

Defining the R-word

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What is a recession?

WHEN your neighbour loses his job, it is called an economic slowdown. When you lose your job, it is a recession. But when an economist loses his job, it becomes a depression. This old joke probably contains a grain of truth about the way economists perceive the severity of recessions. But what, exactly, are they?

According to a popular rule of thumb, recessions are defined by at least two consecutive quarters of declining GDP. However, the National Bureau of Economic Research, America's official arbiter of recessions, takes a more sophisticated approach. A recession, it says, 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 recession-dating committee does not actually look at GDP figures, because they come out only quarterly, not monthly, and are continually revised. Last year's figures initially showed that output fell in only one quarter, but revised figures now show three consecutive quarters of decline.



The NBER defines a recession as an absolute decline in economic activity. However, some economists view it as a period when growth falls significantly below its long-term potential. This makes more sense where an economy's potential growth rate shifts over time, or when comparing economies that are growing at different speeds. Suppose country A has a potential growth rate of 4% and country B one of only 2%. A growth rate of 2% in country A will cause unemployment to rise, but in country B it will leave unemployment unchanged. By this definition, country A would be in recession.

The Japanese have long defined a recession as below-trend growth. By that definition, they suffered several recessions between 1950 and 1992 even though during that period their country's GDP fell in only one year. Their average annual growth of under 1% in the 1990s, compared with over 4% in the 1980s, makes their decade-long recession as deep, by this gauge, as in many economies during the Great Depression. The snag with this definition is that potential growth rates are devilishly hard to estimate. An easier definition of a recession is a drop in GDP per head. This would allow for the fact that America's population is rising, whereas Japan's and Europe's is flat, so slow GDP growth in America can leave the average person worse off.

The choice of measure makes a huge difference when comparing the severity of recessions. Suppose that America's potential growth rate is 3.5%, as the optimists claim, and that the economy grows by an average of less than 2% a year over the next few years, as this survey will suggest it might. If so, the total shortfall in output relative to potential over the four years to 2004 would amount to 8% of GDP, making this the worst recession since 1945.