

BEWARE THE "ECHO RECESSION"

FRANK GRAVES

Now that we are deep into what appears to be a particularly savage recession, it is worth looking back at the last recession to see what we can learn. When I return to my polling data from the 1990s, the lesson is clear: The public's sense of economic security is a fragile thing, and it does not always mirror what is happening in the "real" economy.

Even though Canada technically emerged from the last recession as early as 1991, as the nervous nineties unfolded, a sense of economic confidence and security emerged only slowly and painfully. In fact, it took roughly six more years for the public to recover its sense of optimism. That lag contributed to an "echo recession," in which recovery was slower than it might otherwise have been, because of the public's reluctance to invest and spend.

Just as an "irrational exuberance" can lead to the economic troubles we now face, by tempting people and businesses to make what in retrospect seem like irrational bets, an excessive pessimism in a downturn can impede our ability to return to robust growth.

We already know that the current downturn is having an extremely deleterious impact on consumer intentions. In a recent survey, we found that two-thirds of Canadians plan to cut back their spending on big-ticket items such as cars, appliances and computers. Interestingly, this is true even though the public continues to be more optimistic than most economic forecasters about the depth and duration of recession, and the ability of government to address it. Fears of job loss, for example, are still much lower now than they were in the mid-'90s, when the jobless rate had fallen considerably from its peak in 1993.

If the forecasters are right, consumers probably will become gloomier as reality sinks in. And the history of the last recession shows that the gloom does not lift anywhere near as quickly as growth returns.

This dynamic in public opinion is going to make recovery harder. It may be prudent for consumers to act cautiously during periods of economic decline; but when the economy starts growing again, this caution undermines the recovery. The point is that once the public's sense of economic security is surrendered, it is very difficult to restore.

It may well be that corrosive impacts of this "echo recession" may be as serious as the recession itself. Unlike the recessions of the early 1980s and '90s, the current downturn is taking place in a demographic context that may magnify the exaggerated sense of economic insecurity.

Canada had the largest baby boom of any advanced Western society, save Australia. The exuberant yuppies of the '80s are now shell-shocked grumpies. As equity markets smoulder in ruin, the iconic Freedom 55 now looks like Freedom 95.

But we do not have to despair in the face of this likely echo recession. There are ways to reduce its length and severity. As governments spend and central banks loosen monetary policy in a neo-Keynesian frenzy to jump-start the economy, they should focus on the problem of the echo.

One approach has been the "noble lie." Prime Minister Stephen Harper, President Barack Obama, Bank of Canada Governor Mark Carney and U.S. Federal Reserve chairman Ben Bernanke have all been suggesting that things are better - or will soon be better - than they manifestly are. Maybe they have no choice, given that much of the media have seized almost gleefully on the most apocalyptic pronouncements of economists and other "experts." The net effect, however, is likely to confuse the public.

We also know that exaggerated risk perceptions are highest when the source of fear is relatively alien or unfamiliar and when individuals feel they have no direct control over their circumstances. So what to do? A skeptical but, by historic measures, relatively sophisticated public wants absolute candour. And individuals have to be shown ways in which they can fit themselves into the economic recovery.

There is no magic bullet that will cause the public to recognize the end of the recession and act accordingly. But there are three things we can do to minimize this problem.

First, we can shift away from specious forecasts and conjecture to provide the most rapid, accessible and neutral picture of actual economic performance. We need a distilled summary of where we are, day to day and week to week. This should come from a blue ribbon source such as the Bank of Canada, but it should come faster than it does now and be more accessible to ordinary people. Cutting the lag time between economic reporting and economic reality would reduce our reliance on the cacophony of conflicting forecasts.

Second, we should focus stimulative spending on reconstructing our economy for the 21st century. Our research indicates that Canadians are just as concerned with where we will be in 10 years as they are about the current recession. So let's fill the potholes, but let's also construct a world-leading post-carbon economy.

Third, the crucial mechanism for determining both individual and national success in the 21st century will be knowledge and innovation. We need a blueprint that will allow us to combine a smarter, more agile population with technical and business innovation to elevate our competitive position. Canadians want higher productivity and the better quality of life that comes with it. They want to feel a sense of participation and ownership in efforts to rebuild our economy - and if they have that sense, they will go out and learn, innovate, invest and buy.

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