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Economics and Construction

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To Mum and Dad

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Preface

Economics is concerned with resource allocation. It confronts explicitly the problems we all have to face: as householders choosing between commodities on the basis of the income and time we have at our disposal; and as owners or employees of firms or public sector organisations deciding which goods and services should be produced. Nowadays many students encounter economics as a subsidiary subject within their programme of study, not only within social sciences courses but also within humanities and applied science degree courses. This book is intended for students whose field of study lies within the activities associated with the construction industry, such as surveying, estate management and civil engineering.

For many, this will be their first experience of having to learn economics. The aim of this book therefore is to provide a self-contained framework that describes the basic principles of economic analysis in a relative context. The discussion is arranged into eight chapters, which build upon each other in a manner consistent with most economics textbooks. It will be shown that economics provides a clear framework within which construction activity can be analysed. As a result it is important for the student not only to understand the terminology used in economics, but also how to apply it in a relevant way. Consequently the economics is introduced in an order that facilitates an understanding of the subject rather than being contrived to fit in with construction-related issues.

The assumption underpinning Chapter 1 is that most readers will be picking up an economics book for the first time. It therefore provides a brief outline of some of the more general assumptions and definitions that underpin economic analysis. Essential to the successful application of economics to the construction industry, or indeed to any other industry, is an ability to be able to locate and utilise relevant data in essays, presentations, reports and other pieces of written work. To facilitate this process, Chapter 1 not only includes a section that identifies some of the publications that provide useful data, but also a discussion of some of the problems that can arise when interpreting such data. This section should not be taken to imply that the rest of the book contains a seemingly endless supply of statistical tables. Rather, the commentary simply uses relevant data where appropriate to emphasise or illustrate particular points. Figures are more easily remembered and utilised if they are presented in a memorable way. Tables are usually forgotten when it comes to writing essays or exam answers.

The remaining seven chapters encompass four broad topic areas, each related specifically to the construction industry: the economics of markets; the economic appraisal of projects; the economics of production; and the analysis of government policy. Chapters 2 and 3 focus on the factors that determine the way buyers and sellers behave towards each other and the characteristics of the markets that emerge as a result. It will be seen that, in some cases, governments choose to intervene in markets if it is felt that without such intervention 'undesirable' outcomes may result. Governments are likely to adopt a paternalistic approach if they perceive buyers and sellers to be ill-informed and/or opportunistic in their behaviour. Either can result in an undesirable mix of commodities being produced in tandem with an undesirable set of prices, for example cheap heroin and expensive health care. Furthermore, unregulated markets may impose costs on others without them receiving compensation in return. For example a factory that does not have to account for its actions may take no account of the pollution it produces if legislation does not require it to. To illustrate the principles that underpin the analysis of markets and the ways in which they may be perceived to 'fail', specific reference will be made to the housing market.

Chapter 4 addresses some of the problems that confront economists when they are asked to carry out appraisals of construction projects. It will be seen that the economist's approach goes beyond a simple cost-accounting process to identify both the costs and the benefits that are expected to arise from the development in question. With specific reference to the construction of roads, the discussion highlights a number of problems that economists frequently have to address: how to take account of the differential timing of the costs and benefits associated with projects; the problem of valuing commodities that are not traded explicitly on markets (and hence do not have a market price, for example the environment); how to take account of the possibility of uncertain outcomes; and whether it is possible to present results in a clear and unambiguous way.

The analysis contained in Chapters 5 and 6 focuses explicitly on firms and the industries to which they belong. Chapter 5 is concerned with the relationship between the inputs firms use and the outputs that can be derived from them, while Chapter 6 analyses the way in which the behaviour of firms is often determined by the degree of competition that exists between them. Given the emphasis the economics literature frequently places on the advantages of large-scale production, it is noted that the construction industry is characterised by a number of unique features that allow it to persist as an activity carried out by a large number of relatively small-scale firms.

The final two chapters are concerned with government policy, both

in terms of the variables governments seek to control (for example inflation and unemployment) and how the policies that result impinge on the construction sector. Chapter 7 is overtly theoretical, but this is necessary if the reader is to understand the rationale underpinning the policies that successive governments have adopted since the Second World War. It will be seen that until the mid-1970s, government policy (whether Conservative or Labour) reflected a belief that the government could 'fine-tune' the level of activity taking place within the economy. Subsequent governments, particularly since 1979, have adopted an alternative view: that such policies are not sustainable in the long term if the underlying state of the economy is not itself satisfactory. Hence the emphasis has been on policies intended to provide a stable economic environment, within which economic agents can operate effectively. As the output of the construction industry is used by many commentators as a crude barometer to measure the 'health' of the economy at any given time, the discussion identifies the ways in which changes in government policy have affected the performance of the industry.

In common with all other disciplines, economics has its own terminology. The same principles apply to learning economics as to learning a foreign language in anticipation of a holiday abroad: it is not only important to be able to memorise the vocabulary but also to understand the grammar and rules associated with it. Thus, although a glossary of the basic terms introduced in each chapter is provided at the end of the text, it is important to realise at the outset that time needs to be set aside to become familiar with the principles covered at each stage of the text. Although some people may initially deny that economics is a logical subject, it will soon be found that it can provide a consistent framework within which the construction industry can be studied and evaluated.

ANDREW J. COOKE

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