Role of the construction industry in economic stability economics essay

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Monetary policies involves the use of interest rates and other monetary tools in an attempt to manage macro economic variables such as inflation, the level of consumer spending, consumer confidence, exchange rate index, economic growth and unemployment in an economy. Recession is a result of widespread downturn in economic activity and the government could react by the use of expansionary monetary policy which involves reducing banks' reserve requirements, by lowering interest rates to increase money supply and boost economic growth. This policy could also be applied contractionary, to control the rise in demand by increasing the interest rates thus reducing the supply of real money in the economy. This plays a great role in controlling inflation (Economy watch).

In the UK, monetary policy is being controlled by the bank of England which has independence in setting interest rates. The objectives of the UK government in the recession have been to reduce inflation, reduce unemployment, influence consumer spending and build a strong economic growth.

Limitations Of Monetary Policies

Although expansionary monetary policies could help reduce the severity of an economic recession, there is no guarantee achieve the desired results due to the following limitations.

It is difficult to control many economic variables with just one tool – interest rate

Low interest rates may fail to encourage consumer spending if there is little confidence in the economy. They might fail to increase their spending if their

jobs are at risk because of the downturn in the economy – Liquidity trap. Banks are unwilling to increase their lending during a recession, and businesses may not be able to invest in new facilities for expanded operations due to the confidence level in the economy.

Time frame: the effect of policy decisions, a decrease in interest rate could take as long as a year or more to be felt and have a significant impact on a recession.

Interest rates could have more effect on some sectors of the economy than on other sectors. A reduction in interest rates reduces the rates on mortgage payment, thereby increasing their disposable income but reducing the disposable income of people with savings.

A change in interest rate has an effect on the exchange rate index.

Fiscal Policies

Fiscal policies are the use of changing taxation and government spending in an effort to influence the level of planned expenditure in an economy (aggregate demand) and thus, the level of economic activity.

Fiscal policy can be applied in various ways. In a recession, the government can increase their spending and cut down taxes thus increasing the disposable income of consumers which in turn boosts the level of economic activity (Expansionary fiscal policy). On the other hand, if there is inflation, the government can increase taxes and cut spending to slow the economy down a bit (Deflationary fiscal policy). Principally, the implementation of

fiscal policy tends to stabilise economic growth and activity, keeping away the boom and slump economic cycle.

Limitation Of Fiscal Policies

Time Frame: Effective management of the macroeconomic variables is difficult as fiscal policy is effectively made once a year during the annual budget while monetary policy decisions are taken monthly and each policy instrument could put a strain on the other one. The effect of the policy could take a long while to filter through the economy.

Since fiscal policy is implemented once a year during the annual budget, it will suffer from poor forecast information. For example, if a recession is being forecasted, the government would in turn increase spending and cut taxes to increase aggregate demand, however, if the forecast went wrong, it could cause inflation in the economy.

Effects of reduced government spending: Reduced spending could negatively affect public services such as education, defence, health, transport causing social inefficiency.

Cutting down of taxes might not in reality increase consumer spending if there is a low confidence level in the economy.

Budget Deficit: In a recession, increased government spending could lead to a budget deficit which would warrant increased taxes in the future and may cause a brain drain or crowding out in the economy.

Impact of government borrowing: Increased government spending to increase aggregate demand results in selling bonds and borrowing, during a recession, this leads to a decrease of the private sector investment.

Increased spending leading to higher interest rates could put pressure on interest rates thus causing a slowdown in economic activity.

The UK government in the 60’s and 70’s implemented the use of fiscal policy to stabilise economic activity. However, in the late 70’s experienced an increase in unemployment and inflation as evidence of the inadequacy of fiscal policy in maintaining economic stability. Current UK demand policy focuses more on the use of monetary policy because of its advantages over fiscal policy. Changes in interest rates can be effected easily than changes in government spending and taxes. Fiscal policy has more effects on government borrowing and work incentives thereby affecting the economy as a whole.

The Role Of The Construction Industry In Maintaining Economic Stability

The construction industry is greatly reliant on funds from the finance sector to fuel the demand for buildings and cash flow requirement of construction projects. Monetary and fiscal policies are applied to the economy to achieve their macroeconomic objectives and a change in these policies would have an impact on the construction industry (Geoff Briscoe, 2009).

An increase in interest rate will raise the costs of credit loans having consequences on the activities of the construction industry as well as the clients.

The rate of taxes determine how much disposable income consumers are willing to spend on all services including construction related activities which includes housing.

Source: H. M. Treasury

(Available: www. economicshelp. org/macroeconomics/fiscal-policy/uk-fiscal-policy. html)