

CH.12

TRADE CYCLE

Introduction

The economic activities fluctuate in a capitalistic economy. There is sometimes a period of prosperity and the living standard of people increases. This economic climate never remains constant but keeps on taking new shapes. The prosperity is followed by adversity. The business activities become slow down and unemployment spreads in this phase of depression. These ups and downs in economic activities that take place over a period of time are called trade cycle.

Definition

The ups and downs in economic activities in a country are called trade cycle. If it starts from prosperity and then it comes to adversity from a maximum level. Then it reaches its lowest level. After this the period of recovery starts. In this way, a trade cycle is completed.

The economists defined trade cycle in their own ways. The definitions of trade cycle presented by some economists are as follows:

1. **According to J. M. Keynes**

A trade cycle is composed of periods of good trade characterized by rising prices and low unemployment percentage, alternating with periods of bad trade characterized by falling prices and high employment percentages."

2. **According to Prof. Hansen**

The business cycle is a fluctuation in employment, output and prices."

PHASES OF TRADE CYCLE

A trade cycle has four phases which are explained as:

Boom or Prosperity

The boom phase of trade cycle is also known as prosperity or expansion phase. Following are the characteristics / conditions of this phase of trade cycle.

- (i) There is a rapid rise in production
- (ii) Demand for factors of production increases.
- (iii) Unemployment falls and wages increase.
- (iv) The living standard increases.
- (v) The rate of profit is greater than the rate of interest.

- (vi) The quantity supplied increases. Loans are easily available which induce new investors to start new projects.
- (vii) Attention is paid towards socio-economic activities. For example hospitals, universities, research laboratories etc.
- (viii) The capital market flourishes rapidly.
- (ix) The prices of goods and services increase.
- (x) The cost of production decreases.
- (xi) The new capital is to be installed and firms become more competitive.

2. Recession

There is a fall after every rise. The loans have been issued in more quantity in the period of boom. The repayment of these loans starts and it leads to decrease in profit rate. The volume of investment also starts to decrease. The economy gradually moves towards recession. The characteristics / conditions of this period are as follows.

- (i) The prices of factors of production increase and cost of production also increases.
- (ii) There is decrease in investment.
- (iii) Prices start to decrease and profit margin also decreases.
- (iv) People prefer saving to consumption due to increase in interest rate.
- (v) The demand of consumer decreases and goods are lying in the shape of stock.
- (vi) The production level decreases and unemployment starts.
- (vii) The hard conditions of loans are found in banks.
- (viii) The condition of uncertainty starts.
- (ix) The economy moves toward depression passing through the process of recession of economy.
- (x) The economy contracts due to decrease in public expenditure.

3. Depression

The economy is under crises in this phase of trade cycle and the economy has to face difficulties, the characteristics or conditions of this phase are as under:

- (i) The prices of goods and services decrease.
- (ii) The economic activities are under crises.
- (iii) Disappointment is found in businessmen.
- (iv) The level of income and revenues decreases.
- (v) Many firms shut down their business.
- (vi) The demand of goods decreases.
- (vii) The production of capital goods also decreases.
- (viii) Stock exchange and capital market is under crises and difficulties.

(ix) There is adverse balance of payments due to decrease in exports.

(x) Unemployment expands.

(xi) The volume of investment decreases

Recovery or Revival

The minimum limit of depression phase is the cause of its end. During depression, the government takes different expansionary measures and incurs capital expenditures. It starts new projects, roads, etc by adopting the policy of deficit financing. The demand of goods starts to increase and the economy moves towards revival. The characteristics of this phase are as under.

(i) The demand of goods starts to increase due to low prices.

(ii) The producers increase production because of increasing demand.

(iii) The government plays important role in this phase and increases its productive expenditure.

(iv) Prices start increasing in the light of increasing demand and profit margin reappears.

(v) Unemployment starts to decline.

(vi) Investment increases by increase in savings.

(vii) Privatization is an important feature of this phase and private sector gains importance.

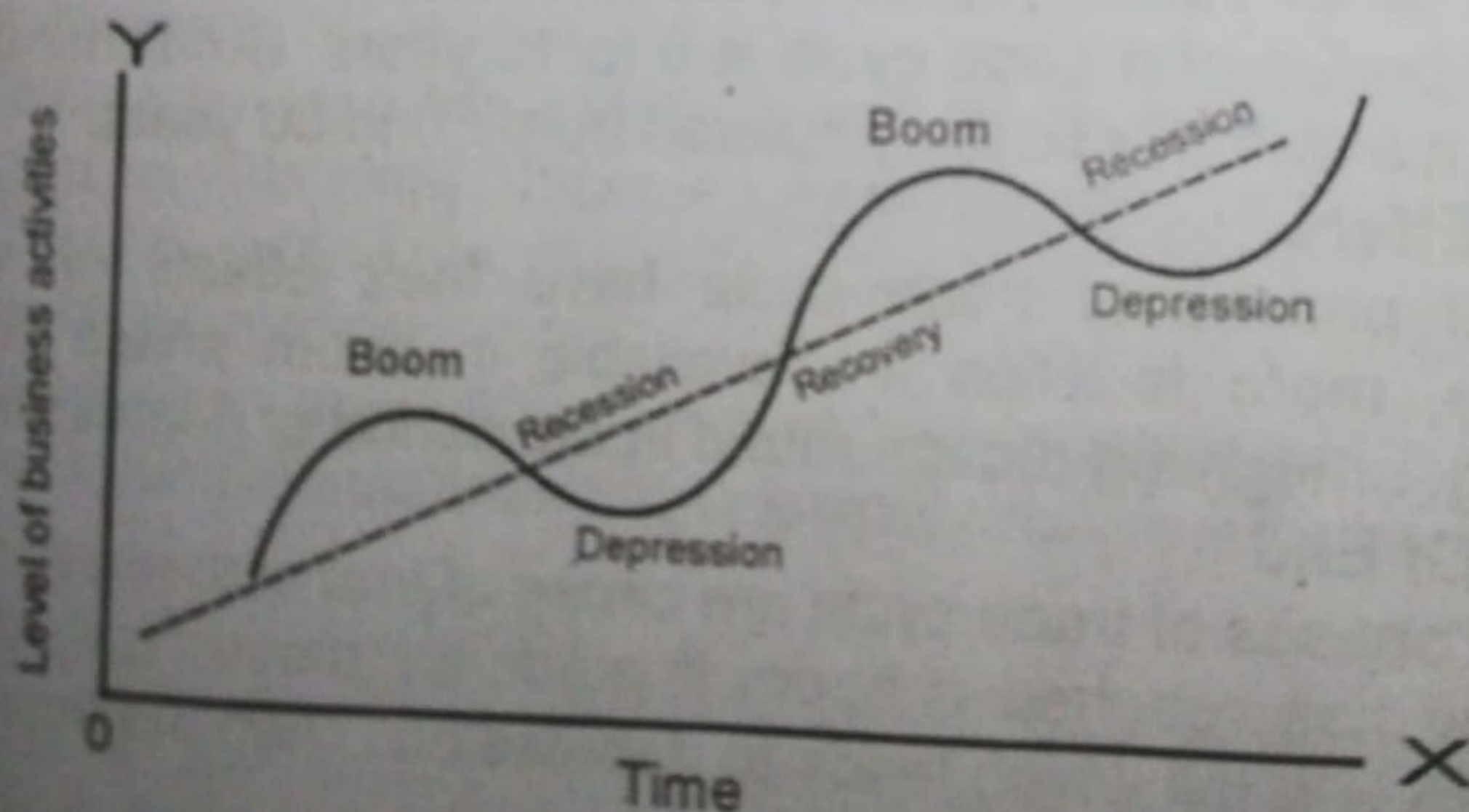
(viii) There is increase in factor's pricing and National Income increases.

(ix) The quantity and velocity of money increases.

(x) The expansion of every sector of the economy starts in this phase.

(xi) The entrepreneurs start chalking out new plans and policies.

The different phases of trade cycle are shown in the following diagram.



In the diagram, the time period on X-axis and the level of business activities are shown on Y-axis. The dashed line shows the normal growth path of the economy. The trade cycle starts from boom phase and next

comes recession phase. The slope of curve is negative in this phase. Then the revival phase starts and the slope of curve becomes positive. In this way, a trade cycle is completed.

CHARACTERISTICS OF TRADE CYCLE

The following are the characteristics of trade cycle.

(1) International Nature

All countries depend on each other due to international trade. Therefore, the trade cycle have international nature. If a country is passing through a phase of trade cycle, the other countries are affected by this process.

(2) General Nature

All the sectors of an economy are interdependent. If the agricultural sector is in depression situation, then the industrial sector is also affected by the depression situation of agricultural sector. Therefore, trade cycle have general nature.

(3) Difference In Intensity

There is a difference in intensity of a phase of trade cycle in various sectors of the economy. For example, the intensity of boom phase is greater in industrial sector than in agricultural sector.

(4) Difference In Speed

The important characteristic of trade cycle is that the recovery of the economy from depression is very slow and time consuming and from boom to recession is very fast.

(5) Difference In Period

The period of trade cycle is different. For example, some people think that the period of a trade cycle is 9 to 10 years. But some other people think that a trade cycle is completed from 50 to 60 years.

(6) Social Effect

Different phases of trade cycle have their effects on society. For example, more facilities are available in boom phase but hoarding, cheating, smuggling etc are found in the period of depression.

(7) Cause Of End

Various phases of trade cycle are cause of end of themselves. When an economy has reached a boom it gradually moves towards recession and there is a fall which leads to depression. Then the economy comes towards revival automatically.

(8) High Level Of Income

The economists have observed that every next trade cycle causes the high level of income.