## AD = C + I + G + (X-M)

## Investment

Starter Activity:

1. **In economics, investment is best defined as**

**A** the flow of money into the stock of savings.

1 mark

**B** spending by firms on capital goods in the economy.

**C** the profit kept back by firms to finance future expenditure on new machinery and equipment.

**D** the stock of economic resources such as factories and machinery.

1. **Define Real GDP** **(3 marks)**

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**What is investment? (3 marks)**

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**Other key definitions:**

**Investment in ‘physical capital’**:

**Investment in ‘human capital’**:

**Investment in ‘infrastructure’:**

**Gross investment:**

**Net investment:**

**Activity 2: Read the Case study below and answer question.**

The Riley’s factory in Scunthorpe (Yorkshire) makes a variety of oven baked crisps. As the market demand for crisps grew in the 1970s they invested in extra factories and machinery in order to increase production levels. By the 1980s British consumers had developed a taste for ‘thicker cut’ varieties of crisps with better quality packaging; these could be sold at higher prices and therefore generated higher profits. Riley’s therefore decided to change production to the ‘thicker cut’ premium crisps – which required the purchase of a new potato cutting, frying and packaging equipment. By the end of the 1980s there had been a proliferation of crisp manufacturers in the UK which meant that there was increased competition in the crisp market. Output in the industry grew and firms sought to lower the price of their products by lowering the cost of production by investing in new machinery.

 Between 1989 and 1992 Riley’s share of the UK crisp market fell by 10% as a consequence of the competition from new firms undercutting their prices. And as their market share fell so did their profitability and by 1995 Riley’s crisps was forced to close.

From the case study above suggest 4 different reasons why firms would choose to invest

1.

2.

3.

4.

**Why do firms invest?**

**1.**

**2.**

**3.**

**4.**

**5.**

**6.**

**What are the factors that determine the level of Investment in an economy?**

1. Rate of Interest
2. Cost of Capital Goods
3. Technological change
4. Expectations/confidence
5. Government Policy (e.g. If the Government plans to modernise the road and motorways in the UK this may encourage road hauliers to invest in new lorries)
6. Rate of change in Real GDP a.k.a. National Income (**the accelerator effect**)

**Explain the accelerator effect:**

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**Activity 3**

What will be the effect on planned investment if the following events occurred? Explain why...

1. There is a rise in the real prices of commercial property.
2. The government announces a billion pound programme to encourage the use of computers in industry
3. The Economy grew much faster than expected last year and forecasts show this is set to continue.
4. The price of computers and computer aided tools falls

**The production possibility curve and investment**

1. Use a PPF diagram to show the effects of a diversion of resources away from the production of consumer goods (point A) to the production of capital goods (point B).
2. On the same diagram, show the long-term effects of a bias to producing capital goods (point C).

Use the space below to explain your answer.

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**Extension:** Using a PPF diagram, show the effects of an increase in production following a severe recession where factories have been left idle and capital equipment unused.

**Activity 4**

How might Investment benefit the following sections of the economy?

|  |  |
| --- | --- |
| **Consumers**  | **Workers** |
| **Firms**  | **British Exporting Firms** |

**Government Investment**

This is capital investment spending by the public sector, which results in the creation of a larger capital stock for society as a whole

Examples:

* New roads, motorways and by-passes
* New hospitals
* New schools

**Note Government Investment is a part of G, NOT I**

**Plenary**

1. Using an AD diagram, show the effects of increased investment in the economy
2. Give 2 reasons why a firm might want to invest in new machinery?
3. Give 2 factors that affect the total investment in an economy?
4. Why might a decrease in interest rates increase planned investment

Extension: if net investment is negative, what is the impact on the total capital stock of the economy?