

The Good, The Bad, and The Ugly About Recessions

by Andrew Brod

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The Triad continues to receive bad economic news. VF Corporation has announced that it will lay off about 13,000 workers nationally. Burlington Industries has filed for bankruptcy protection. And a steady stream of lay-off announcements has come from smaller companies such as aircraft-maintenance provider TIMCO and furniture maker Klaussner.

Not all of this news is due to the recession we appear to be in. But we do appear to be in one, and with that in mind a primer on recessions seems in order: what they are, how long they last, and whether they contain any good news at all.

First of all, what is a recession? The definition you hear most frequently in the media is that a recession is at least two successive quarters of declining real (i.e. inflation-adjusted) gross domestic product, or GDP. However, while this is usually a symptom of recessions, it's not actually the definition used by economists.

The private National Bureau of Economic Research is widely accepted as the most authoritative voice on what is and is not a recession. According to the NBER's definition, "a recession is a significant decline in activity spread across the economy, lasting more than a few months, visible in industrial production, employment, real income, and wholesale-retail trade."

The NBER's definition takes into account a number of economic indicators. And because the NBER wants a monthly picture of the business cycle, it focuses on variables other than GDP, which is updated only quarterly and is subject to substantial revision.

Economywide employment (not the unemployment *rate*) is the single most important variable the NBER considers in deciding whether the U.S. economy is in recession. Employment reached a peak in March 2001 and has declined since then, at about the same rate as in past recessions. Industrial production hit its peak earlier, in September 2000.

Muddying the picture slightly is real personal income, which has continued to rise through October, though at a slower pace than before this spring. A committee of NBER economists will meet at some point and weigh these data and decide whether a recession started in March 2001, at some later date, or not at all.

Because so many of these economic data are only available months after the behavior they reflect took place, calling recessions always involves analyzing the past. This is why macroeconomic forecasting is so different from weather forecasting. If rain is forecast for tomorrow, then we'll know tomorrow whether it rained or not. But if a recession is forecast for December, we'll have to wait for months before we know if December's economic experience was in fact recessionary.

In April 1991, the NBER announced that a recession had begun in July of the previous year. In December 1992 it announced that the recession had ended in March 1991. In other words, our last recession was over before the economists were able to say for sure that it had started.

While the NBER's economists deliberate, the rest of us guess. And it's a good guess that the U.S. economy has been in recession since last spring. Since World War II, recessions have lasted a little less than a year on average. The shortest recession on record was six months, which has given rise to the misconception that two quarters of declining real GDP is in fact the definition of a recession. And no recession since the Great Depression has lasted for more than 16 months.

So if this recession is an average one, it should be over by the spring of 2002, which is in fact what some economists are predicting. At the outside, it could last through next summer.

The relative shortness of recessions explains why federal jobs programs generally do nothing to counteract them. By the time the program is put in place, the recession is usually over.

Every recession is a little different than the others. Some are driven by government policy, such as the sharp and concurrent increases in domestic and military spending in the late 1960s.

Some appear to be triggered by "supply shocks," dramatic events like the OPEC oil embargo in 1973 and the drop in agricultural productivity that hit the economy in 1972. The terrorist attacks of September 11 may turn out to be mid-recession supply shocks that aggravate the current downturn.

And there are regional differences among recessions. The one that ended in early 1991 left residual pockets of economic hardship well into 1992. That many of these pockets were in populous states like California helped presidential candidate Bill Clinton win that fall's election.

The current recession appears to have hit manufacturing-intensive states like North Carolina especially hard. It's hit even harder in the Triad, which is the region in the state most dependent on manufacturing. And in fact the local experience illustrates another point about recessions, which is that sometimes it's difficult to detect which economic hardships are caused by the recession and which are caused by longer-term structural changes in the economy.

For example, many of California's problems in the early 1990s derived from downsizing among defense contractors in the wake of the fall of the Soviet Union. Similarly, there were problems in North Carolina's textile and apparel industry long before this year. "It's the recession" is often a convenient excuse when workers are laid off.

But the difference between a recession and those longer-term structural changes is important, because recessions are cyclical. This means they carry within them the seeds of the next economic expansion.

During the first Bush administration, Treasury Secretary Nicholas Brady was once asked what the government could do about the impending recession. His reply: “The tide comes in, the tide goes out.” Brady was criticized for being insensitive, but he was right about the inevitability of recession.

But perhaps Brady chose the wrong metaphor from nature. Instead of a tide, think of a forest fire. Like tides, forest fires just happen, though not regularly or predictably. Many species of pine tree depend on fire to break open seed cones and allow them to germinate. So forest fires are beneficial, and it is now standard for forest managers to implement controlled burns in order to realize those benefits. Similarly, recessions happen, though not regularly or predictably. And they confer benefits as well as generate costs.

As a recession progresses, inventories get drawn down and eventually need rebuilding, which increases business spending. Prices of capital and raw materials eventually get bid down far enough to spur new investment and purchases. Households also notice lower prices, which eventually generates more consumer spending. Companies that can weather the storm emerge leaner and meaner and more productive.

A useful leading indicator of a recession’s imminent end is the length of the work week. During recessions, employers lay off all but their most productive workers (hence the recent reported increase in labor productivity).

As the economy begins to turn around, companies work that core of employees harder and harder in response to increased demand, thereby increasing the average work week. Ultimately, the recession ends as companies take on new employees.

In manufacturing the average work week has been holding steady at a little over 40 hours at the national level, a bit below that in the Triad. When the work week finally begins to lengthen, it’ll be a good bet that the start of the next economic expansion is close at hand. The much tougher question is just when we’ll see that average work week get longer.

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