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## Abstract

This paper traces the effects of the recent recession in the economy at large and on the incomes of the poor in particular. While the recession has been more severe than others in the past twenty-five years, the expansion of the transfer system and several progressive tax cuts have cushioned a significant portion of the aggregate income loss. The number of poor individuals did increase, but they were eligible for greater than average income cushioning through the new tax and transfer provisions.

# Some Effects of the 1974-1975 Recession on the Level and Distribution of Income

## Introduction

The recent recession, the longest and most severe of the post-World War II era, began about September 1974 and reached bottom about June 1975. Presently we are in a period of recovery--the gross national product (GNP) is increasing in real terms, and unemployment is falling. However, a year after the bottom of the recession, the current unemployment rate of 7.9 percent (August 1976), is at about the same level as was recorded at the bottom of the 1957-1958 recession, the deepest postwar recession until the present one.

The next two sections trace the effects of the recent recession on the economy at large and on the incomes of the poor in particular. While the recession has adversely affected those individuals with incomes below the poverty line, cyclical fluctuations are not now the major cause of poverty as officially defined [Gottschalk, 1976]. If we use a relative measure of poverty (such as the Gini coefficient or the share of the bottom quintile) and examine inequality across the entire range of incomes, the relative position of the poor probably has not deteriorated at all during this recession. The incomes of the poor have fallen, but the incomes of the nonpoor have fallen as well, and possibly by relatively larger amounts. Long-term trends in the economy--the growth of social welfare expenditures, the expansion of transfer programs, demographic change, and the unchanging structure of the labor market--are the primary determinants of the economic welfare of the poor [Plotnick and Skidmore, 1975].

In the last section the distributional impacts of the recent recession are placed in the context of the trend of income inequality over the past twenty-five years. One important consequence of this recession on the poor may prove beneficial in the years ahead. Two progressive tax reductions have been passed in response to the stagnation of the economy. If these reductions are made permanent, then a severe recession may provide the stimulus for a long-run improvement in the relative position of the poor.

## Economy-Wide Effects of the Recent Recession

From the fourth quarter of 1973 through the first quarter of 1975, GNP in constant dollars fell by 6.6 percent. The duration, five quarters, and the size of this decrease make it the most severe recession in recent times. The recession of 1969-1970, although lasting for five quarters, produced a drop of only 1.1 percent in real GNP; the recessions of 1953-1954 and 1957-1958, were of shorter duration and produced declines of 3.3 percent [Economic Report of the President, 1976].

Unemployment increased rapidly, from 5.1 percent in the second quarter of 1974 to 8.9 percent in the second quarter of 1975, an increase of about 75 percent. Adult men (20 years and older) experienced the largest increase in unemployment, their jobless rates more than doubling, from 3.4 to 7.1 percent. Although the rates for other demographic groups did not increase as much, these rates were higher than the levels experienced by adult males. Youths (ages 16 to 19) had the highest rate, 20.5 percent, but the smallest rate of increase (about 35 percent, from 15.2 percent a year earlier). The differential increases in unemployment by occupation were even more striking than those by demographic group. Blue collar unemployment more than doubled from 5.3 percent in the second quarter of 1973 to 12.9 percent in the second quarter of 1975. White collar unemployment during the same period increased from 3.0 to 5.0 percent [St. Marie and Bednarzik,1976]. Despite the larger rise among blue collar workers, this is a relatively large rise for white collar workers. The recession was so severe that it affected not only the low-wage end of the labor market, but the economic mainstream as well.

While the loss in output and the increase in unemployment are the familiar, easily measured effects of a recession, they are not the only ways in which individuals experience economic adversity. Many individuals retained their jobs but worked fewer hours--either through reduced overtime, or through an increase in involuntary, part-time work. Discouraged workers also drop out of the labor force in response to reduced job opportunities. About one million workers were classified as discouraged in 1975; about eight million, as unemployed. Neither of these effects are captured in the aggregate unemployment rate, although they are reflected in the GNP data. Recessions also reduce opportunities for promotion for many workers and deny labor-market experience to others. Again, these effects are not officially measured, but have a long-lasting effect on future earnings streams. These adverse effects are not offset by any government programs. In the aggregate, by the end of 1975, the average spendable weekly earnings of nonagricultural workers in private industries had fallen (in constant dollars) to about the levels that prevailed during 1967. Household income in 1975 (in constant dollars) had also fallen, but by less than wages, partly because of the increase in the number of earners per family and the growth of the transfer system.

Government transfers provided a greater cushion against the loss of earnings during the recent recession than in previous ones because of secular growth in both the number of programs and their size, and because of special provisions adopted during the past two years.

> In this recession, per capita real disposable income fell from peak to trough by one half of 1 percent, compared to a drop of 4 percent in per capita real disposable income net of transfers. By contrast, in the 1958 recession per capita real disposable income fell by 2 percent from peak to trough, while per capita real disposable income net of transfers declined 3 percent [Economic Report of the President, 1976: 81].

In 1958 the ratio of government cash transfers to wage and salary disbursements was about 10.8 percent; in 1975 this ratio had doubled to about 22 percent. Despite the length and severity of this recession, individuals in the aggregate suffered smaller losses in disposable income than in past recessions.

Part of the increased cushioning effect of transfers is due to the expansion of the unemployment compensation system. In 1950, 59 percent of all wage and salary earners were covered by the permanent federal unemployment compensation system, whereas 85 percent are now covered. In the past, the normal duration of eligibility for benefits was 26 weeks, with an additional 13 weeks triggered by high unemployment rates. However, during the recent recession, Congress temporarily added an additional 26 weeks of eligibility (for a total of 65 weeks) for previously-covered workers (Federal Supplemental Benefits). It also extended the basic coverage of 39 weeks to unemployed workers not eligible for regular benefits because of employment in previously uncovered occupations (Special Unemployment Assistance covered among others, farm workers, domestic workers, state and local government employees.) [Palmer and Minarik, 1976]. At present only the self-employed, unpaid workers in family firms, and new labor force entrants and reentrants, remain uncovered. In 1975, about 5 million persons, two-thirds of the unemployed, received unemployment compensation each week. In 1973 only about one-third of the unemployed received these payments.

In 1974, the last year for which data are presently available, 42 percent of all household units received government cash transfers, averaging $2800, from one or more of the following programs--Social Security, Public Assistance, Unemployment Insurance, Workmen's Compensation, government pensions or veterans benefits. About 95 percent of aged units received at least one of these payments. For the non-aged, about 60 percent of female-headed units, and about 25 percent of male-headed units also received some form of cash payment. The transfer system has broad coverage, but categorization does prevent many low-income families with prime-age male heads from receiving benefits. If data on in-kind transfers were available, these percentages would be slightly higher. This average transfer of $2800 was 25 percent of the median income of all families and unrelated individuals. For low-income units, transfers comprised over 60 percent of total income. The effects of the recession on these low-income units, who are dependent on government transfers at every stage of the business cycle, will now be examined.

## Effects of the Recent Recession on the Poor

Most of the unemployed are eligible for some form of unemployment compensation. Those with low incomes may also be eligible for benefits from several income-tested programs (e.g., AFDC-UP, Food Stamps, Medicaid). Because of these programs and the recently enacted tax changes, the poor--at least those who receive all the transfers for which they are eligible--may have suffered a relatively smaller decline in spendable income than those with higher income. This in no way suggests that the recession was "good" for the poor, since even relatively small losses in income for poor families may cause serious hardship. It should also be emphasized that the participation rates of eligibles in many programs, especially those that are means-tested, are low.

An increase in unemployment increases the number of poor persons. As income rises the probability of unemployment falls, but for those who do suffer spells of unemployment, the percent of earnings replaced by transfers declines as income rises [Gramlich, 1974]. For example, an unemployed head of household who previously worked at the minimum wage could be entitled to between 50 and 80 percent of previous aftertax earnings, if he/she received benefits from Unemployment Compensation, Public Assistance and Food Stamps. A head of household who previously earned high wages would be entitled only to the maximum unemployment compensation payment, replacing about one-third of his/her previous aftertax earnings [Barth et al., 1975]. Female heads experience a smaller reduction in incomes than male heads. Holding incomes constant, larger families also have smaller reductions. Of course these are only hypothetical examples, since unemployment compensation benefits vary widely across states, since many eligibles do not receive program benefits, and since less than one-half of the states have adopted the unemployed parent provision of AFDC. In 1975 there were large increases in the numbers of recipients of income-tested programs, with an especially large increase in the number receiving Food Stamps. In 1975, 19.2 million families received food stamps,up from 13.5 million in 1974, with participation of about 4 million due to the recession [Barth et al., 1975].

Low-income households have been aided during the current recession not only by the transfer system, but also by two temporary tax reductions that have been enacted, the Tax Reduction Act of 1975 and the Revenue Adjustment Act of 1975. Both of these have progressively rebated large sums to low-income households. Two provisions of these acts are particularly noteworthy. First, the per capita credit allows a constant reduction in tax liabilities for all taxpayers, regardless of income. Second, the earned income credit for low-income families with dependent children provides a cash rebate of up to $400 in excess of tax liabilities. On average, families with earnings below $7000 saved between $300 and $400 relative to their 1974 tax liability.

If these provisions are maintained or expanded, then the recession will have produced significant tax reform. Not only are all households with incomes below the poverty line exempt from the federal income tax, but some of these families receive cash rebates. It should be noted that the tax proposals contained in President Ford's State of the Union

Message would eliminate both the per capita credit and the earned income credit. In addition, they have been extended only through 1977.

## The Recent Recession and the Trend in Income Inequality

What then happened during the recent recession? The recession has been more severe than others in the past twenty-five years. Yet, the transfer system and the tax changes have cushioned a significant portion of the income loss in the aggregate: while the number of poor individuals has increased [Garfinkel and Plotnick, 1975], they are provided greater than average cushioning. However, precise data on their utilization of transfer programs is still unavailable.

The recessionary increase in the number of poor persons as defined by the official poverty line should be counterbalanced in the near term by the expansionary economy. The recession is unlikely to have any significant short-term effect on the degree of income inequality, but it may have produced the basis for future reductions in income inequality.

The record of income inequality since World War II has been one of stability [Danziger and Smolensky, forthcoming 1977]. Earnings inequality has increased throughout the period [Henle, Schultz, 1972] and the shifting demographic composition of household types has also increased inequality over the long term [Kuznets, 1972 and 1974; Rivlin, 1975; Danziger and Plotnick, 1975]. Cash transfers have grown both absolutely and as a share of personal income and have counteracted these trends. The 1974 data show, and the 1975 data are likely to confirm, a small increase in pretransfer inequality due to the recession, but no change in total income inequality due to the increased cushioning effect of transfers.

While the tax system has drifted from progressivity to proportionality during the past twenty-five years [Reynolds and Smolensky, 1975], the temporary tax provisions induced by the recession have countered this trend.

These tax reforms together with the continuing expansion of the government transfer programs offer some hope for reducing inequality in the near term. However, the increasing inequality in the distribution of earnings generated by the labor market may continue to counterbalance the effect of government actions as it has during the recent past.

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