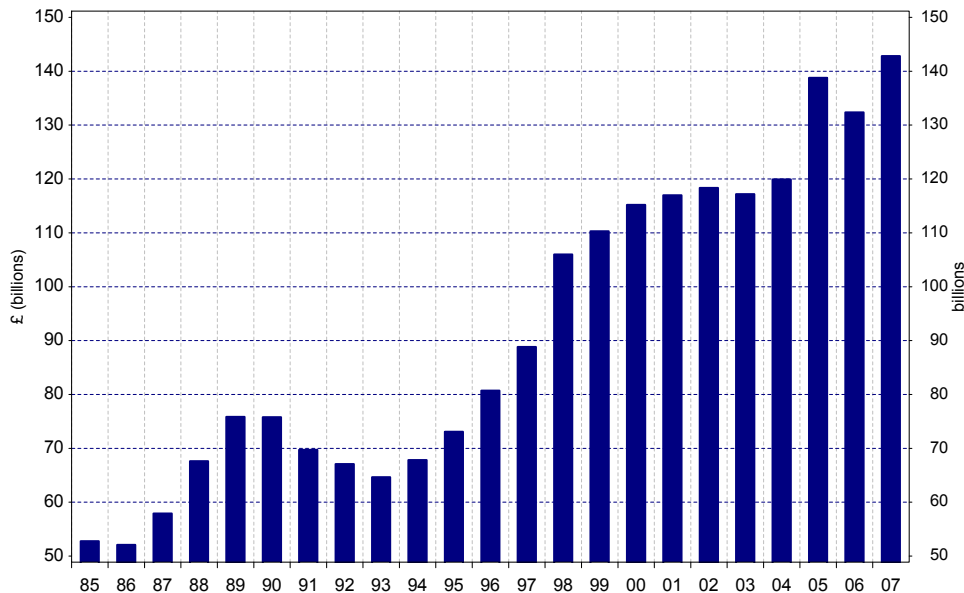


Revision: Investment and Economic Performance

Gross Fixed Capital Investment by Businesses

Investment at constant 2001 prices, £ billion



Source: Reuters EcoWin

In 2007 the real level of capital investment spending by private sector businesses in the UK economy reached a record high of £142 billion.

If we add in public sector capital spending then total investment amounted to around 17 per cent of GDP.

Investment is spending on capital goods in order to supply consumer goods and services in the future.

Investment is a component of aggregate demand (AD)

Private sector (business) investment driven by commercial factors (be prepared to explain two factors well)

1. Business confidence
2. Expected growth of demand
3. Costs of capital equipment
4. Prices of substitute factor inputs
5. Business taxation (corporation tax)
6. Economic uncertainty
7. Speed of technological change
8. Amount of competition in an industry / market
9. Willingness to take risks
10. Amount of investment being undertaken by other businesses

Businesses need to estimate the **expected real rate of return on a capital investment project** and then compare with the alternative uses to which funds might be put (**opportunity cost** becomes relevant)

Economic importance of investment

- Capital investment spending affects both the demand and the supply-side of the economy:
- There are economic and social effects from investment

Aggregate Demand (C+I+G+X-M) - Investment is around 18-20% of GDP although this varies year on year

Possible multiplier effects from projects

- Demand for factor inputs e.g. raw materials and components used to complete a project
- Rising employment – some jobs lost from new capital but many others created
- Profits and dividends from investment – a further source of income – boosts spending

Aggregate Supply

Fixed capital affects LRAS

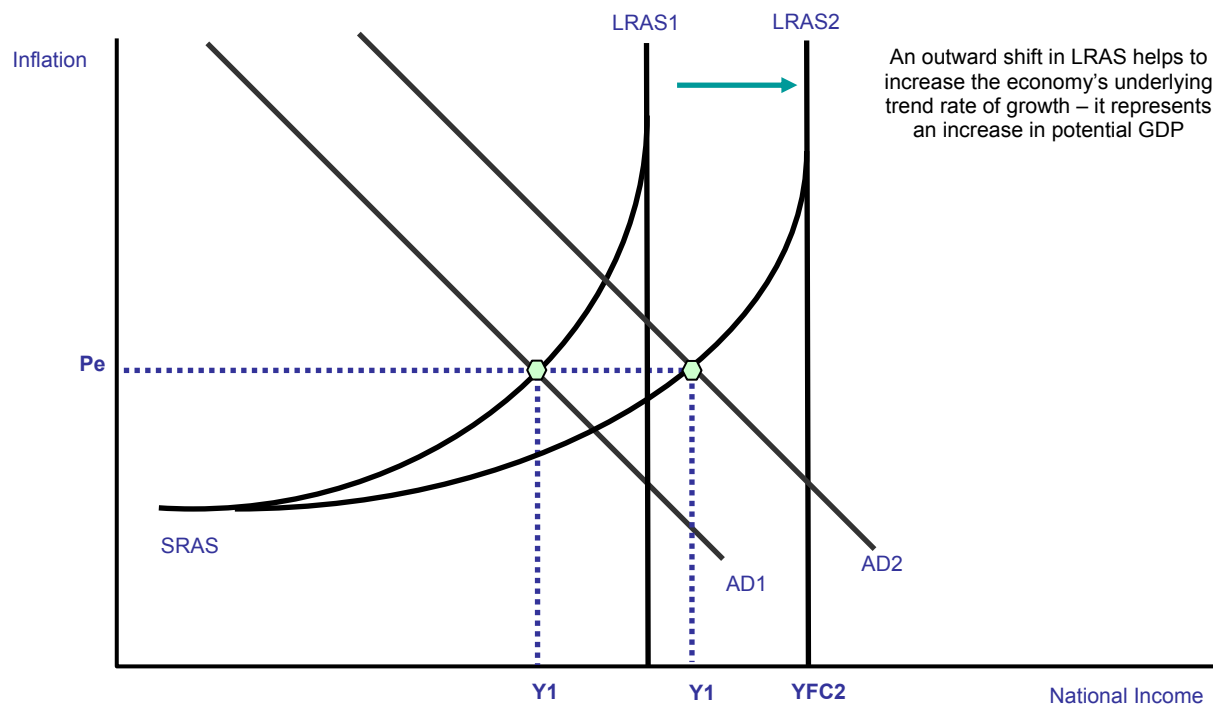
Important for the trend rate of growth (long run growth rate that the economy can sustain)

SRAS – involves using existing productive capacity

Economic Significance of Investment – 10 points to remember in revision

1. Employment creation
2. Helps to improve labour **productivity** – with a time lags
3. Creates capacity for **exporting** – helps to improve the balance of payments
4. **Economies of scale** / lower costs and prices – welfare gains for producers and consumers?
5. Key factor affecting "**trend growth**" – helps to improve living standards
6. Outward shift of the **PPF** could be used to illustrate the effects
7. Infrastructure important for **FDI inflows** especially transport and telecommunications
8. **Environmental benefits** from new technology e.g. improved fuel efficiency and investment in renewables
9. Boosts overall **economic competitiveness**
10. Investment in **public services** e.g. education and health

Key diagram to use is an AD_AS diagram showing how rising investment can boost both demand and supply



Test your understanding with a 5 question multiple choice quiz:

<http://vle.tutor2u.net/mod/quiz/view.php?id=2770>

Revision resources and study notes on investment available here:

<http://vle.tutor2u.net/course/view.php?id=4#section-7>

Quality of investment often as important as the quantity