2.2.3 Investment (I)

a) *Distinction between gross and net investment*
b) *Influences on investment:*
   - *The rate of economic growth*
   - *Business expectations and confidence*
   - *Keynes and 'animal spirits'*
   - *Demand for exports*
   - *Interest rates*
   - *Access to credit*
   - *The influence of government and regulations*

- Investment is money spent by firms on assets which they'll use to produce goods or services; an increase in the capital stock
- Savings and investment are different as savings tend to be made by households but investment is made by firms
- Firms invest with the intention of making profit in the future
- Investment makes up about 15% of AD in the UK
- Gross investment is the total amount invested, before any account is taken of depreciation of assets. Capital loses values as it wears out or becomes less efficient. Much investment in technology is quickly outdated
- Net investment takes account of the fall in value of capital assets therefore it is more useful as a sign of improvements in the prospects for the economy, or only investment which increases productive capacity
- Factors affecting investment:
  - Rate of economic growth: an increase in GDP means firms need more capital to meet the increased demand
  - Confidence levels: if firms think they will sell more in the future they are more likely to invest today
  - Interest rates: if interest rates rise, investment tends to fall because it costs more to borrow money
  - Animal spirits: term used by Keynes. Sometimes firms and consumers act on gut instinct, emotion and intuition, not rationality. According to Keynes, firms sometimes need a boost from the government; firms may need more than some evidence to spur them into action.
  - Risk: the higher the higher the level of risk, the lower the level of investment as firms can't be confident they will receive a return on their investment
  - Access to credit: Low interest rates may not make borrowing cheaper as banks may not be willing to take risks. After the credit crisis, firms found it difficult to borrow even if they wanted to
  - Government decisions: changes in government decisions and rules have a significant impact on capital spending, especially if firms have to pay fines. Changes in taxes direct affect firms e.g. cut in corporation tax (a tax on profits) cause firms to be more likely to invest
  - Government bureaucracy: a relaxation in regulation may reduce a firm's costs making them more likely to invest
  - Technical advances: firms need to invest in new technology to stay competitive. Investment will rise when significant technological advances are made