

Business Cycles

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The business cycle is a pulse common to most sectors of economic life and diverse countries. To explain this, a first clue is seen in the greater amplitude of fluctuations of investment or durable-capital-goods, which follows the **acceleration principle**.

Suppose you have 1 machine producing products with a sale of \$30. The next year, you invest \$20 to buy another machine and double the sales to \$60. If we view yearly sales and net investment apart, both of them have increased tremendously. However, on the following year, with enough machines working well, you buy no extra machines and leaves the net investment drops to 0, while the yearly sales remain in the same level. In other words, consumption has to continue to keep increasing at the same speed in order for investment to stand still. This is why it's called "acceleration principle".

What if the investment drops down? Recall the multiplier theory from the previous chapter, the slump of GNP will be at least a multiple of the investment decline. Since no business can keep increasing indefinitely, economists believe this acceleration principle and the multiplier theory interact to produce a cumulative deflationary (or inflationary) spiral.

Although most economists agree on this fact, they differ in their emphasis upon external or internal factors. On the one hand, importance is attached to fluctuations in inventions, in population and territorial growth and warfare. On the other hand, economists stress the way that these external changes are modified by the reactions of the economic system, by the credit practices of banks and fiscal policies, etc.