Analysis of Business Cycles

The term “business cycle” (or economic cycle or boom-bust cycle) refers to economy-wide fluctuations in production, trade, and general economic activity. From a conceptual perspective, the business cycle is the upward and downward movements of levels of GDP (gross domestic product) and refers to the period of expansions and contractions in the level of economic activities (business fluctuations) around a long-term growth trend.

Broadly speaking, business cycles are a kind of fluctuations which occur in business activity with a certain degree of regularity and periodicity.

Business cycles are wavelike movements found in the aggregate economic activity of a notion.

According to **Keynes**, a business cycle is characterized by alternating expansionary and contractionary fluctuations in business activity. There is always some measure of regularity in respect of the duration and the time sequence of the upward and downward movements of the business cycle.

Business fluctuations do not have a fixed rhythm, but are characterized by alternating waves of expansion and contraction—they are cyclical in the sense that the phases of contraction and expansion recur frequently and in a fairly uniform patterns. These business cycle fluctuations may be distinguished from seasonal and other types of fluctuations by the nature of their rhythm.

The period of high income, output and employment has been called the period of expansion, upswing or prosperity, and the period of low income, output and employment has been described as contraction, recession, downswing or depression. These alternating periods of expansion and contraction in economic activity has been called business cycles. They are also known as trade cycles.

A noteworthy feature about these fluctuations in economic activity is that they are recurrent and have been occurring periodically in a more or less regular fashion. Therefore, these fluctuations have been called business cycles. It may be noted that calling these fluctuations as ‘cycles’ means they are periodic and occur regularly, though perfect regularity has not been observed.

The duration of a business cycle has not been of the same length; it has varied from a minimum of two years to a maximum of ten to twelve years, though in the past it was often assumed that fluctuations of output and other economic indicators around the trend showed repetitive and regular pattern of alternating periods of expansion and contraction.

However, actually there has been no clear evidence of very regular cycles of the same definite duration. Some business cycles have been very short lasting for only two to three years, while others have lasted for several years. Further, in some cycles there have been large swings away from trend and in others these swings have been of moderate nature.

A significant point worth noting about business cycles is that they have been very costly in the economic sense of the word. During a period of recession or depression many workers lose their jobs and as a result large-scale unemployment, which causes loss of output that could have been produced with full employment of resources, come to prevail in the economy.

Besides, during depression many businessmen go bankrupt and suffer huge losses. Depression causes a lot of human sufferings and lowers the levels of living of the people. Even boom when it is accompanied by inflation has its social costs. Inflation erodes the real incomes of the people and makes life miserable for the poor people. Inflation distorts allocation of resources by drawing away scarce resources from productive uses to unproductive ones. Inflation redistributes income in favour of the richer sections and also when inflation rate is high, it hinders economic growth.

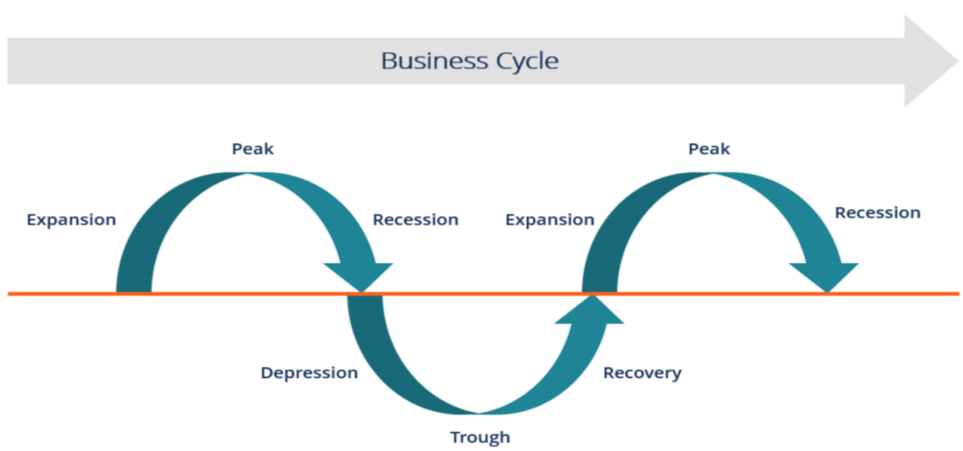
Types of Business Cycles

1) **The Minor Cycle:** This is also known as Short Kitchin Cycle. This has gained popularity after the name of the British economist Joseph Kitchin in the year 1923. He made a research and came to this conclusion that a cycle takes place within duration of approximately 30 to 40 months.

2) **The Major Cycle:** This has been emphasised as the fluctuation of business activity between successive crises. This is also known as "The Long Jugler Cycle." A French economist Clement Jugler showed that the periods of prosperity, crisis and liquidation followed each other always within a span of the average of nine and half years.

3) **The Very Long Period Cycle:** This is also known as Kondratieff Cycle. This was propounded by N. D. Kondratieff the Russian economist in the year 1925. He has written that there are longer waves of cycles of more than fifty years duration. A very long cycle may contain in itself many major and minor cycles.

Phases of Trade Cycles



1. **Expansion**
    - a high level of output and trade
    - a high level of effective demand
    - a high level of employment and income
    - a high marginal efficiency of capital
    - a price inflation
    - a rising structure of interest rate
    - a large expansion of bank credit
    - overall business optimism
    - Tendency of the economy to operate at almost full capacity along its production possibility frontier.
2. **Recession**
    - It lasts relatively for a shorter period of time
    - Fall in income and output.
    - Workers are rendered unemployed.
    - Prices began to fall.
    - Wages fall
    - Profits fall
    - Contraction of bank credit
    - Fall in investment sets in motion the reverse action of the multiplier. Consequently, income falls many times more than the decline in investment.
    - Demand for goods fall
    - Sharp decline in stock of goods
    - Feeling of doubt and fear among the people
3. **Depression**
    - Shrinkage in the volume of output, trade and transactions;

- Rise in the level of unemployment;
- Price deflation;
- Fall in the aggregate income of the community (especially wages and profits);
- Fall in the structure of interest rates;
- Curtailment in consumption expenditure and reduction in the level of effective demand;
- Collapse of the marginal efficiency of capital and decline in the investment demand function;
- Contraction of bank credit
- People become pessimist. It affects economy adversely.

4. Recovery

- Replacement investment result into increase in income and output.
- Employment increases
- Demand for goods rises
- Price begin to rise
- More profits
- Investment increases
- Demand for bank loans and advances increases
- A bullish atmosphere will prevail on the stock exchanges.
- Pessimism gives place to optimism.