The Washington Times

Close Print

Wednesday, October 14, 2009

The worst recession?

Richard W. Rahn

Is the current recession the worst since the Great Depression? Even though the president, many members of Congress and many journalists keep saying we are in the worst recession since the 1930s, it is an assertion that is premature, to say the least.

At the end of World War II, from 1945 to 1946, there was a very sharp drop in U.S. output (12.1 percent) as the war economy began its transition to a civilian economy. The deepest and longest-lasting recession the United States has experienced since then began in 1980, when Jimmy Carter was president (the gross domestic product dropped 9.6 percent in the second quarter of that year) and did not end until fourth-quarter 1982, almost two years into the Reagan presidency. There were positive quarters during this almost three-year period, resulting in what is known as a double-dip recession, but GDP did not return to the 1979 level until well into 2003. Unemployment peaked at 10.6 percent in the fall of 1982.

As can be seen in the accompanying chart, both President Reagan and President Obama inherited an economy suffering from a year of no growth, along with rising unemployment. (The numbers are almost identical.) But Mr. Reagan faced a far direr situation in that inflation was in the double digits and the prime interest rate was at 20 percent. In contrast, Mr. Obama inherited an economy in which inflation was falling (in fact, inflation has been close to zero for this year) and interest rates were very low.

A situation in which the number of jobs available is falling is bad enough, but if inflation is also destroying purchasing power, the misery is compounded. In the 1960s, economist Arthur M. Okun created the Misery Index by adding the unemployment rate to the inflation rate. In the 1976 presidential race, Jimmy Carter frequently attacked President Ford for allowing the Misery Index to reach 13.57, even though it was lower when Mr. Ford left office than what he had inherited from the Nixon years. Ironically, four years later, when President Carter was running against Ronald Reagan, the Misery Index reached a record high of 21.98. Mr. Carter had no defense and lost the election. The Misery Index dropped by more than 10 points during the Reagan presidency, the single largest improvement during any president's tenure in the last half-century.

Economists do not fully agree on the precise definition of a recession, even though a recession is commonly referred to as two or more consecutive quarters of negative economic growth. The private National Bureau of Economic Research (NBER) has served as an authority for defining recessions in the United States. The NBER uses a number of factors - including judgment and not just GDP changes - to characterize a recession. Other economists and organizations, such as the International Monetary Fund, use different definitions than the NBER. Recessions may be as short as eight months, like the 1990-91 and the 2001 recessions, or may continue for a couple of years. Depressions normally are defined as a downturn of 10 percent or more, lasting for more than four years.

President Obama has taken the polar opposite approach to President Reagan's to reignite the economic-growth engine. Reagan pushed for cuts in marginal tax rates to encourage people to work, save and invest in an effort to spur the supply side of the economy as well as the demand side. Mr. Obama has chosen only to greatly increase government spending in an attempt to increase demand while, at the same time, many of his new labor, environmental, energy and other regulations are impeding the supply side of the economy.

Mr. Obama had the advantage of both houses of Congress being controlled by his party, so he was able to get his stimulus package passed within a few weeks of taking office. Reagan was handicapped by having the opposition party in control of the House of Representatives, whose members both delayed (until August 1981) and reduced his tax-reduction stimulus package.

In fact, the Reagan tax cuts were not fully phased in until 1983, more than two years after he assumed office. Reagan, hobbled by an opposition Congress, was not able to get the spending-growth restraint he wanted, so substantial budget deficits occurred early in his administration, at one point reaching 6 percent of GDP. In retrospect, the Reagan deficits look small compared to the deficit of 13.5 percent of GDP this year and the Obama administration and Congressional Budget Office projections of huge deficits in the years to come.

Once Reagan's tax cuts were largely phased in, the economy took off - it grew by 7.6 percent in 1984 alone. We are in the midst of a most interesting experiment. The administration and the CBO forecast moderate and uninterrupted economic growth between the end of this year and 2019. If they are correct, 1980-82 - not the current recession - will remain the longest sustained period without economic growth since World War II. If they are wrong, they indeed will have the worst economic downturn since the Great Depression and no one to blame but themselves.

Richard W. Rahn is a senior fellow at the Cato Institute and chairman of the Institute for Global Economic Growth.