

DOES THE INEQUALITY CAUSE THE TRADE CYCLES?

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Trade cycle means the cyclical fluctuations in aggregate economic activity. Different theories have presented to explain the causes of Trade Cycle. In which different causes of it discussed but one of the major cause of it is usually ignored i.e. the Inequality. Inequality and Trade Cycle are closely related. Inequality in income distribution is one of the major causes of the trade cycle. Inequality may cause the trade cycle and also speedup the intensity of the different phases of trade cycle, caused by some other factors. Let's study the role of Inequality in the different phases of trade cycle one by one and then "The Measure to Control the Trade Cycles."

a) INEQUALITY AND THE PHASES OF TRADE CYCLE.

EXPANSION

We start with an example of a typical economy, where there is the inequality in the income distribution in the Economy and society is divided into two groups; "The Rich" minority, which holds most of the income in their hands. On the other side "The Poor" majority, those usually hold only the 20%-25% of the income and constitute the 80% of the total population approximately. "The Rich" which include the businessmen, investors and industrialists have most of income in their hands. So, they increase the investment. As a result the income of the people increases, due to the multiplier effect of this investment. So, the aggregate demand, employment, price level and output go on to rise. Aggregate economic activity increases. Prices of the commodities and the profits of the producer and the investors ("The Rich") start rising. Overall economic activity takes momentum. The output, employment, demand and Price level reach to its peak point. Economy enters into the phase of "Boom" or Expansion.

RECESSION

During the phase of Expansion or Prosperity, the demand, output, employment and Income are at the highest level. All these factors are tending to raise the level of prices. But wages and salaries are not raised in the same proportion as the profits of "The Rich" increases. And if there is Inequality of the Income distributions, then it means due to expansion income is collected into few hands. And due to Prosperity prices of the commodities and the profits of the businessmen ("The Rich") are going on to rise. So, they are increasing the Investments. But at the same time income of "The Poor" majority is not increasing with the same proportion. As a result the purchasing power of "The Poor" is decreasing and which cause to decrease the Aggregate Demand. But the Aggregate Supply by the producers and investors are going on to increase. And due to the "accelerator effect" the aggregate supply and output increases further. But at the same time the aggregate demand remains low due to low purchasing power of "The Poor", which results in the deficiency of Aggregate Demand. There is over production in the economy. Due to this, the level of price tends to decline; producers and businessmen decline the investment and production. A cumulative process of decline in the employment, income, output and wages starts. As there is unequal distribution and the income of labor or poor class reduces due to unemployment. And aggregate demand further reduces. Recession becomes more severe and causes to begin the phase of depression. As M.W. Lee says, "A recession, once started, tends to build upon itself much as forest fire, once underway, tends to create its own draft and give internal impetus to its destructive ability."

DEPRESSION

Recession merges into depression when there is general decline in economic activity. Inequalities give further impetus to the process of reduction in output, employment, income, demand and prices. During depression, due to the decline in income and employment, the majority of poor population, which hardly met their livelihood, becomes poorer and their purchasing power further reduces due to the "multiplier effect". The fall in purchasing power is the fundamental background of the fall in the general level of

prices. So, businessmen face losses. Overall economic activity declines and economy reaches to its lowest or standstill point.

REVIVAL

The depression may prolong for a long period of time, if there is a severe inequality. But sooner or later the “originating forces” set in motion, which ultimately convert the contraction phase in revival. Because during depression consumption and demand reaches to their minimum point and it cannot be reduced further. Expenditures of “The Rich”, their purchasing is not so affected, and the wear & tear expenditures or replacement cost on semi-durable goods leads to increase in demand. To meet this demand, investment and output tends to grow, employment generates. And process of revival becomes cumulative. As a result level of employment, income, demand and output rise steadily. Business activity increases and revival turns into boom and the cycle complete.

So, it is clear that inequality causes the trade cycles

a) MEASURES TO CONTROL THE TRADE CYCLES.

To control the business cycle, there should be reduction in the inequalities. And government transfer payments, other security allowances and charity expenses by private sector can play a vital role to reduce the intensity of the trade cycle. For example, during expansion, aggregate demand is higher than the aggregate supply. If the producers spend some part of their profits for the charity, instead of increasing the investment they can reduce the deficiency in aggregate demand. When, due to these Transfer Payments, the income and the purchasing power of “The Poor” increase. This increase in the income of “The Poor” has an accelerator effect on the aggregate demand and investment. There will be equilibrium between aggregate demand and aggregate supply. And the phase of expansion may be extended.

Similarly, in depression the charity funds and other transfer payments by government and “the Rich” can control the depression and recession, because these spending have a multiplier effect on the investment and on the aggregate demand. As a result the Trade cycle may be controlled or its intensity may be reduced.

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