



Interest Rates, Investment by Small and Large Enterprises and Overall Effects on the Economy

Name:

Institution

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An increase in interest rates tends to moderate economic growth. Higher rates result in an increase of the cost of borrowing and reduction in the amount of disposable income. Consequently, this restricts the growth in consumer spending. On the other hand, a reduction in the interest rates leads to an increase of the number of people that are willing to borrow and make big purchases. Lower rates allow customers to have access to more money for spending and this has the potential of causing increased spending. Although low interest rates are desirable for both small and large businesses, they can freeze the economy (Harrison, 2019). For example, when the rates fall, small businesses may be more willing to borrow money for expansion purposes. Meanwhile, large companies can also borrow at low rates to finance a relatively larger expansion that may 'steal' the customers of smaller enterprises and possibly put them out of business. Contrary to popular opinion, small businesses are encouraged to only borrow when rates are high.

Research evidence suggests that a decrease in the interest rates causes a reduction in the cost of borrowing (Rosenberg, Gonzalez, & Narain, 2009). The opinion of most economists is that the major benefit of low interest rates is stimulating the growth of the economy by encouraging businesses to spend on capital goods (Caporale & Williams, 2002; Bosworth, 2014; Hansen & Seshadri, 2013). However, when the rates of interest fall, the big players in an industry can fully exploit the market situation to the disadvantage of small enterprises. Particularly, the major players are lent more money by the banks and this allows them to be more productive and grow relatively faster than the small businesses (Harrison, 2019). The small companies are unable to keep up with the pace at which the larger businesses are expanding, and in the long-term, the former ones become discouraged and stop investing in new technologies or products. Harrison (2019) explains that the leaders get so major since they are no longer vulnerable to competition from the smaller players in the industry. The overall impact of this market situation is a meltdown in productivity growth and sluggish growth of the economy.

The insights that Harrison (2019) provides in his article with regard to the effect of low interest rates are significantly persuasive. The author succeeds in debunking the widespread notion that is held by many economic experts that a decline in interest rates supports the growth of the economy. The long-term impact of low interest rates is low output and slow growth of the economy. Therefore, small businesses are discouraged to borrow when the interest rate is low as this may, in the long run, reduce the capacity to compete favorably with larger companies and as a consequence, they may be forced out of the market. It is suggested that further research should be carried out to determine the long-term impact of low rates on economic performance and to provide adequate empirical evidence.