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"Neoclassical Theory" the Process of Forming Sources of Investment

Salamov Farrukh Fattoevich
Senior Lecturer at the Department of Economic Theory,
Samarkand Institute of Economics and Service

Abstract. *the article is devoted to the analysis of the neoclassical theory about the process of forming investment sources.*

Keywords: *investment, price fluctuations, behavior of economic entities, investment process, equilibrium principle.*

Representatives of neoclassical theory were less critical of the importance of trade in making a profit. They believed that it could be mutually beneficial, but not equivalent in the traditional sense of this definition, which allows the parties involved in the transaction to gain due to a higher subjective assessment of the acquired good compared to the given one. The famous Austrian economist O. Böhm-Bawerk believed that the price formed on the market is the price at which the consumer will be able to purchase a given product in the future, but since this future is uncertain, it is necessary to constantly revise the assessment of the good. Changing the assessment of future goods leads to constant fluctuations in the prices of capital goods.

Within the framework of the positive theory of capital, O. Böhm-Bawerk understands the latter as a set of funds “productively used for roundabout methods to increase the amount of goods in the future, which can take such forms as commercial, industrial and loan capital [1]. ” It should be noted that Böhm-Bawerk estimates the marginal utility of goods available in the current period to be much higher than the marginal utility of the future volume of goods. From his point of view, refusal to consume goods at the moment must be compensated by a certain reward [2].

The investment process described by O. Böhm-Bawerk clearly demonstrates that the ideas of researchers at the end of the 19th century are based on fundamentally different approaches, according to which the sphere of consumption is given a dominant role, including in the process of forming sources of investment. Authors are increasingly arguing that capital as a stock category and investment as a flow category should be determined not by the cost method, but by estimating future income, which is most clearly demonstrated in the works of I. Fisher. He believes that income represents the excess of cash flow over initially available inventory. The key form of income is interest, which permeates all economic relations, serving as a link between the present and the future. The main incentive for investment is the difference between the rate of return and the market interest rate. An increase in the rate of income, which contributes to the expansion of investment opportunities, is a consequence of scientific and technological progress.

Fisher, studying the nature of capital and interest, believes that their emergence is associated with the process of pricing, determined by the size of the money supply. Thus, we can conclude that,

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[1] Boehm-Bawerk , O. Selected works on value, interest and capital / -M .: OOO Publishing House EKSMO, 2009. P. 76-78.

[2] O. Boehm-Bawerk relies in his theory of positive capital on the concept of abstinence proposed by W.N. Senior , who also defines interest as compensation income for the capitalist’s refusal of current consumption of goods.

according to I. Fischer, investments can also arise in the sphere of circulation.

The argument that investment is a function of the rate of interest, and of a decreasing nature, is also reflected in the works of A. Marshall. The founder of neoclassicism, the core of which is the position of J.B. Say on the equality of supply and demand [3], considers the principle of equilibrium through the categories of investment and savings.

Accumulation in the ideas of A. Marshall is the source of the birth of savings [4], which are formed as a certain excess income received from the sale of various factors of production. In his opinion, you can save from wages, rent, and profit. In the short run, savings lead to an imbalance between production and consumption. But thanks to the financial market, the size of planned investments can be equal to the amount of savings. The interest rate is a balancing mechanism between savings and investments, regulating their value. Thus, according to A. Marshall, investments can only exist in the long term. By exploiting economies of scale, firms will benefit from quasi-rent, creating conditions that stimulate the investment process. Only equality between past and current investment costs, on the one hand, and the discounted value of future income, on the other, will ensure stationary equilibrium in the long run. It is clear that this is an ideal model, which is unrealizable in practice.

Another representative of the neoclassical movement, A. Pigou, more closely links the investment activity of business entities with the amount of money in circulation. If, according to I. Fisher, equality in the economy is ensured by the supply of money, then A. Pigou talks about money demand as a factor of equilibrium, which makes his theory more realistically reflect the motivation of economic entities in the process of accumulating savings and investments. The liquidity preference coefficient introduced into the exchange equation by I. Fisher clearly illustrates the degree of influence of accumulation on the investment activity of actors .

Neoclassical theories are characterized by a synthetic approach to the study of the investment process; they study not only the objective factors of the formation of real investments, but also the subjective, often irrational motives for carrying out investment activities by macroeconomic agents, while using the methodology of equilibrium analysis. It should be noted that within the framework of the neoclassical approach, questions of the formation of macroeconomic investment models are beginning to be raised (the theory of general equilibrium of L. Walras, the social optimum according to V. Pareto, the theory of cash balances of A. Pigou, etc.), but they are based on microeconomic analysis. The authors, using the analogy method, transfer the ordinal functions of utility and productivity to the macroeconomic level, completely depriving it of specific patterns [5].

Conclusion: The development of investment theory, starting from the traditional ideas of the classics of economic science and ending with the works of the new institutional school, is due to the transformation of socio-economic conditions: the development of the industrial mode of production, the expansion of the monetary sphere, the emergence of information bases for the functioning of the investment mechanism.

List of sources used

[3] Law J.B. Say , so named by J.M. Keynes , states that the supply of a product always creates a demand for it, and, therefore, production equals consumption, income equals expenses, prices equal costs. This model is built by Say for a barter-type economy, money exists, but its functionality is very limited, money acts only as a measure of value and a means of circulation. The neoclassical school tries to apply Say's law to a monetary economy, using the mechanism of interest rates.

[4] “As opportunities for investing capital expand, there is a constant increase in the excess of production over the necessary means of subsistence, which gives rise to the ability to save” (Marshall A. Principles of Economic Science / M.: Progress, 1993. P. 302.).

[5] Thus, according to J.B. Clark, the natural distribution of income inherent in economic entities at the micro level can also be used to substantiate conclusions of a social nature. Clark introduces two categories “social capital” and “social labor”, which are the total functions of the marginal productivity of these factors of each economic entity. Many such functions on a plane form a “zone of indifference”, which characterizes the state of equilibrium in the economy (Clark J.B. Distribution of wealth / M.: Helios ARV, 2000.P.345-380.), which is similar to the reasoning of F. Edgeworth when describing transactions between economic actors at the micro level.

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