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## **2001 Recession In Perspective: Economic and Budget Situation**

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# 2001 Recession In Perspective: Economic and Budget Situation

By John S. Irons

## Summary

A comparison of the last three recessions shows that even while declines in total output in the 2001 recession were smaller than average, the recovery has been weaker than average. In particular, the employment situation has seen substantial deterioration relative to the start of the recession as well as compared to past recessions.

The budget outlook is particularly troubling. Despite the relatively small drop in total output, federal government revenue has dropped to record levels, and record surpluses have turned into record deficits in a few short years. Comparisons with past recessions show that the deterioration in the budget situation is unlikely to be due to the economic situation, and that current tax and budget policy are likely to blame.

## Introduction

The recession that began in March 2001 was relatively mild by historical standards when measured by total output. The recession saw just three quarters of negative growth and a cumulative output decline of less than 1% of gross domestic product (GDP). By the end of 2001, GDP had fully recovered to pre-recession levels.

Economic performance since the end of the recession in November 2001, however, has been weak – averaging just over 2.5%, which was below the average growth rates in the previous two recoveries.

When looking at employment measures, recent economic performance has been much worse. The unemployment rate has risen from 4.2 percent at the beginning of the recession to the current rate of 6.2 percent. In addition, the number of jobs has fallen by around 2.6 million.

Despite the relatively small drop in total output, federal government revenue has dropped to 16.4% of gross domestic product (GDP) – the lowest level since 1959. In addition, deficits have reached a record \$455 billion after being in surplus at the start of the recession.

A natural question to ask is whether the current economic and budget situation is somehow “normal” in the recovery period just after a recession. This report attempts to answer that question by comparing the economic and budget performance of the current recovery with that of the two previous recoveries. Each recession and recovery cycle contains unique characteristics; however, this comparison should shed some light on how the economy is currently performing, and on how successful economic policy has been in recent years.

Unfortunately, we find that policies that were sold as economic and job stimulus did not do their job. Instead we are faced with job losses, massive deficits, and very little stimulus “bang for the buck.”

The next two sections compare the current 2001 recession and recovery cycle with the past two recessions in terms of general economic performance and the budget situation respectively.

## Economic Performance

Figure 1 shows the growth rate of total output as measured by GDP over the past 5 years (the shaded portion marks the beginning and end of the recession as determined by the National Bureau of Economic Research (NBER). The NBER determined that the recession began in March 2001 and ended in November of that same year.

While the recession was brief and rather mild, total output growth for most of the past two years of the recovery has continued to be below average. In total, aggregate output at this point in the cycles has roughly matched previous recessions, while having followed a slightly different path.

Figure 2 shows total output for each of the past three recessions normalized to the beginning of the recession (the business cycle peak).<sup>1</sup> The beginning of the recession is in quarter “0” and the following 4 years are shown in the figure along with 1½ year prior to the beginning of the recession. Again we see that the output decline in the 2001 recession was relatively mild, and also that, since the recovery, output has grown more slowly – even though, until now, total output relative to the peak has remained above previous recessions.

The employment picture, however, shows a much bleaker picture of the state of the economy.

Figure 3 shows that employment has yet recovered, and still remains 2% below the level at the start of the 2001 recession. The figure also shows that employment had recovered to a certain extent in the two recessions prior to 2001 – in the 1981-82 recession, employment was about 2% greater than at the peak, and even in the “jobless recovery” after the 1991-92 recession, employment had returned to prior levels by this point in the recovery. In addition, employment in the past two recessions began to recover at a much earlier stage – and we have still not yet seen a turnaround in employment.

## Budget Performance

The output picture shows a mild output recession and a severe employment recession. From these charts, we might expect that the budget situation might roughly

<sup>1</sup> The last three recessions were

- July 1981 – November 1982,
- July 1990 – March 1991, and
- March 2001 – November 2001.

Figure 1. Real GDP Growth (Annual Rate, 1998q2 - 2003q2)

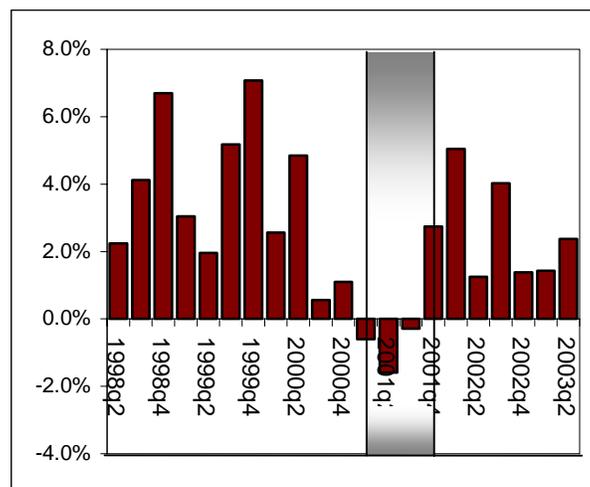


Figure 2. Real GDP (% change from cycle peak)

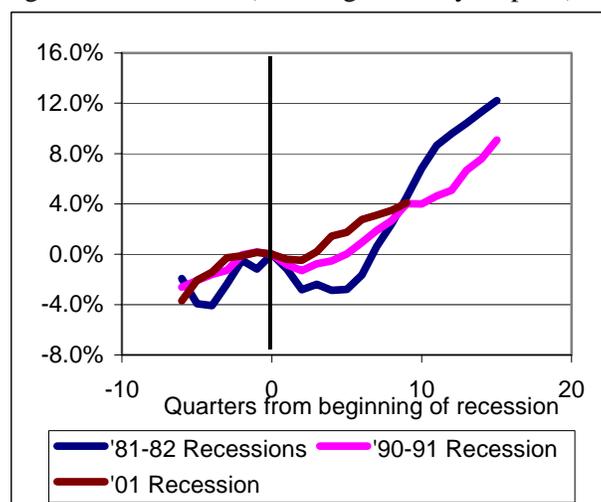
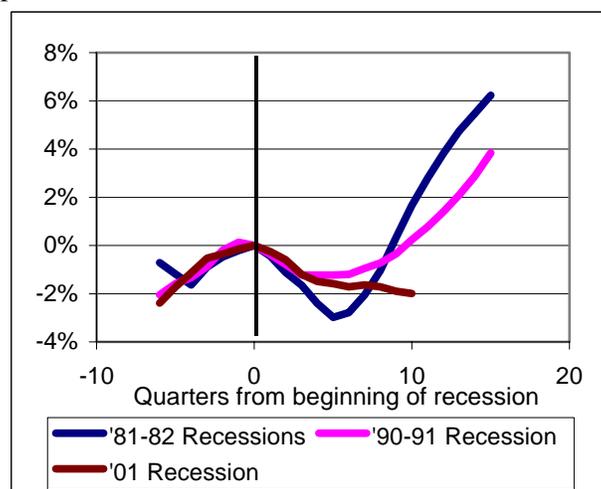


Figure 3. Employment (% deviation from cycle peak)



mirror the experiences from past recessions. However, the current policy response to the economic situation has been extreme, with the current administration pursuing an aggressive tax-cutting agenda with minimal short-term economic stimulus.

Figures 4 and 5 show a comparison of federal expenditures and federal revenue from the past 3 recession and recoveries (1½ year prior and 4 years after the start of the recession). The path of expenditures from the 2001 cycle is roughly equivalent to past recessions; however, the path of revenue shows that the 2001 cycle has seen a significant drop in revenue relative to past recessions. In fact, total revenue has declined by 12% since the start of the recession, even despite the fact that total output has increased by over 4%.

As expected, the revenue deterioration has led to the reemergence of federal deficits. Figure 6 shows that since the start of the recession, the deficit has increased by nearly 6% of GDP. In addition, when compared to past recessions, the decline in the budgetary situation has been faster and more severe than in either of the prior two cycles. Importantly, by this time in the previous cycles, the budget situation had already begun to stabilize or improve.

**Policy effectiveness**

While we see that total output has not suffered dramatically, we also have not seen a strong recovery. The poor employment situation relative to past recessions shows that recent policy has not been effective in stemming job losses, let alone in creating new jobs. In addition, these policies have come at a very hefty price and have thrown the budget into severe deficit – reaching \$455 billion for this year alone.

Simply put, policies that were sold as economic and job stimulus did not do their job. Instead we are faced with massive deficits and very little stimulus “bang for the buck.” In addition, comparisons with past recessions show that the current budget situation is not simply the normal course of a business cycle, but rather that current policies are contributing to the most severe fiscal decline in at least 25 years.

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Figure 4. Expenditures (% deviation from cycle peak)

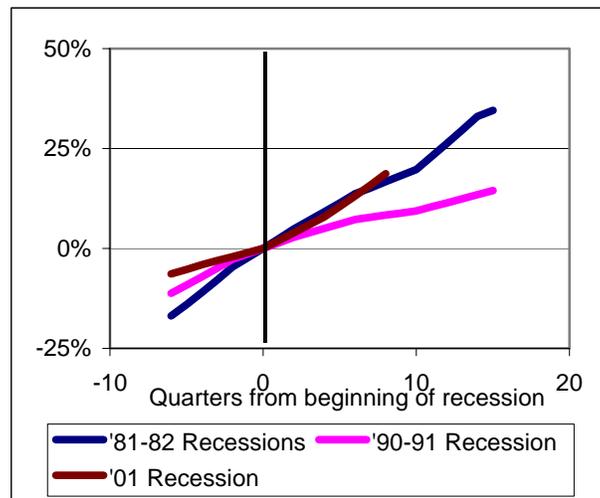


Figure 5. Revenue (% deviation from cycle peak)

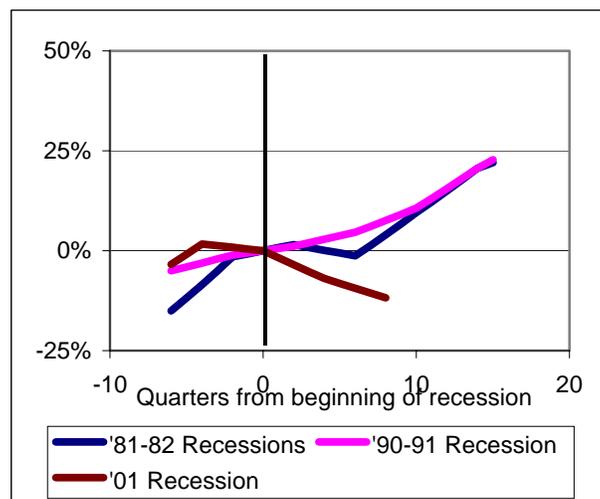


Figure 6. Budget Surplus/Deficit (Change from cycle peak, % of GDP)

