NAME____ Class Period ______

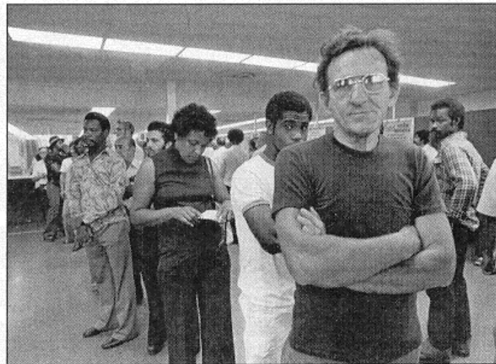
ECONOMICS
HOMEWORK ASSIGNMENTS
DUE FRIDAY, MAY 15, 2009

I. Why Recessions Happen

With unemployment on the rise, consumer confidence in free-fall, and spending spiraling down, most economists believe the U.S. is either in recession or about to be. What makes economies run out of gas?

How do we know we're in a recession?

For consumers, it's a bit like pornography—you know it when you see it. But economists are more precise. The traditional definition of a recession is two consecutive quarterly declines in gross domestic product—the nation's total output of goods and services. The National Bureau of Economic Research, a nonpartisan body of economists, now determines the official start and end dates of recessions, using a range of criteria to confirm "a significant decline in economic activity." The bureau looks for declines not only in GDP but in personal income, employment, industrial production, and wholesale and retail sales. The bureau has yet to declare this economy in recession. But judging by the standard of the late economist John Kenneth Galbraith, things don't look good. Whenever a leader says the economy is "fundamentally sound," Galbraith warned, "all who hear these words should know that something is wrong."



Getty Images

A deep recession: Lining up for jobless benefits in 1980

What causes recessions?

Recessions usually result from excess capacity, when supply exceeds demand. When the economy is expanding, businesses build factories, buy inventory, and hire staff. But businesses often misgauge the market's long-term appetite. When anticipated demand falls short, businesses respond by closing plants, firing workers, and discounting merchandise. As the downturn spreads, it becomes contagious, discouraging job growth, spending, and investment. Today's economy suffers in part from excess housing capacity, which drove down home prices before rippling through the rest of the economy.

Do markets always fall in a recession?

Oddly, markets often rise while the economy contracts. When Franklin Roosevelt took office in 1933, the economy was in ruins, but the stock market had already rallied 30 percent from its 1932 bottom. However, markets often anticipate downturns, falling sharply before a recession. They can also jump the gun, as in October 1987, when the Dow Jones Industrial Average fell 508 points in a day. Many analysts concluded that a recession was inevitable, but the economy continued growing until July 1990. An old Wall Street joke credits the stock market with predicting "10 of the past five recessions."

How long have recessions been with us?

As long as we've had market economies. Since the mid-1800s, when reliable economic data first appeared, the U.S. has suffered 32 recessions. One of the worst occurred in 1873. The economy had boomed following the Civil War, leading newly affluent Americans to speculate on rising stocks. But a real estate bust in Europe led to the collapse of Jay Cooke & Co., then the largest U.S. bank, sending "a coal-black steed named Panic" thundering down Wall Street, in the words of one journalist. In the subsequent sell-off, many speculators lost everything, and consumer and industrial demand withered. The recession lasted more than five years.

Is every recession initiated by a market panic?

No. The 1990–'91 recession was launched, in part, by the end of the Soviet Union and of the first Gulf War. The defense industry, which had ballooned during the Reagan-era military buildup, contracted sharply. Defense-related jobs were lost, manufacturing and exports plummeted, and the U.S. economy shrank 1.3 percent.

What is the worst modern recession?

The recession of 1980–'82, during which unemployment topped 10 percent for the first time since the Great Depression. The industrial Midwest was especially hard-hit, with employment in the steel industry alone falling 30 percent. If a recession lasts longer than two years, with unemployment of 25 percent or more, it's designated a depression. Since 1900, the U.S. has experienced only one—the Great Depression, which engulfed most of the 1930s.

Are recessions getting worse?

Just the opposite. The 22 recessions prior to the end of World War II lasted an average of 20 months. The 10 recessions since have averaged half that. One explanation is that the Federal Reserve has gotten better at providing countercyclical stimulus—that is, pumping money into the economy when everyone else is pinching pennies. Unfortunately, recessions are not the only thing getting milder. So are recoveries. After the 2001 recession, employment remained stagnant for two years, a period some call the "jobless recovery."

How do recessions end?

When demand again exceeds supply. That's when businesses start hiring again and consumers feel secure enough to spend. But recoveries, like recessions, are not all alike. In a "V-shaped" recession the economy experiences a sharp drop, followed by a steep recovery. But in an L-shaped recession, the economy stagnates for years without recovering. That's what happened in Japan in the 1990s. The U.S. recession in the early 1980s was W-shaped. The economy dipped, began to recover, and then plunged again before finally bouncing back. If current projections of impending recession are accurate, we may get a U-shaped recession, with a flat period followed by gradual growth. Avoiding a prolonged downturn will likely require massive federal stimulus. "There is only one institution in the world that can borrow enough for long enough to counteract all those recessionary forces," says famed investor and Obama economic advisor Warren Buffett. "And that's the United States Treasury."

Recessions and presidential politics

Recessions can exert great influence on presidential elections. Richard Nixon blamed his 1960 loss to John F. Kennedy in part on the recession that marked the end of Dwight Eisenhower's presidency. As Eisenhower's vice president, Nixon shared the blame for the bad economy, at least in voters' minds. Bill Clinton defeated George H.W. Bush by constantly invoking the nation's economic worries and assuring voters, "I feel your pain." But perhaps the most effective attack on a recession-plagued incumbent came from Ronald Reagan during his 1980 campaign against Jimmy Carter. With unemployment at around 8 percent and discontent high, Reagan offered a simple lesson in politics masquerading as economics. "A recession," he would say, "is when your neighbor loses his job. A depression is when you lose yours. And a recovery is when Jimmy Carter loses his."

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II. Questions

Answer the following questions on a separate sheet of loose-leaf paper using the article on the first page.

1. How do economists define a recession?
2. What factors does the National Bureau of Economic Research look at to determine if there is a recession?
3. How does overproduction cause recessions?
4. Why did the economy boom after 1873 and how did that result in a recession?
5. What turns a recession into a depression?
6. Why are recessions becoming milder and what affect does this have on recoveries?
7. How do recessions end?

III. Political Cartoon

IV. Questions

Answer the following questions on a separate sheet of loose-leaf paper using the cartoon above.

1. What is the first person saying in this cartoon, and what is the last person in the cartoon saying?
2. What caused this shift?
3. What point is the cartoonist trying to make about our current economic situation?