

Cyclicality - Unavoidable Process in the Economic Evolution

Băeșu Camelia
„Ștefan cel Mare” University of Suceava
cameliab@seap.usv.ro

Abstract

In general, conditions of economic nature undergo changes; moderate expansions give often birth to inflation and it turn to recessions. Lately more and more economists have tried to approach a series of aspects concerned with the development of business cycle at macro-economic level, the relationship existing between business cycle at macro-economic level and business cycle specific to micro-economic one.

When identifying a business cycle special attention is given to the periods in which the economic activity declines. The phases of cyclic movement are mutually conditioned and prepare in time the premises which provide the economic activity with continuity, qualitative changes and progress.

Key words: Cycle, cyclicality, fluctuations, productivity

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1. Introduction

In time, economic activity does not have a uniform, linear evolution, but a fluctuant one. Therefore, distinction must be made between the following categories of fluctuations: (Negucioiu, 1996, p.208)

➤ *seasonal fluctuations* of economic activity which occur all along the same calendar year and are generated by natural or social causes. They have a high degree of predictability (they can be generated by the seasonal character of some activities which are being carried on in agriculture, in the field of building industry, tourism industry) and they can also be determined by a series of social circumstances (traditions, habits, religious holidays);

➤ *accidental fluctuations*, usually determined by a series of events and causes which cannot be foreseen in advance such as: natural cataclysms, diverse political and social events;

➤ *cyclic economic fluctuations (aggregates)*; these fluctuations are generated by internal economic causes of functioning of national economies and they occur with a certain regularity. Such fluctuations, with cyclic character, occurred significantly at the beginning of the 19th century, and the following conclusion has been drawn from their analysis that the alternation of business expansion and contraction periods, of the economic activity on the whole is being carried on with a certain regularity in time.

On the whole, the evolution of main economic phenomena is carried on under wave-like form having a cyclic character.

In the characterization of cyclicality, as a movement form of economic activity, it starts from the succession and repeatability in time of some economic estates (certain phases of cycle) which resemble in broad lines from one cycle to another. The phases of cyclic movement are mutually conditioned and prepare in time the premises which provide the economic activity with continuity, qualitative changes and progress. Therefore, economic theory has drawn the conclusion that cyclicality is the natural, normal form of evolution of the economic activity.

2. On Cyclicity

The literature provides a multitude of definitions of the concept of economic cycle.

Paul Samuelson defines the concept of business cycle "as an oscillation in the total national production, income and use (labor force)", which in the author's view lasts between two and ten years, being marked by „ a large extraction or contraction in the most sectors of economy". (Samuelson, 1992,p.551)

An important role in economic cycles is played as well by Joseph Schumpeter (his books *Die Theorie der Wirtschaftlichen Entwicklung* ; *Business Cycles*, who considers that an economic cycle consists of the phase of prosperity, phase of recession, phase of depression and phase of recovery.

Arthur Burns and Wesley Mitchell, in the study *Measuring Business Cycles* identify a few of the relevant characteristics of business cycle: (Burns, 1946, p.480)

➤ It is „ a type of fluctuation of the aggregated economic activity of a nation that organizes its activities in the main on the count of trading companies”;

➤ A business cycle consists in an expansion which „occurs at the same time in many economic activities” followed by a period of recession;

➤ The duration of a business cycle can be longer than a year, up to 10-12 years.

The literature provides more categories of economic cycles: long cycles, decennial cycles and short cycles.

➤ Long cycles have a period of evolution from 20-30 years up to 500 years; they include cycles of 100 years, cycles of 180 years, cycles of 500 years and Kondratieff cycles;

➤ Decennial cycles or also called Juglar after the name of the French economist concerned with the evolution of medium-term fluctuations;

➤ Short or Kitchin cycles, thus called after the name of the American economist who in the year 1923 highlighted them.

Kondratieff cycles identify a dominant ascending part of prosperity as well as a descendent one specific to the decline period of economic activity.

Ascending phase is characterized by preponderance of years of economic prosperity and relatively high growth rhythms of the national income, investments, production, sales, including sustained raise of the standard of living. According to Kondratieff, this phase is specific to the following periods: (Tacu, 1998, p.387)

* 1779-1814, when: the industrial revolution is propagated from England towards other countries, constructions and agriculture are developed (England); investments in USA and Europe are encouraged, a moderate rate of interests is kept.

* 1849-1873, when: a low rate of interests is kept; the first signs of economic boom in Germany are registered; remarkable discoveries and inventions (steel, chemicals) are made;

* 1896-1920, innovations and inventions previously made, become widely exploitable; Taylor's and Fayol's ideas are getting spread (both in the USA and Europe); interests are kept relatively low and credit availabilities are registered; the unitary national state is getting formed in Romania, developing measures of national industry are adopted.

* 1939-1971, at the beginning of this period a lower rate of economic growth is registered; in all capitalist countries the development of company structures of corporation type are encouraged; the reconstruction after the second world war takes place in Romania, by promoting centralized economy.

In *the descending phase* a slowdown of the rhythms of production growth takes place, including investments and incomes, while the persistence of some negative phenomena in economy (inflation, unemployment) are accentuated. The periods specific to this phase are mainly characterized by:

* 1814-1849, real incomes and demand are gradually reduced; great financial speculations take place; attraction of bond papers in financial fluxes brings about an explosion of prices; economic decline is emphasized also by the material losses registered after the world wars and revolutions which took place all over the world; the revolution of 1848 takes place in Romania.

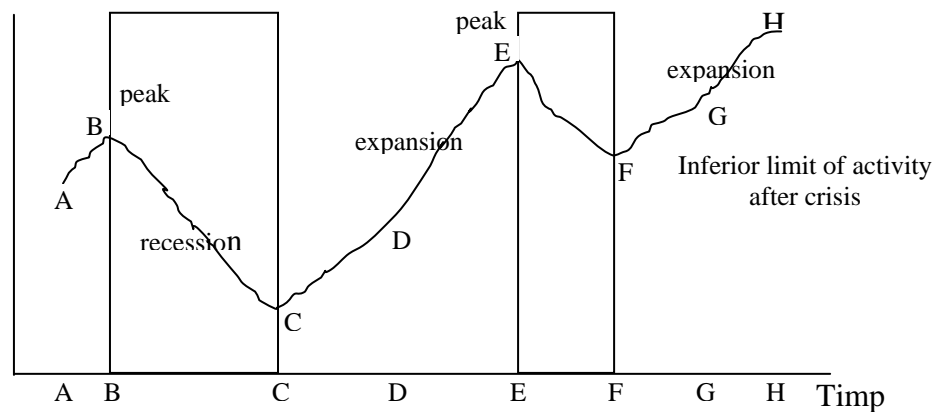
* 1873-1896 is the period when unemployment reaches high rates both in Europe and in the USA; global demand is reduced; drops in the exchange house in Wien, London are registered; the first great strikes take place in Europe and USA.

* 1920-1939, the beginning of recession is marked by the year 1920 when the highest level of interest rates is registered; in 1929 stock exchange market crashes in USA and in other western countries; massive bankruptcies are registered all over the world; credit price increases and global demand is drastically reduced.

* 1971- 1997, is the period when fundamental changes take place in Central and East Europe; new economic regional groups are getting formed; as trading exchanges are getting diversified, developed countries take advantage significantly of comparative account; the transition in the East European countries requires supplementary investments and credits provided by the Occident; the number of member states increases within the European Union (15 member countries).

Decennial cycles are also known as Juglar type cycle, after the name of the French economist Clement Juglar who analyzed them. In the paper *Des crises commerciales et leur retour périodique en France, en Angleterre et aux États Unis* (1860) Clement Juglar identifies four phases of this cycle: prosperity, crisis, liquidation and recession. (Houston, 1995,p.22). The Juglar cycle is characterized by regularity (there is a period of 6-10 years), generality (it is found in the main activity branches and all capitalist countries) and great amplexness (a relatively long period between the highest and the lowest level of activity is registered)

Figure no.1 Phases of decennial cycle



Source: P. Wonnacott, R. Wonnacott, *Economics (Third Edition)*, Mc. Graw – Hill, Inc, 1986, p.138

Small or Kitchin cycles are specific to the sector of constructions and farmers. These cycles do not show themselves by a real crisis but by braking expansion which influences the overall economy.

3. Economic Fluctuations

Economic market theories register fluctuations at the general level of economic activity.(Stiglitz, 2002, p.559)

Expansion (boom) is characterized by an increase in sales and prices and by a general growth of incomes. In such a more favorable economic conjuncture, businesses flourish and demand of goods becomes dynamic with perspectives of getting consolidated. A strong investment process takes place in economy together with the modernization of the existing capacities of production and generation of new ones, and the increase in demand of consumption goods is the determining factor for production growth and employment rate of labor force. The company accrues fast the volume of sales, products are well received on the market by clients, and the profit made is big enough to cover the investment expenses.

In this phase artificial stimulation of demand takes place in multiple ways, making obvious stock growth in view of bargain sales with greater gains. Aggregated demand in artificially stimulated growth, by enlargement of monetary mass and rotation speed of currency determines a slow but long term tendency of price rise. Monetary authorities adopt measures against inflationist phenomena in order to slow down the global demand, especially by rising interest rate fact that leads to slowdown of investments. Effective rate of profit in new investments tends to be smaller than the anticipated one, thus causing a slowdown of renewal and modernization of production capacities. Under these circumstances, economy enters a new phase, a new cycle. (Băeșu-Constantinescu, 2005, p.168)

To describe the moment when economy goes from the expansion phase to the recession one or the other way around, economists use notions of inferior peaks and points of hump. The local maximum of production is the peak whereas the local minimum of production is the inferior point of hump. Since the Second World War and up to present the medium duration of expansions has been of 56 months, the shortest expansion has been of 12 months, and the longest has been of 106 months. (Stiglitz, 2002, p.559).

A crisis is being defined as a temporary but often violent and profound break of an ascending evolution of economy, balance between production and consumption which follows after the maximum point of growth in a cycle. The so-called crisis is a sudden, disturbing phenomenon which in the company is felt by an abrupt fall of prices, by massive dismissions of labor force, by stock exchange crashes, and even by the bankruptcy of that company.

Depression is the period which comes after crisis and it is characterized by stagnation of economic activity, diminishing of production, price cutting, unemployment increase, a series of companies withdrawing their activities or slowing them down. The demand tends to decrease more and more as a consequence of the deceleration or reduction of investment process as well as because of diminution of incomes of some part of the population, this one being unable of dealing with price rise. A reduction in current production volume takes place under the incidence of diminution of orders correlated to tightening of monetary mass and significant decrease of profit rate, shares' flow. The companies that have born up the crisis and depression are adopting drastic measures of cost reduction such as renewal of active labor means based on some technical innovations.

Recommencement or reanimation of economic activity is closely related to the update of permanent capital and especially of its active part, fact that leads to the overcoming of the lowest point in the cycle in question. The company tries to improve its production capacity and find new ones. Thus, the demand for labor force increases and reduction of unemployment takes place.

Recovery or reanimation of activity turns gradually into a boom whose duration can differ depending on the conditions of every country.

Modern economies are being faced with cyclic fluctuations of businesses. The international crisis since the 1950s influenced the economies all over the world. The price rises of oil since 1973 had global consequences leading to the entry to recession of most industrialized economies. Statistical data show that in the period 1990-1991 countries such as USA, Canada and Great Britain have come across recession, while Japan has undergone an economic growth. After the year 1991, the economies of these three countries began to recover and register some economic growth as well, while Japan's economy has known a prolonged recession period until the year 1995. (Stiglitz, 2002, p.566).

4. Conclusions

Business cycles are specific to each economy, but their frequency, duration and amplitude differ significantly from one country to another. It is difficult to draw a comparison between business cycles registered over the time at international level (Stiglitz, 2002, p.566).

Increase in productivity is the fundamental element of economic growth and implicitly of the standard of living in a modern economy. In the moments when the economy goes through expansion and recession periods, PIB and occupancy of labor force fluctuate. To understand the

way business cycle influences productivity one should analyze the evolution of a company when the economy goes through a recession period. (Stiglitz, 2002, p.675)

It should be taken into consideration that companies do not have an identical evolution on the market; the evolution of distinct phases of business cycles can be in the following situations: on the ascending phase, the cyclic evolution of economic agents can be constant and in regard to the economic growth, and on the descending phase the cyclic evolution of economic agents can lead either to the company's recovery or to its bankruptcy. Consequently, in practical activity there is a relationship of dependence between the business cycle at macro-economic level and that at micro-economic level.

In the characterization of cyclicity as a form of movement of economic activity it starts from succession and repeatability in time of some phases of economy (certain phases of cycle) which resemble in broad lines from one cycle to another. The phases of cyclic movement are mutually conditioned and prepare in time the premises which provide the economic activity with continuity, qualitative changes and progress. Therefore, the economic theory has drawn the conclusion that cyclicity is a natural, normal form of evolution of the economic activity.

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