The macro economic peak theory

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The Business Cycle has movements; these are ups and downs in form of peak, recession, trough, expansion, and effect 3 major economic activities

- Industrial Production
- Employment
- Real Income

The Macro Economic Peak Theory states that "**It is possible to avoid the recession and troughs of Business Cycle** ".

<u>Explanation of The Macro Economic Peak Theory:</u> The business cycle has ups and downs in form of four points

** Peak: At this point the economy is on top of activity.

- Industrial Production: Industrial Production is on top.
- Employment : Employment is on maximum rate, most people of working age population are doing jobs.
- Real Income: House hold can afford to buy maximum quantity of goods.

**Recession: This is decline in activity across economy.

- Industrial Production: Industrial production starts to fall or is falling.
- Employment : Employment rate starts to fall or is falling.
- Real Income : Real Income starts to fall or is falling.

**Trough: At this pointy economy is at lowest activity.

- Industrial Production: It is at minimum.
- Employment : It rate is at minimum rate.
- Real Income : It is at minimum, prices are high and consumption power of consumer is low.

** Expansion: At this point economy is growing.

- Industrial Production: Industrial Production starts to increase or is increasing.
- Employment : Employment rate starts to increase or is increasing.
- Real Income : Real Income starts to increase or is increasing.

The Macro Economic Peak Theory states that "**It is possible to avoid recession and troughs of Business Cycle (economic activity)".** This is to be done with help of Macro Economic Peak Tools.

Macro Economic Peak Tools: Macro Economic Peak Tools are the tools to avoid recession and troughs. These tools are

****Government Purchases**: Goods and services purchased by government are Government Purchases.

** **Taxes**: Taxes are the financial charges upon individuals and legal entities by state. These taxes are both direct and indirect.

****Subsidies**: Subsidies are payments made by government to private producers.

****Transfer Payments:** These are payments usually by government where no good / service, is received in exchange.

<u>Usage of Macro Economic Peak Tools</u>: The usage of Macro Economic Peak Tools depends upon the judgment of Economic Analysts. When Economic Analysts judge a depression or decline in economic activity, or depression or decline in economic activity coming ahead, They may implement the Macro Economic Peak Tools and give a upward push to economy.

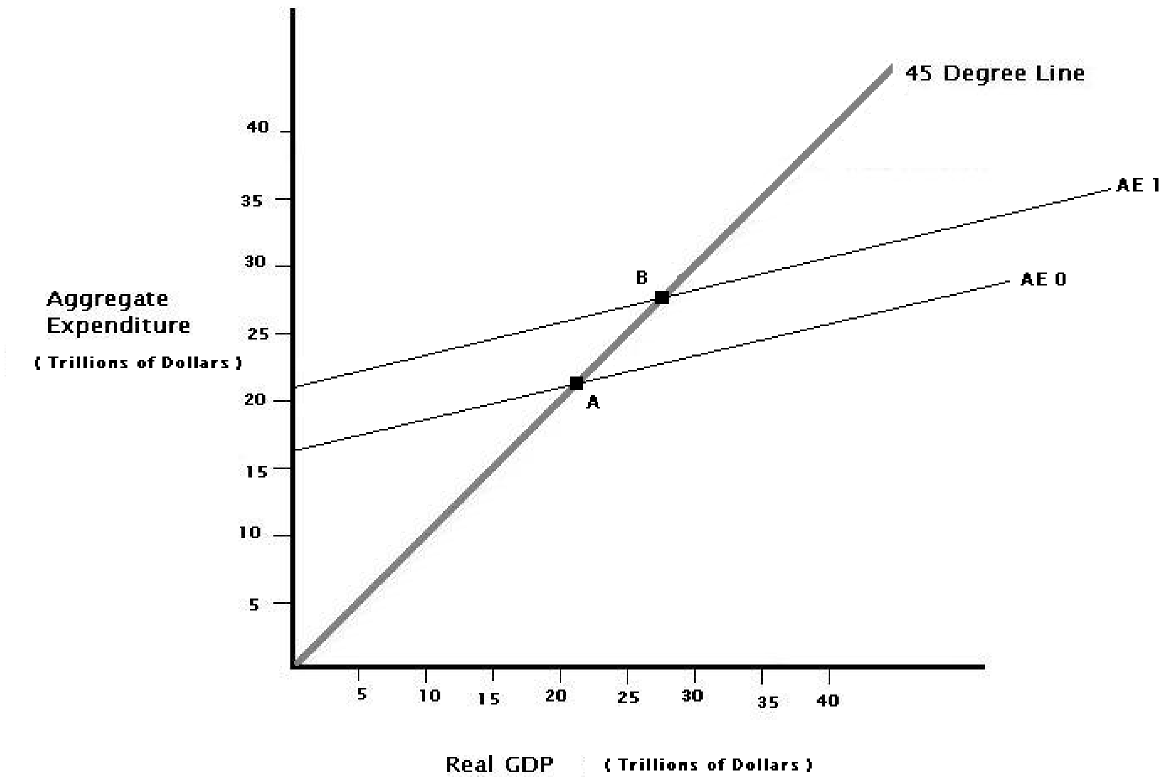
I) **Government Purchases**: Increase or Decrease in government purchases has effect on economy and on aggregate expenditure.

Example: Government Purchases in 1960 at Cape Canaveral, Florida, increased Aggregate Expenditure and gave upward push to economy.

**Effects of Increase in Government Purchases:

- Industrial Production: Increase in government purchases increases Aggregate Expenditure and gives a boast to industrial production.
- Employment: Increase in government purchases increases Aggregate Expenditure and gives a boast to employment.
- Real Income: Increase in Government Purchases increases Aggregate Expenditure and gives additional spending capacity to people.

Graph:



Initially AE 0 (aggregate expenditure) was at point A. Increase in Government Purchases resulted in increase of aggregate expenditure. The real GDP also increased thus AE 0 became AE 1.

**Effects of Decrease in Government Purchases:

- Industrial Production: Decrease in government purchases reduces aggregate expenditure so industrial production falls.

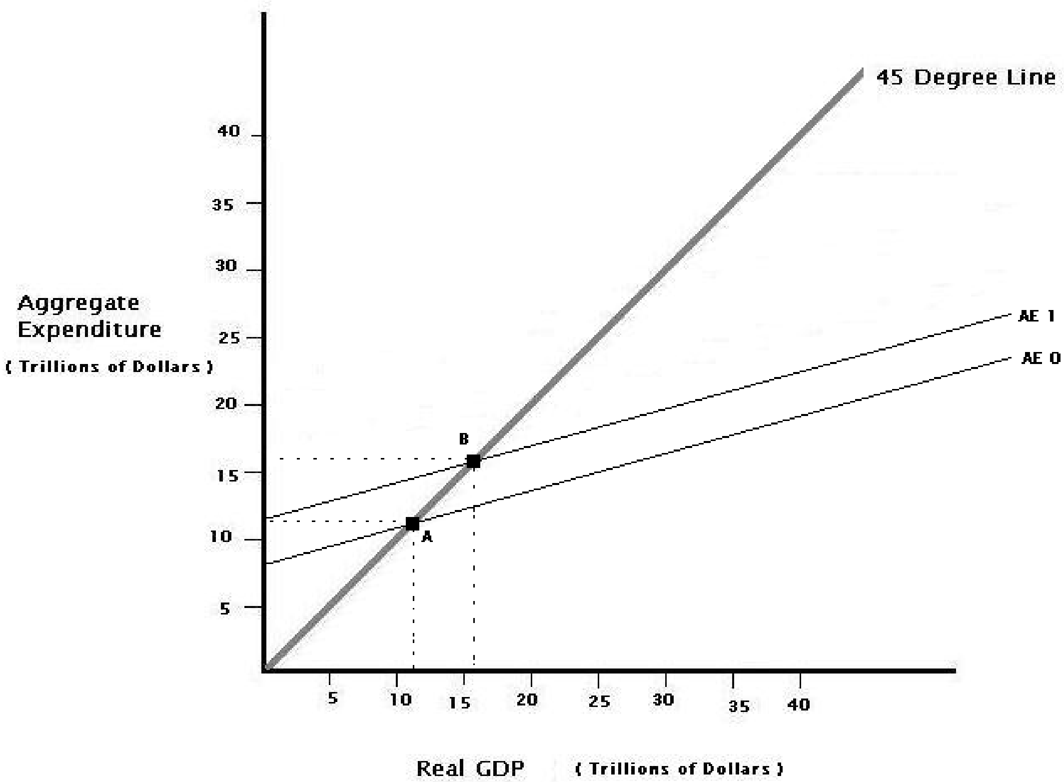
- Employment: Decrease in government purchases reduces aggregate expenditure which results in fall of employment.

- Real Income: Decrease in government purchases reduces aggregate expenditure this reduces real income.

II) **Taxes:** Increase or Decrease in taxes both direct and indirect has effect on economy. They effect the aggregate expenditure.

**Effects of Decrease in taxes:

- Industrial Production: Decrease in taxes reduces cost of production; it gives a boast to industrial production.
- Employment: Decrease in taxes increases demand and require more production this results in rise of employment.
- Real Income: Decrease in taxes results in increase of real income (enhances spending capacity of the people).



Initially aggregate expenditure was as AE 0, decrease in taxes (direct, indirect or both) effected the AE 0 and shifted AE 0 upwards (AE 0 becomes AE 1), this increases the real GDP and gives upward push to economy.

**Effects of Increase in Taxes:

- Industrial Production: Increase in taxes results in increase in cost of production, this decreases the industrial production.

- Employment: Increase in taxes results in decrease in demand these further results in a cut in production and finally decreases employment.

- Real Income: Increase in taxes results in fall of real income.

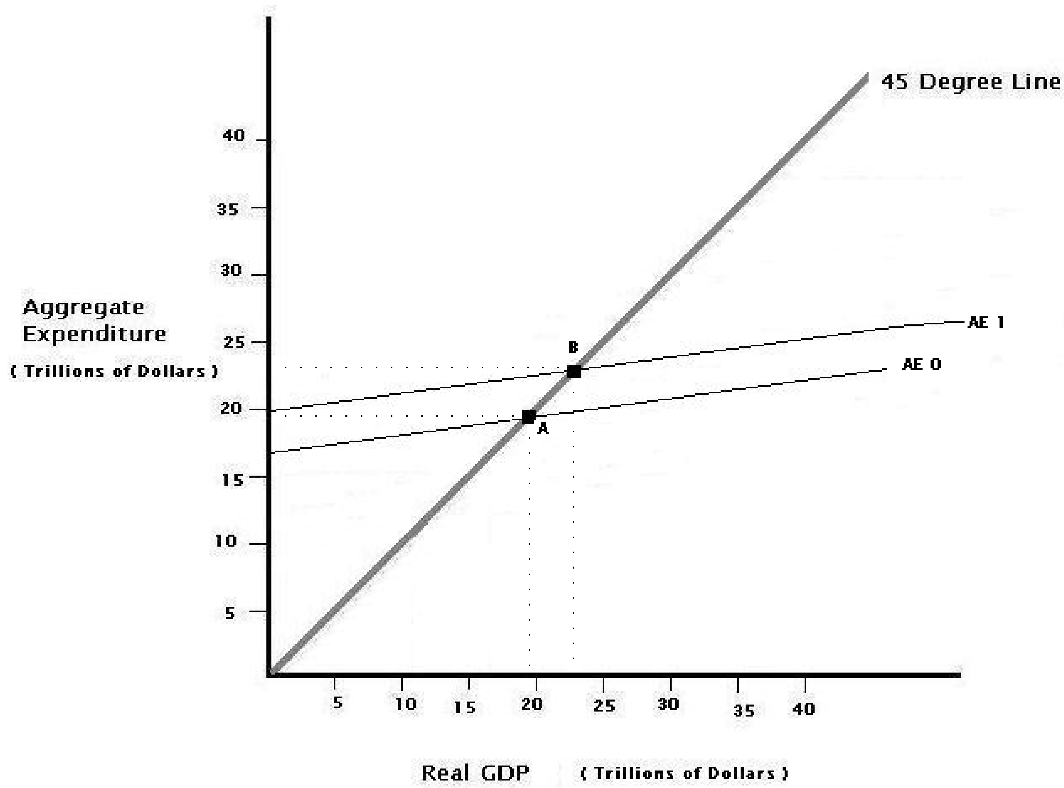
III) **Subsidies:** Increase or decrease in subsidies makes the good / service cheaper or expensive and effects the quantity of good / service consumed, therefore aggregate expenditure is effected.

**Effects of Increase in Subsidies:

- **Industrial Production:** Increase in subsidies gives to producers, decreases cost and industrial production is increased.

- **Employment:** Increase in subsidies decreases cost which may result in firms hiring more people (employment increased).

- **Real Income:** Increase in subsidies makes the good cheaper – people buy more goods therefore real income is increased.



Initially aggregate expenditure was at AE 0 aggregate expenditure is 19.5 Trillion Dollars at point A and real GDP is 19.5 Trillion Dollars. The Government announced increase in Subsidies, increase of subsidies moved the aggregate expenditure upwards the new aggregate expenditure became 24.5 Trillion Dollars and new real GDP also became 24.5 Trillion Dollars at point B. This gave an upward push to economy.

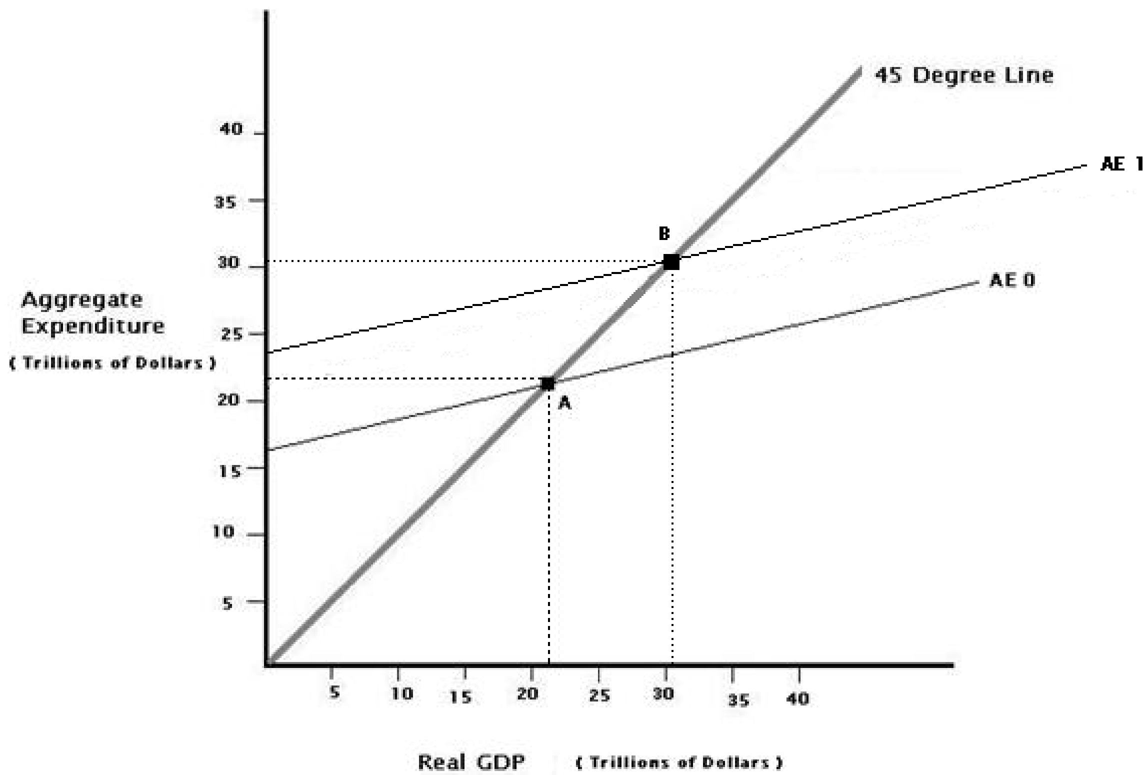
**Effects of Decrease in Subsidies:

- Industrial Production : Decrease in subsidies result in increase in cost of production , the industrial production falls
- Employment : Decrease in subsidies result in greater cost of production, therefore employment falls
- Real Income: Decrease in subsidies makes the good expensive - people buy more goods , therefore real income decreases.

IV) Transfer Payments: Increase or decrease in transfer payments results in rise or fall of Aggregate Expenditure.

**Effects of Increase in Transfer Payments:

- **Industrial Production:** Increase in transfer payments results in increase in demand therefore industrial production rises.
- **Employment:** Increase in Transfer Payments results in increase of demand, the industrial production rises, therefore employment also rises .
- **Real Income:** Rise in transfer payments result in increase of real income , consumption rises , aggregate expenditure rises.



Initially AE 0 was at point A. The increase in transfer payments resulted in purchase of more goods and services by consumer. Therefore aggregate expenditure also rises and AE 0 becomes AE 1 at point B.

**Effects of decrease in Transfer Payments:

- **Industrial Production:** Decrease in transfer payments may result in decrease in demand of goods and services.

- **Employment:** Decrease in transfer payments results in decrease demand therefore producers may cut the production, Employment decreases.

- **Real Income:** Decrease in transfer payments results in fall of real income, the consumption falls therefore aggregate expenditure falls.

Implementation of Macro Economic Peak Theory: The implementation of Macro Economic Peak Theory requires economic expertise and suitable mixture of "Macro Economic Peak Tools". The increase or decrease mixture of

- Government Purchases
- Taxes
- Subsidies
- Transfer Payments

Is to implemented in such a way that **Aggregate Expenditure is increased.** This increase in expenditure would give a upward push to economy and recessions and trough could be avoided.

Example:

Suppose that NBER (National Bureau of Economic Research) judge a recession they may suggest the suitable increases or decrease mixture of Macro Economic Peak Tools (which results in increase in Aggregate Expenditure). This would give up ward push to economy.

<u>Benefits of The Macro Economic Peak Theory</u>:

- Gives always improving atmosphere , which attracts foreign investors
- Gives economic growth
- Gives upward push to economy
- Increases Industrial production
- Increases employment
- Increases real income
- Improves living standard of citizens
- Increases exports

- - The End - -