UNIT-4

MARKET STRUCTURE

Difference between Perfect Competition and Imperfect Competition

Based on competition, the market structure has been classified into two broad categories:

1) Perfectly competitive- **Perfect Competition** is not found in the real world market because it is based on many assumptions
2) Imperfectly competitive- But an **Imperfect Competition** is associated with a practical approach.

The type of market structure decides the market share of a firm in the market. If there exists a single firm, it will serve the entire market, and the demand of the customers are satisfied with that firm only. But if we increase the number of firms to two, the market will also be shared by the two. Similarly, if there are about 100 small firms in the market, the market is shared by all of them in proportion.

Therefore, it is the market structure, which affects the market. So here we are going to describe the differences between perfect competition and imperfect competition, in economics

BASIS FOR COMPARISON	PERFECT COMPETITION	IMPERFECT COMPETITION
Meaning	Perfect Competition is a type of competitive market where there are numerous sellers selling homogeneous products or services to numerous buyers.	Imperfect Competition is an economic structure, which does not fulfill the conditions of the perfect competition.
Nature of concept	Theoretical	Practical
Product Differentiation	None	Slight to Substantial
Players	Many	Few to many
Restricted entry	No	Yes
Firms are	Price Takers	Price Makers

iii. Barriers in Entry and Exit:

Prevents the entry of new organizations. The barriers of entry and exit distinguish the oligopoly market from monopolistic competition. In oligopolistic market, new organizations cannot easily enter the market due to various legal, social, and technological barriers. In such a case, existing organizations have a complete control over the market.

iv. Mutual Interdependence:

Refers to one of the important characteristic of the oligopoly market structure. Mutual interdependence implies that organizations are influenced by each other's decisions. These decisions include pricing and output decisions of organizations.

In monopoly and perfect competition, organizations do not take into consideration the decisions and reactions of other organizations, therefore, the decision of organizations in such types of market structures are independent. However, in oligopoly, an organization is not able to take an independent decision.

For example, in oligopoly, a few numbers of sellers compete with each other. In such a case, the sale of one organization depends on its own price of products as well as the price of competitor's products. This mutual interdependence differentiates oligopoly from rest of the market structures

v. Lack of Uniformity:

Refers to another important characteristic of oligopoly. In oligopoly, organizations are not uniform in their sizes. Some organizations are very large in size while some of them are very small. For example, in small car segment, Maruti Udyog has the share of 86%, while Tata and Cielo have very low market share.

vi. Existence of Price Rigidity:

Implies that organizations do not prefer to change the prices of their products in oligopoly. This is because the change in price would not be profitable for an organization in oligopoly. In case, an organization reduces its price, its rivals also reduce prices, which adversely affect the profits of the organization. In case, the organization increases prices, it would lose buyers.

Definition of Perfect Competition

Perfect Competition is an economic structure where the degree of competition between the firms is at its peak. Given are the salient features of the perfect competition:

- Many buyers and sellers.
- Product offered is identical in all respects.
- Any firm can come and go, as per its own discretion.
- Both the parties to the transaction are having complete knowledge about the product, quantity, price, market and market conditions as well.
- Transportation and Advertising cost is nil.
- Free from government interference.
- The price for a product is uniform across the market. It decided by the demand and supply forces; no firm can affect the prices, that's why the firms are price takers.
- Each firm earns a normal profit.

Example: Suppose you go to a vegetable market to buy tomatoes. There are many tomato vendors and buyers. You go to a vendor and inquire about the cost of 1 kg tomatoes, the vendor replies, it will cost Rs. 10. Then you go ahead and inquire some more vendors. The prices of all the vendors are same for the demanded quantity. This is an example of perfect competition.

Definition of Imperfect Competition

The competition, which does not satisfy one or the other condition, attached to the perfect competition is imperfect competition. Under this type of competition, the firms can easily influence the price of a product in the market and reap surplus profits.

In the real world, it is hard to find perfect competition in any industry, but there are so many industries like **telecommunications, automobiles, soaps, cosmetics, detergents, cold drinks and technology, where you can find imperfect competition.** By the virtue of this, imperfect competition is also considered as real world competition.

There are various forms of imperfect competition, described below:

- **Monopoly:** Single seller dominates the entire market.
- **Duopoly:** Two sellers share the whole market.
- **Oligopoly:** Few sellers are there who either act in collusion or competition.
- **Monopsony:** Many sellers and a single buyer.
- **Oligopsony:** Many sellers and few buyers.
- **Monopolistic Competition:** Numerous sellers offering unique products

Table 1 : Features of Market Structures

Features	*(Market Forms)*			
	Perfect Competition	Monopoly	Monopolistic Competition	Oligopoly
1. No. of Firms	Large	One	Varied but not too many	A few
2. Nature of Product	Homoge-neous	One type	Product Differentiation	Homogeneous or Differentiated
3. Entry of Firms	Free	No entry	Free	Restricted
4. Degree of Mono-poly Power	Zero	Full	Limited	Limited due to product differentiation
5. Price Policy of Firm	Price-taker	Price-maker	Price-maker	Price-maker
6. Market Knowledge	Complete	Incomplete	Incomplete	Incomplete
7. Elasticity of Demand	Perfectly elastic	Less elastic	Less elastic	Less elastic
8. AR and MR	Equal	Different	Different	Different
9. Selling Cost	No	Small	Large	Small

National Income and Measurement of National Income

National Income Concept

National Income is the total value of all final goods and services produced by the country in certain year. The growth of National Income helps to know the progress of the country.

• In other words, the total amount of income accruing to a country from economic activities in a year's time is known as national income. It includes payments made to all resources in the form of wages, interest, rent and profits.

• From the modern point of view, national income is defined as "the net output of commodities and services flowing during the year from the country's productive system in the hands of the ultimate consumers."

National Income Accounting (NIA)
National Income Accounting is a method or technique used to measure the economic activity in the national economy as a whole.

NIA is mainly done for:
• **Policy Formulation:** It helps in comparing the estimates of the past from the future and also forecast the growth rates in future. For example, if a country has a GDP of Rs. 103 Lakh which is 3 Lakh rupees higher than the last year, it has a growth rate of 3 per cent.

• **Effective Decision Making:** To estimate the contribution of each of the sectors of the economy. It helps the business to plan for production.

• **International Economic Comparison:** It helps in comparing the level of development of countries and provides useful insight into how well an economy is functioning, and where money is being generated and spent. One can compare the standard of living of different nations and its growth rate.

There are various terms associated with measuring of National Income.

Measures of National Income

GDP | GNP | NNP | NNP_{FC} | PI | DPI

A. GDP (GROSS DOMESTIC PRODUCT)
• Here the catch word is 'Domestic' which refers to 'Geographical Area'
• The total value of all final goods and services produced within the boundary of the country during a given period of time (generally one year) is called as GDP.
• In this case, the final produce of resident citizens as well as foreign nationals who reside

within that geographical boundary is considered.

GDP = Q-P

Q = total quantity of final goods and services produced in the country (both by Indians and fo residing within Indian boundary).

P = price of the final goods and services.

Types of GDP: Real GDP and Nominal GDP

- **Real GDP:** Refers to the current year production of goods and services valued at base year prices. Such base year prices are Constant Prices.

- **Nominal GDP:** Refers to current year production of final goods and services valued at current year prices.

Which one is a better measure?

- Real GDP is a better measure to calculate the GDP because in a particular year GDP may be inflated because of high rate of inflation in the economy.
- Real GDP therefore allows us to determine if production increased or decreased, regardless of changes in the inflation and purchasing power of the currency.

Concept of Base Year: It is the year used as the beginning or the reference year for constru and which is usually assigned an arbitrary value of 100.

The base year is also known as Rebasing as by every 10 years there is change which will be rise in price of items which requires changing the base year.

Economists use a Price Index to find the real GNP/GDP to make the calculation of GNP/ Price index is a number showing the changes in the overall level of prices. It shows a change price level of an economy.

Recently the Indian Government changed the base year for calculating GDP to 2011-12 fro Base Year selection is made on the basis of:

- **Stability of macroeconomic parameters. It has to be a normal year without large production, trade and prices of goods and services.**
- **Data availability: Data available for the year should be reliable.**
- **Comparability- so that same parameters should be in use both the years. Therefore recent year and not go long back into history.**

B. GROSS NATIONAL PRODUCT (GNP)

- Here the catch word is 'National' which refers to all the citizens of a country.
- GNP is the total value of the total production or final goods and services produced by the nationals of a country during a given period of time (generally one year).
- In this case, the income of all the resident and non-resident citizens (who resides in abroad) of a country in included whereas, the income of foreigners who reside within India is excluded.
- The GNP contains the income earned by Indian Nationals (both in Indian Territory and Abroad) only.

GNP = GDP + (X-M) **X = Export, M = Import**

X-M is called the Net Factor Income from Abroad (NFIA)

So, GNP = GDP + Net Factor Income from Abroad

GDP and GNP are measured on the basis of Market Price and Factor Cost.

a) Market Price

It refers to the actual transacted price which includes indirect taxes such as custom duty, excise duty, sales tax, service tax etc. (impending Goods and Services Tax). These taxes tend to raise the prices of the goods in an economy.

b) Factor Cost

It is the cost of factors of production i.e. rent for land interest for capital, wages for labour and profit for entrepreneurship. This is equal to revenue price of the final goods and services sold by the producers.

Revenue Price (or Factor Cost) = Market Price – Net Indirect Taxes

Net Indirect Taxes = Indirect Taxes – Subsidies

Hence, Factor Cost = Market Price – Indirect Taxes + Subsidies

C. Net National Product (NNP): NNP = GNP – Depreciation

• It is calculated by subtracting Depreciation from Gross National Product.

• Depreciation – Wear and Tear of goods produced.

• This deduction is done because a part of current produce goes to replace the depreciated parts of the products already produced. This part does not add value to current year's total produce. It is used to keep the products already produced intact and hence it is deducted.

D. Net Domestic Product (NDP): NDP = GDP – Depreciation

• It is the calculated GDP after adjusting the value of depreciation. This is basically, Net form of GDP, i.e. GDP – total value of wear and tear.

• NDP of an economy is always lower than its GDP, since their depreciation can never be reduced to zero. The concept of NDP and NNP are not used to compare different economies because the method of calculating depreciation varies from country to country.

The difference between Net Domestic Product and Net National Product:

- **"Domestic" means that it includes everything produced within country (domestically) and it doe matter who have produced it - foreigners or residents.**
- **"National" means that it includes everything that are produced by residents only (or by capital belon to residents) - and it doesn't matter if it is produced domestically or internationally (for instance if goes to work into another country then my work should be included in national but not in dome product).**
- **"Net" means that depreciation used in production capital (consumed capital) is deducted from G (for both domestic and national).**

E. National Income at Factor Cost (NIFC):

• It is the sum of all factors of income earned by the residents of a country (Indian) both from within the country as well as abroad.

• **National Income at Factor Cost = NNP at Market Price – Indirect Taxes + Subsidies**

• In India, and many developing countries across the world, National Income is measured at factor cost instead of market prices. Some of the reasons for the same are lack of uniformity in taxes, goods not being printed with their prices, etc.

F. Transfer Payments

• A payment made by the government to individuals for whom there is no economic activity is produced in return. For example: Old Age Pensions, Scholarship etc.

G. Personal Income

- It refers to all of the income collectively received by all of the individuals or households in a country.
- It includes compensation from a number of sources including salaries, wages and bonuses received from employment or self employment; dividends and distributions received from investments; rental receipt from real estate investments and profit sharing from businesses.
- In National Income Accounting, some income is attributed to individuals, which they do not actually receive. For Example: Undistributed Profits, Employees' contribution for social security, corporate income taxes etc. which needs to be deducted from National Income to estimate the Personal Income.
- **PI = NI + Transfer Payments – Corporate Retained Earnings, Income Taxes, Social Security Taxes.**

H. Disposable Personal Income

- It is the amount left with the individuals after paying Personal Taxes such as Income Tax, Property Tax, and Professional Tax etc. to spend as they like.
- DPI = PI – Taxes (Income Tax i.e. Personal Taxes)
- DPI results into Savings and Expenditure i.e. (Spend and Save). This concept is very useful for studying and understanding the consumption and saving behaviour of the individuals.

WHAT ARE THE FACTORS THAT AFFECT NATIONAL INCOME?

Several factors affect the national income of a country. Some of them have been listed below:

1. Factors of Production

Normally, the more efficient and richer the resources, higher will be the level of National Income or GNP

(a) Land

Resources like coal, iron and timber are essential for heavy industries so that they must be available and accessible. In other words, the geographical location of these natural resources affects the level of GNP.

(b) Capital

Capital is generally determined by investment. Investment in turn depends on other factors like profitability, political stability etc.

(c) Labour

The quality or productivity of human resources is more important than quantity. Manpower planning and education affect the productivity and production capacity of an economy.

(d) Entrepreneur

(e) Technology

This factor is more important for Nations with fewer natural resources. The development in technology is affected by the level of invention and innovation in production.

(f) Government

Government can help to provide a favourable business environment for investment. It provides law and order, regulations.

(g) Political Stability
A stable economy and political system helps in appropriate allocation of resources. Wars, strikes and social unrests will discourage investment and business activities.

Methods of National Income Calculation
There are three approaches and methods of measuring National Income:

A. Income Method
• By this National Income is calculated compiling income of factors of production viz., land, labour, capital and entrepreneur.
• **National Income = Total Wage + Total Rent + Total Interest + Total Profit**
• In Indian context, since 1993 as per the System of National Accounts (SNA), National Income is total of the following:
• **GDP = Compensation of Employees + Consumption of Fixed Capital + (Other Taxes on Production – Subsidies of Production) + Gross Operating Surplus**
• Compensation of employees: (Wage) salaries paid in cash and kind and other benefits provided to employees.
• Consumption of Fixed Capital: wear and tear of machinery which are replaced by new parts.
• Other Taxes on Production minus Subsidies: Net tax on production.
• There is a difference between tax on products and tax on production. Tax on products includes taxes like sales tax and excise duty. Tax on production is tax imposed irrespective of production like license fees and land tax.
• Gross Operating Surplus: balance of value added after deducting the above three components. It goes to pay rent of land and interest of capital.

B. Product Method (or Value Added Method, Output Method)
• It is used by economists to calculate GDP at market prices, which are the total values of outputs produced at different stages of production.

Some of the goods and services included in production are:
• Goods and services actually sold in the market.
• Goods and services not sold but supplied free of cost. (No Charge/Complementary)

Some of the goods and services not included in production are:
• Second hand items and purchase and sale of the same. Sale and purchase of second cars, for example, are not a part of GDP calculation as no new production takes place in the economy.
• Production due to unwarranted/ illegal activities.
• Non-economic goods or natural goods such as air and water.
• Transfer Payments such as scholarships, pensions etc. are excluded as there is income received, but no good or service is produced in return.
• Imputed rental for owner-occupied housing is also excluded.
• Here the Gross Value of final goods and services produced in a country in certain year is calculated.
• GDP is a concept of value added; it is the sum of gross value added of all resident producer units (institutional sectors, or industries) plus that part of taxes (total) less subsidies, on products which is not included in the valuation of output.
• **Gross Value Added = Output of Final Goods and Services – Intermediate Consumption**
• **National Income = Gross Value Added + Indirect Taxes – Subsidies**

C. Expenditure Method

- It measures all spending on currently-produced final goods and services only in an economy.
- In an economy, there are three main agencies which buy goods and services: Households, Firms and the Government.

This final expenditure is made up of the sum of 4 expenditure items, namely;

- **Consumption (C):** Personal Consumption made by households, the payment of which is paid by households directly to the firms which produced the goods and services desired by the households.

- **Investment Expenditure (I):** Investment is an addition to capital stock of an economy in a given time period. This includes investments by firms as well as governments sectors.

- **Government Expenditure (G):** This category includes the value of goods and service purchased by Government. Government expenditure on pension schemes, scholarships, unemployment allowances etc. are not included in this as all of them come under transfer payments.

- **Net Exports (X-IM):** Expenditures on foreign made products (Imports) are expenditure that escapes the system, and must be subtracted from total expenditures. In turn, goods produced by domestic firms which are demanded by foreign economies involve expenditure by other economies on our production (Exports), and are included in total expenditure. The combination of the two gives us Net Exports.

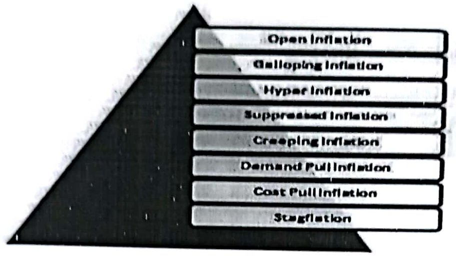
- **National Income = Consumption (C) + Investment Expenditure (I) + Government Expenditure (G) + Net Exports (X-IM)**

- **Calculating GDP (National Income)** is extremely important as the performance of the economy is fixed by means of this method. The results would help the country to forecast the economic progress, determine the demand and supply, understand the buying power of the people, the per capita income, the position of the economy in the global arena. The Indian GDP is calculated by the expenditure method.

Inflation: Meaning, Types, Causes, Effects and Remedies

- Inflation is State in which the Value of Money is falling and the Prices are rising."
- In Economics, the Word inflation Refers to General rise in Prices Measured against a Standard Level of Purchasing Power.

Types of Inflation-



- **Demand Pull Inflation** – Inflation created and sustained by excess of aggregate demand for goods and services over the aggregate supply . In other words , demand pull inflation takes place when increase in production lags behind the increase in money supply
- **Cost Pull Inflation** – Inflation which is created and sustained by increase in cost of production which is independent of the state of demand (e.g. Trade unions can bargain for higher wages and hence contributes to inflation)
- **Stagflation** – In this types there is fall in the output and employment levels . Due to various pressure , the entrepreneurs have to raise price to maintain their margin of profits . But as they only partially succeed in raising the prices , they are faced with a situation of declining output and investment . Thus on one side there is a rise in the general price level and on the other side there is a fall in the output and employment .
- **Open Inflation** - The rate where Costs rise due to Economic trends of Spending Products and Services.
- **Suppressed Inflation** - Existing inflation disguised by government Price controls or other interference in the economy such as subsidies. Such suppression, nevertheless, can only be temporary because no governmental measure can completely contain accelerating inflation in the long run. It is Also Called Repressed Inflation.
- **Galloping Inflation** - Very Rapid Inflation which is almost impossible to reduce.
- **Creeping Inflation** - Circumstance where the inflation of a nation increases gradually, but continually, over time. This tends to be a typically pattern for many nations. Although the increase is relatively small in the short-term, as it continues over time the effect will become greater and greater.
- **Hyper Inflation** - Hyperinflation is caused mainly by excessive deficit spending (financed by printing more money) by a government, some economists believe that social breakdown leads to hyperinflation (not vice versa), and that its roots lie in political rather than economic causes.

Causes of Inflation

Factors on Demand Sides –

- Increase in money supply
- Increase in Export
- Increase in disposable income
- Deficit(insufficient) financing
- Foreign exchange reserves

Factors on Supply Side –

- Rise in administered prices
- Irregular agriculture growth
- Agricultural price policy
- Inadequate industrial growth

Some others Factors-

1) Black money (fake currency)
2) Increase in public expenditure
3) Decrease in the aggregate supply of goods and services

Effect of Inflation –

- They add inefficiencies in the market, and make it difficult for companies to budget or plan long-term.
- Uncertainty about the future purchasing power of money discourages investment and saving.
- There can also be negative impacts to trade from an increased instability in currency exchange prices caused by unpredictable inflation.
- Higher income tax rates.
- Inflation rate in the economy is higher than rates in other countries; this will increase imports and reduce exports, leading to a deficit in the balance of trade.

Measurement of Inflation –

The 2 ways of Measuring Inflation are –

1. CPI
2. PPI

- Inflation is measured by general prices index . General price index measures the changes in average prices of goods and services . A base year is selected and its index is assumed as 100 and on this basis price index for the current year is calculated . If the index of the current year is below 100 , it indicates the state of deflation and , on the contrary , If the index of the current year is above 100 it indicate the state of inflation
- Inflation rate and the value of money (Or the purchasing power of money) are inversely correlated . Hence , the value of money can also be measured with the help of price indices . The value of money declines when price index goes up and Vice-Versa.

Consequences of Inflation –

- Adverse effect on production
- Adverse effect on distribution of income
- Obstacle to development
- Changes in relative prices
- Adverse effect on the B.O.P (Balance of Payment)

Measures of Inflation –

Monetary policy

- Credit Control
- Demonetization of Currency
- Issue of New Currency

Fiscal policy

- Reduction in Unnecessary Expenditure
- Increase in Taxes
- Increase in Savings
- Surplus Budgets
- Public Debt

Other Measures

- To Increase Production
- Rational Wage Policy
- Price Control

Inflation a threat to Indian economy -

- Inflation has become a household name for millions of Indians who are finding it extremely difficult to make both ends meet. Prices are growing faster than the household income almost for all products and services including real estate, food, transportation, luxuries.
- The global economic crisis saw many economies stumble but India rebounded faster and was surging ahead with a growth rate of 9%. But the inflationary pressure is forcing the government to adopt measures which are taking the steam out of the Indian growth story
- For the last two years India is witnessing double digit food inflation which had reached a high of around 18% in December 2010 with prices of onions, garlic and tomatoes skyrocketing. Lentils, milk and meat have witnessed a steady rise in prices which is putting pressure on the home budget of millions of Indians.
- Millions of poor people in India are struggling to arrange a two-square meal for their family members. We are running the risk of having an entire generation of malnourished children who are otherwise considered the future of India.

- The tightening of the economy may control inflation in the long run but it is also slowing our economy and as predicted by the IMF India's growth will be only around 6-7% instead of 9%.

Current status of inflation in India –

- Currently inflation rate is around 9.44% in India, much above the acceptable rate of 5%.
- The food price index is at 8.31% causing much discomfort to the policymakers, which under the current scenario seems impossible.

How to Control Inflation –

Monetary Measures –

- Credit Control
- Issue of new currency

Fiscal Measures –

- Reduction in Unnecessary Expenditure
- Increase in taxes
- Increase in savings
- Surplus Budgets
- Public Debts
- To increase in production
- Rational wage policy
- Price control
- Rationing

BUSINESS CYCLE

5 Phases of a Business Cycle (With Diagram)

Business cycles are characterized by boom in one period and collapse in the subsequent period in the economic activities of a country.

These fluctuations in the economic activities are termed as phases of business cycles. The fluctuations are compared with ebb and flow. The upward and downward fluctuations in the cumulative economic magnitudes of a country show variations in different economic activities in terms of production, investment, employment, credits, prices, and wages. Such changes represent different phases of business cycles.

The different phases of business cycles are shown in Figure-1:

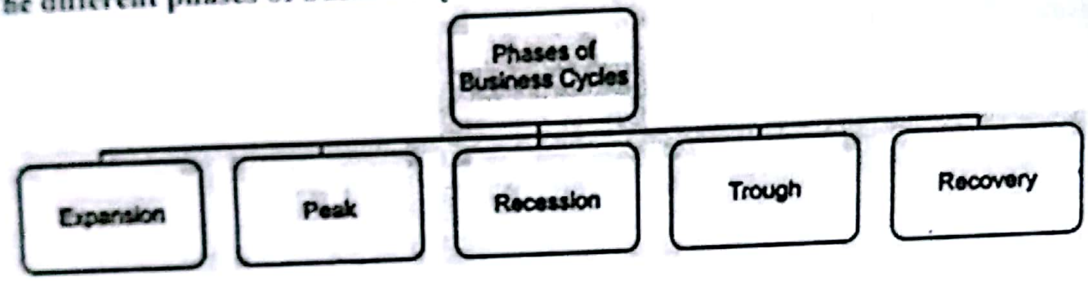


Figure-1:Different Phases of a Business Cycle

There are basically two important phases in a business cycle that are prosperity and depression. The other phases that are expansion, peak, trough and recovery are intermediary phases.

Figure-2 shows the graphical representation of different phases of a business cycle:

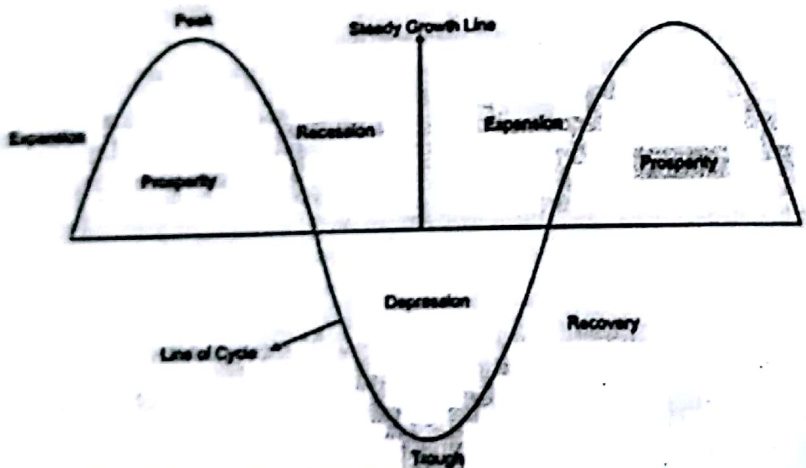


Figure-2: Representation of Phases of a Business Cycle

As shown in Figure-2, the steady growth line represents the growth of economy when there are no business cycles. On the other hand, the line of cycle shows the business cycles that move up and down the steady growth line. The different phases of a business cycle (as shown in Figure-2) are explained below.

1. Expansion:

The line of cycle that moves above the steady growth line represents the expansion phase of a business cycle. In the expansion phase, there is an increase in various economic factors, such as production, employment, output, wages, profits, demand and supply of products, and sales. In addition, in the expansion phase, the prices of factor of production and output increases simultaneously. In this phase, debtors are generally in good financial condition to repay their debts; therefore, creditors lend money at higher interest rates. This leads to an increase in the flow of money.
In expansion phase, due to increase in investment opportunities, idle funds of organizations or individuals are utilized for various investment purposes. Therefore, in such a case, the cash inflow and outflow of businesses are equal. This expansion continues till the economic conditions are favourable.

2. Peak:

The growth in the expansion phase eventually slows down and reaches to its peak. This phase is known as peak phase. In other words, peak phase refers to the phase in which the increase in growth rate of business cycle achieves its maximum limit. In peak phase, the economic factors, such as production, profit, sales, and employment, are higher, but do not increase further. In peak phase, there is a gradual decrease in the demand of various products due to increase in the prices of input.
The increase in the prices of input leads to an increase in the prices of final products, while the income of individuals remains constant. This also leads consumers to restructure their monthly budget. As a result, the demand for products, such as jewellery, homes, automobiles, refrigerators and other durables, starts falling.

3. Recession:

As discussed earlier, in peak phase, there is a gradual decrease in the demand of various products due to increase in the prices of input. When the decline in the demand of products becomes rapid and steady, the recession phase takes place.
In recession phase, all the economic factors, such as production, prices, saving and investment, starts decreasing. Generally, producers are unaware of decrease in the demand of products and they continue to produce goods and services. In such a case, the supply of products exceeds the demand.
Over the time, producers realize the surplus of supply when the cost of manufacturing of a product is more than profit generated. This condition firstly experienced by few industries and slowly spread to all industries.
This situation is firstly considered as a small fluctuation in the market, but as the problem exists for a longer duration, producers start noticing it. Consequently, producers avoid any type of further investment in factor of production, such as labor, machinery, and furniture. This leads to the reduction in the prices of factor, which results in the decline of demand of inputs as well as output.

4. Trough:

During the trough phase, the economic activities of a country decline below the normal level. In this phase, the growth rate of an economy becomes negative. In addition, in trough phase, there is a rapid decline in national income and expenditure.

In this phase, it becomes difficult for debtors to pay off their debts. As a result, the rate of interest decreases; therefore, banks do not prefer to lend money. Consequently, banks face the situation of increase in their cash balances.
Apart from this, the level of economic output of a country becomes low and unemployment becomes high. In addition, in trough phase, investors do not invest in stock markets. In trough phase, many weak organizations leave industries or rather dissolve. At this point, an economy reaches to the lowest level of shrinking.

5. Recovery:

As discussed above, in trough phase, an economy reaches to the lowest level of shrinking. This lowest level is the limit to which an economy shrinks. Once the economy touches the lowest level, it happens to be the end of negativism and beginning of positivism.
This leads to reversal of the process of business cycle. As a result, individuals and organizations start developing a positive attitude toward the various economic factors, such as investment, employment, and production. This process of reversal starts from the labor market.
Consequently, organizations discontinue laying off individuals and start hiring but in limited number. At this stage, wages provided by organizations to individuals is less as compared to their skills and abilities. This marks the beginning of the recovery phase.
In recovery phase, consumers increase their rate of consumption, as they assume that there would be no further reduction in the prices of products. As a result, the demand for consumer products increases.
In addition in recovery phase, bankers start utilizing their accumulated cash balances by declining the lending rate and increasing investment in various securities and bonds. Similarly, adopting a positive approach other private investors also start investing in the stock market As a result, security prices increase and rate of interest decreases.
Price mechanism plays a very important role in the recovery phase of economy. As discussed earlier, during recession the rate at which the price of factor of production falls is greater than the rate of reduction in the prices of final products.
Therefore producers are always able to earn a certain amount of profit, which increases at trough stage. The increase in profit also continues in the recovery phase. Apart from this, in recovery phase, some of the depreciated capital goods are replaced by producers and some are maintained by them. As a result, investment and employment by organizations increases.
As this process gains momentum an economy again enters into the phase of expansion. Thus, a business cycle gets completed.