverty?**

Figure 6 shows that the risk of poverty for working families is much lower than for workless families, regardless of family type. However, because there are many more working families overall, in-work poverty affects a greater number of families than workless poverty. Figure 6 shows that working lone parents and couples with children are more likely to be living in poverty compared to couples and single people without children.

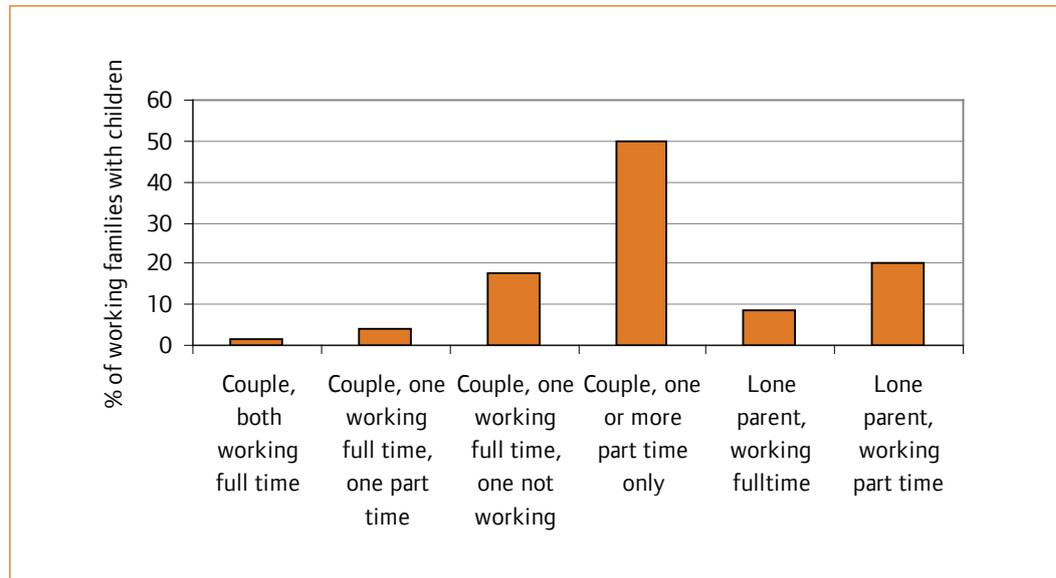


Source: Authors' calculations using Households Below Average Income 2008/09 data

<sup>3</sup> This is made up of 90% couples where no one is working full-time (90% of 33% = 30%) plus the 36% of working poor families with just one earner to make 66% of all working poor families with children.

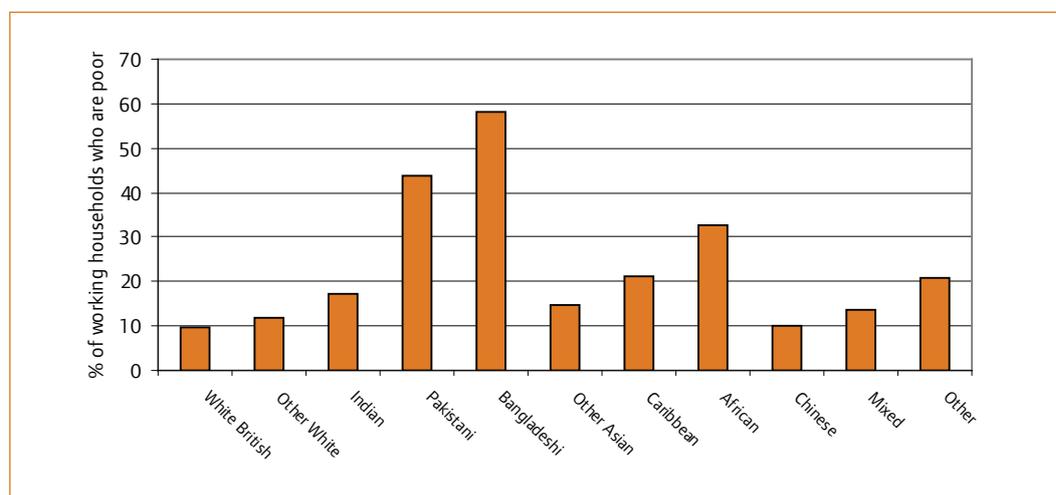
Unsurprisingly, couple families with children where both partners are working have a very low risk of poverty, as figure 7 shows. This risk is higher for families with children where only one adult is working; and half of couples where no one works full-time are poor. Less than 10 per cent of lone parents who are in full-time work are below the poverty line, but this doubles to 20 per cent for lone parents working part-time.

**Figure 7**  
Risk of working poverty among families with children



The risk of in-work poverty also varies between different ethnic groups. Figure 8 shows working households defined as poor as a proportion of all working households, by the ethnic origin of the head of household. Over 45 per cent of households are headed by someone from a Pakistani or Bangladeshi background. Poverty is also relatively high among working Black African families, at nearly a third.

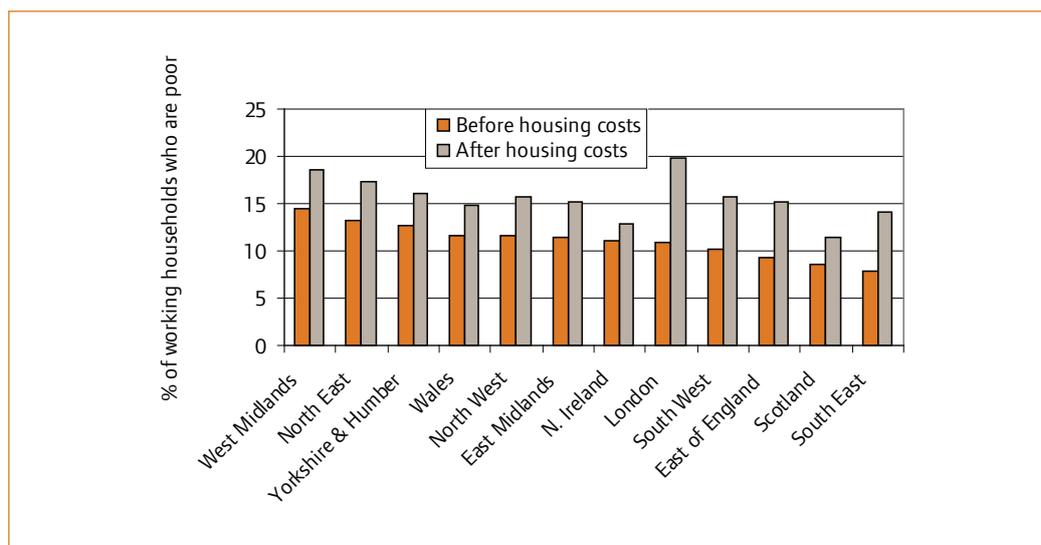
**Figure 8**  
Risk of working poverty, by ethnicity



Source: Authors' calculations using Households Below Average Income 2008/09 data

Figure 9 highlights the difference in poverty rates across the regions and nations of the United Kingdom. Whether poverty is measured before and after housing costs is crucial, because housing costs vary so much across the UK. On a before-housing-costs basis, the rate of in-work poverty in London is similar to other regions; measured after housing costs, in-work poverty in the capital is much higher than elsewhere. This reflects the much higher cost of housing in London. In-work poverty is particularly low in Scotland and the South East, and higher in the West Midlands and the North East.

**Figure 9**  
Risk of working  
poverty, by region



Source: Authors' calculations using Households Below Average Income 2008/09 data

## Tackling in-work poverty

Although the risk of poverty for working families is much lower than for those without work, the number of working families in the UK means that working poverty is accounting for a growing share of poverty across the country. It is therefore a serious challenge for everyone concerned about reducing poverty, particularly among children. The data presented above shows that in-work poverty is linked to family type and working patterns, as well as ethnicity and place. Drawing on the evidence presented in this paper, we have identified four key drivers of in-work poverty and seek to provide some possible policy solutions.

### 1. Pay

The relationship between pay and poverty is not straightforward. Households of different sizes need different amounts of money to enjoy the same standard of living. At the same time, earnings are not the only sources of income for households: benefits, tax credits, investment income and pensions can also be important. Analysis from our previous report found that just 7 per cent of low-paid workers<sup>4</sup> lived in poverty (Cooke and Lawton 2008). While this sounds like a small proportion, less than 2 per cent of all workers lived in poor households, so the risk of poverty for a low-paid worker is much higher than for other workers.

The most straightforward way to raise hourly earnings is to directly increase wages, for example, by **raising the minimum wage** or paying workers a '**living wage**'. ippr has recommended that the minimum wage should rise at least in line with average earnings growth – measured over an economic cycle to allow for flexibility in light of particular labour market circumstances – to ensure that the wages of the lowest paid keep in touch with average earners (Cooke and Lawton 2008). We have also proposed a **higher minimum wage for London**, in recognition of the larger gap between low and median earners in the capital compared to the rest of the UK (Cooke and Lawton 2008).

Living wage campaigns across the UK aim to ensure that workers can achieve an hourly wage capable of supporting their living costs. The London Living Wage has been the most successful of these campaigns, with over 80 organisations signed up, including the Greater London Authority, Barclays Bank, KPMG and a number of charities (including ippr) and universities. Living wage campaigns have been led by civil society, highlighting the role of the third sector and businesses in tackling low pay.

Low-wage workers can also be supported to move into higher paying jobs, for example, through **work-focused training and in-work advisory support**. Programmes which have piloted these approaches have shown mixed results (Riccio et al 2008; Miller et al 2008), but some vulnerable people who have a high risk of getting stuck in low-wage work could benefit from continuing in-work support. Studies from the US show that programmes that develop **career pathways**, which

<sup>4</sup> A worker is defined as low-paid if their hourly earnings are less than 60 per cent of full-time median earnings.

link low-paid jobs to intermediate and higher level roles, can help low earners move up (Dresser 2007; Duke et al 2006). Providing advancement support can be complex and the results – in terms of higher wages – may not be evident for many years.

Looking to the longer term, it seems there is unlikely to be a significant reduction in employer demand for low-wage, low-skill workers over the next two decades (Lawton 2009; UK Commission for Employment and Skills 2010). We have argued for **decisive action to address the balance between low-wage and higher paying jobs in the UK**, and particularly to tackle low pay in sectors like retail, hospitality and care.

One way to do this would be to further **integrate and decentralise employment, skills and economic development**. This would ensure that efforts to increase both employment and workforce skills are joined up with strategies for enterprise and economic development, helping to increase investment, innovation and skill utilisation alongside improvements in workforce skills (Lawton 2009). The new Local Enterprise Partnerships would be an ideal vehicle for this work. The UK could also benefit from programmes that promote **improvements in workplace performance and productivity**, drawing on successful programmes in the US and Europe (Lawton 2009).

## 2. Working hours

Evidence presented above shows that in-work poverty is a higher risk among families where no one is working full-time, so one way to address in-work poverty is to help low earners work longer hours. Many low earners already do this; others find it difficult because of other responsibilities, like looking after children or elderly relatives. Some features of the Working Tax Credit (WTC), like the 30-hour credit, are designed to incentivise people on low wages to work longer hours.

Working more hours to compensate for low hourly earnings is not appropriate for everyone. Some low earners have caring responsibilities that prevent them from working longer hours and researchers have identified tensions between reducing income poverty at the expense of ‘time poverty’ – meaning, for example, that parents could have less quality time with their children if they are working longer (Burchardt 2008). Families have to make their own decisions about how to achieve the right balance for them, but if low earners want to work more hours, they should be provided with the right support.

The provision of **affordable and flexible childcare** has improved remarkably over the last decade, yet many parents still find it difficult to find childcare that fits in with the hours they want to work. Pilot programmes have shown that **financial assistance and in-work support** can help lone parents to increase their hours (Riccio et al 2008).

Some people’s working hours are limited by a health condition, and condition management programmes and the entrenchment of **flexible working opportunities** could help these workers to raise their hours.

## 3. Number of adults in work

Many low earners manage to avoid poverty by living with other people who work. For example, young people starting out in their career in low-wage work can avoid poverty by living with their working parents. Our analysis has found that the risk of in-work poverty falls significantly for couple families where both people work and is almost non-existent where both adults are working full-time. However, this is not a realistic option for all families, for example, if one adult cannot work full-time because of a disability or caring responsibilities.

Nevertheless, enabling other adults in a household to work would help couple families, who make up the bulk of working poor families and have the greatest risk of poverty if they only have one earner. This tactic has some of the same challenges as helping low earners increase their hours and families may have to make trade-offs between extra income and time pressures. Again, flexible, affordable and accessible childcare and better flexible working opportunities can be vital.

Another option would be to introduce an individual entitlement to the WTC so that partners have a financial incentive to move into work. Currently, tax credits are assessed on a household basis, so that any extra earnings from a second earner are partially offset by the withdrawal of the WTC. The first earner in a household can earn up to £123.46 a week before their entitlement to WTC starts to be withdrawn, but no such ‘means-test free’ allowance exists for the second earner. This significantly lessens the financial gain if the partner of a low earner moves into low-wage work themselves.

A **Personalised Tax Credit Allowance (PCTA)** would give all adults in eligible families their own personal allowance, allowing them each to earn, for example, £123.46 before the family's WTC entitlement starts to be withdrawn. ippr's calculations have shown that the introduction of a PCTA would almost always benefit the state as well as families, through higher tax receipts and lower spending on other means-tested benefits (Cooke and Lawton 2008). ippr has previously estimated that around three-quarters of couples with children claiming WTC (about 560,000 families) have only one earner (Cooke and Lawton 2008).

The PCTA has the added benefit of encouraging both partners to work, not necessarily both full-time, rather than encouraging one partner to work longer hours. This makes it more likely that work and care responsibilities would be spread across both partners rather than divided along gender lines, as they often are currently. Improving work incentives always involves some 'deadweight costs' where people are already doing what the incentive is trying to promote. Time-limiting the PCTA or placing an upper family-earnings limit on eligibility would focus the incentive on the lowest-income couples and reduce deadweight costs.

#### 4. Other sources of income

Low earners can avoid poverty by drawing on income from other sources. Usually, this involves claiming **benefits and tax credits**. People in work are entitled to universal benefits like Child Benefit and some low earners can also claim means-tested benefits like Housing Benefits and WTC.

ippr has previously argued that the value of WTC should be increased by one-third to reflect the higher poverty line for couples (Cooke and Lawton 2008). Currently, couples and lone parents are entitled to the same maximum amount of WTC. However, we recognise that this would be an expensive change that would be difficult to prioritise at a time of very limited public expenditure and likely cuts to welfare spending.

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