What is a Recession and Who Decided When It Started?

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Summary

The National Bureau of Economic Research (NBER) recently announced that the economy had reached a cyclical peak and that a recession had begun in December 2007. A recession is one of several discrete phases in the overall business cycle. The term may often be used loosely to describe an economy that is slowing down or characterized by weakness in at least one major sector like the housing market. When used by economists, "recession" means a significant decline in overall economic activity that lasts more than a few months. NBER business cycle dating committee is the generally recognized arbiter of the dates of the beginnings and ends of recessions. With all statistics it takes some time to compile the data, which means they are only available after the events they describe. Moreover, because it takes time to discern changes in trends given the usual month-to-month volatility in economic indicators, and because the data are subject to revision, it takes some time before the dating committee can agree that a recession began at a certain date. It can be a year or more after the fact that the dating committee announces the date of the beginning of a recession. Just as it took some time for the business cycle dating committee to determine when the recession began, it is likely to be some time after the fact that they determine when the recession has come to an end.

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Introduction

On December 1, 2008, the National Bureau of Economic Research confirmed what many had suspected for some time – that the economy was in a recession. They announced that the economy had reached a cyclical peak, and that a recession had begun in December 2007. The term "recession" may often be used loosely to describe an economy that is slowing down or characterized by weakness in at least one major sector like the housing market. When economists use the term, however, they try to do so consistently. Recessions typically have common characteristics and so economists try to identify the beginning and ending dates of recessions in order to further their overall understanding of the economy.

What is a Recession?

A recession is one of several discrete phases in the overall business cycle. The beginning of a recession is known as a business cycle "peak," and the end of a recession is referred to as a business cycle "trough." In 1946, Arthur Burns and Wesley Mitchell published a study of business cycles and offered a definition intended as a guide for further study:

> Business cycles are a type of fluctuation found in the aggregate economic activity of nations that organize their work mainly in business enterprises: a cycle consists of expansions occurring at about the same time in many economic activities, followed by similarly general recessions, contractions, and revivals which merge into the expansion phase of the next cycle.[1]

This definition requires both expansions and recessions to be apparent in *many economic activities* at about the same time, which would seem to exclude an economy exhibiting weakness in a single market.

More recently, economists at the National Bureau of Economic Research (NBER), issued a memo with a slightly more precise definition:

> A recession is a significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production, and wholesale-retail sales. A recession begins just after the economy reaches a peak of activity and ends as the economy reaches its trough. Between trough and peak, the economy is in an expansion. Expansion is the normal state of the economy; most recessions are brief and they have been rare in recent decades.[2]

This is the generally accepted view among economists of what constitutes an economic recession. There is also a commonly cited "rule of thumb" that is referred to in the press. That rule is that a recession is two consecutive quarterly declines in real gross domestic product (GDP). But this rule does not always apply. For example, there was a recession beginning in March 2001 and

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[1] Arthur F. Burns and Wesley C. Mitchell, Measuring Business Cycles, National Bureau of Economic Research, 1946, p. 3.

[2] Business Cycle Dating Committee, Memo, National Bureau of Economic Research, Jan. 7, 2008, 3 pp. Available on the internet at http://www.nber.org/cycles/jan08bcdc_memo.html.

ending in November 2001 that was not characterized by two successive quarterly declines in real GDP.

In any case, an important distinction is that a recession is a period of declining output and not just a period of slower economic growth. It is possible for GDP growth to be positive yet so slow that the unemployment rate rises. This is sometimes referred to as a "growth recession."

Who Decides When the U.S. Economy is in a Recession?

Among economists, the NBER is the generally accepted arbiter of business cycle turning points.[3] The NBER is a private nonprofit and nonpartisan organization that was founded in 1920. In the beginning its focus was on the macroeconomy, business cycles, and long-term growth, but now it seeks to promote research on a wide variety of topics. For many years, the NBER itself determined the dates of swings in the business cycle. In 1978, however, a separate *business cycle dating committee* was formed. The members of the committee are appointed by the president of the NBER, and they are now responsible for determining the dates of the beginnings and ends of recessions.[4] The current members of this committee are

- Robert Hall, Chair – Director of NBER's Program of Research on Economic Fluctuations and Growth, and Professor at Stanford University;
- Martin Feldstein – President Emeritus of NBER, and Professor at Harvard University;
- Jeffrey Frankel – Director of NBER's Program in International Finance and Macroeconomics, and Professor at Harvard University;
- Robert J. Gordon – NBER Research Associate, and Professor at Northwestern University;
- James Poterba – NBER President, and Professor at MIT;
- David Romer – Professor at the University of California, Berkeley;
- Victor Zarnowitz – Senior Fellow at the Conference Board, and Professor Emeritus at the University of Chicago.

How Do We Know When a Recession Starts?

One important indicator of economic conditions is growth in real gross domestic product (GDP). GDP statistics are compiled each quarter, and thus there is a time lag between the first month that is reflected in the data and the release of the data. For example, the first release of data for the first calendar quarter of a given year does not occur until late April. The data from that release is

[3] The NBER website is at http://www.nber.org.

[4] A working paper published by the Bureau of Economic Analysis found that "[t]he NBER dating committee's methodology appears to be very robust." See Bruce T. Grimm, "Alternative Measures of U.S. Economic Activity in Business Cycles and Business Cycle Dating," Bureau of Economic Analysis Working Paper 2005-05, Aug. 2005.

subject to revision in each of the next two months and may be revised later on as well. It is not inconceivable that a first release of data that showed a decline in real GDP would later be revised to show an increase. Even so, those using the rule of thumb that two successive quarterly declines in real GDP constitutes a recession would have to wait for the release of the second quarter data in August to establish that a recession began at the start of the year.

Because of the time lag associated with the release of GDP data, and because business cycle turning points are associated with months rather than quarters, the dating committee relies on a number of monthly economic indicators. Among the more important monthly indicators the committee looks at are personal income, employment, and industrial production. Even in the case of monthly indicators, it may require several months of data to establish a change in trends.

When there is a recession, not all of the economic indicators may show a change in trend at the same time. Historically, some indicators, such as housing starts and the stock market, tend to slow or decline in advance of a recession, and some, like the unemployment rate tend to react to changing conditions with a lag.

With all statistics it takes some time to compile the data, which means that the statistics are only available after the events they describe. Moreover, because it takes time to discern changes in trends given the usual month-to-month volatility in economic indicators, and because the data are subject to revision, it takes some time before the dating committee can agree that a recession (or an expansion) began at a certain date. **Table 1** shows, for recent business cycle peaks and troughs, the date of the turning point and the date when the committee issued a release identifying the date of the turning point.

Table 1. Dates of Recent Business Cycle Turning Points and the Dates They Were Announced by the NBER

Turning Point	Date of Turning Point	Date Turning Point was announced by NBER	Months After Turning Point
peak	January 1980	June 3, 1980	5
trough	July 1980	July 8, 1981	12
peak	July 1981	January 6, 1982	6
trough	November 1982	July 8, 1983	8
peak	July 1990	April 25, 1991	9
trough	March 1991	December 22, 1992	21
peak	March 2001	November 26, 2001	8
trough	November 2001	July 17, 2003	20
peak	December 2007	December 1, 2008	12

Source: National Bureau of Economic Research.

The longest delay between the beginning of a new phase of the business cycle and its announcement was when a recession was found to have ended in March 1991 but was not announced until 21 months had passed. The shortest delay was five months after the expansion ended in January 1980. Of the eight examples shown here, four were not announced until at least a year had elapsed.

Rhetorical and Analytical Significance

While all recessions have unique characteristics, they also have many common aspects. Thus they are the object of economic analysis both individually and collectively. Because they are undesirable, economists study them in the hope that they can advise policymakers how to avoid them. To do so, it is important to agree on a chronology, and it may not be an inconvenience to economists that it takes time to establish one.

Policymakers, on the other hand, are more concerned with the present and the immediate future. If they hope to avert or mitigate the consequences of recession, they cannot wait for an "official" declaration. By then the recession may be history.

Although there can be a significant delay between the onset of a recession and the dating committee determination, there is often little doubt that the economy is, or has been, in recession well before the announcement.[5] For policy measures to have mitigating effects, they must be timely. Policymakers may not have the luxury of holding themselves to as strict a definition of recession as economic analysts.

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[5] Just as it took some time for the business cycle dating committee to determine when the recession began, it is likely to be some time after the fact that they determine when the recession has come to an end.