Hicks' Theory of Trade Cycle:

Hicks put forward a complete theory of business cycles based on the interaction between the multiplier and accelerator by choosing certain values of marginal propensity to consume (c) and capital- output ratio (v) which he thinks are representative of the real world situation.

According to Hicks, the values of marginal propensity to consume and capital-output ratio fall in either region C or D of Fig. 13.7.

As seen above, in case values of these parameters lie in the region C, they produce cyclical movements (i.e., oscillations) whose amplitude increases overtime and if they fall in region D1 they produce an explosive upward movement of income or output without oscillations. To explain business cycles of the real world which do not tend to explode, Hicks has incorporated in his analysis the role of buffers.

On the one hand, he introduces output ceiling when all the given resources are fully employed and prevent income and output to go beyond it, and, on the other hand, he visualizes a floor or the lower limit below which income and output cannot go because some autonomous investment is always taking place.

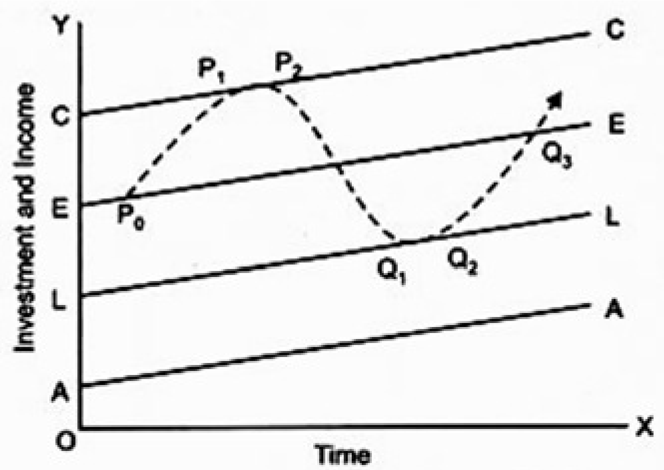

Fig. 13.7. *Hicks 'Model of Business Cycles*

Another important features of Hicks' theory is that business cycles in the economy occur in the background of economic growth (i.e., the rising trend of real income of output over time). In other words, cyclical fluctuations in real output of goods and services take place above and below this rising line of trend or growth of income and output. Thus in his theory he explains business cycles along with an equilibrium rate of growth.