JAYOTI VIDYAPEETH WOMEN'S UNIVERSITY, JAIPUR

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Faculty of Education and Methodology

Faculty Name- JV'n Dr. Md Meraj Alam

Program- BA B.Ed 3rd Semester

Course- Macroeconomics

Digital session name – Investment Function

Introduction:

In ordinary parlance, investment means to buy shares, stocks, bonds and securities which already exist in stock market. But this is not real investment because it is simply a transfer of existing assets. Hence this is called financial investment which does not affect aggregate spending. In Keynesian terminology, investment refers to real investment which adds to capital equipment.

It leads to increase in the levels of income and production by increasing the production and purchase of capital goods. Investment thus includes new plant and equipment, construction of public works like dams, roads, buildings, etc., net foreign investment, inventories and stocks and shares of new companies. In the words of Joan Robinson, "By investment is meant an addition to capital, such as occurs when a new house is built or a new factory is built. Investment means making an addition to the stock of goods in existence."

Capital, on the other hand, refers to real assets like factories, plants, equipment, and inventories of finished and semi-finished goods. It is any previously produced input that can be used in the production process to produce other goods. The amount of capital available in an economy is the stock of capital. Thus capital is a stock concept.

To be more precise, investment is the production or acquisition of real capital assets during any period of time. To illustrate, suppose the capital assets of a firm on 31 March 2004 are

Rs 100 crores and it invests at the rate of Rs 10 crores during the year 2004-05. At the end of the next year (31 March 2005), its total capital will be Rs 110 crores. Symbolically, let I be investment and K be capital in year t, then $I_t = K_t - K_{t-1}$.

Capital and investment are related to each other through net investment. Gross investment is the total amount spent on new capital assets in a year. But some capital stock wears out every year and is used up for depreciation and obsolescence. Net investment is gross investment minus depreciation and obsolescence charges for replacement investment. This is the net addition to the existing capital stock of the economy.

If gross investment equals depreciation, net investment is zero and there is no addition to the economy's capital stock. If gross investment is less than depreciation, there is disinvestment in the economy and the capital stock decreases. Thus for an increase in the real capital stock of the economy, gross investment must exceed depreciation, i.e., there should be net investment.

Real investment may be induced. Induced investment is profit or income motivated. Factors like prices, wages and interest changes which affect profits influence induced investment. Similarly demand also influences it. When income increases, consumption demand also increases and to meet this, investment increases. In the ultimate analysis, induced investment is a function of income i.e., I = f(Y). It is income elastic. It increases or decreases with the rise and fall in income, as shown in figure.

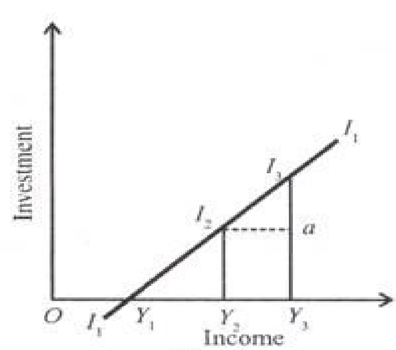

Fig. 1

I1 I1is the investment curve which shows induced investment at various levels of income. Induced investment is zero at OY1 income. When income rises to OY3 induced investment is I3Yy A fall in income to OY2 also reduces induced investment to I2Y2.