Capital Formation and Economic Growth

Part A

Introduction

- There are two important determinants of Economic Growth:

A. The rate of investment

B. Capital-output ratio

- These factors were brought out by the growth model of Harrod and Domer

Introduction

- An important factor which determines capital output ratio in the economy is the technology that is being used for the production in agriculture, industry and other activities
- If the economy makes progress in technology, capital-output ratio will be lowered

What is Capital Formation?

- Capital formation means the increase in the stock of real capital in a country
- In other words, capital formation involves making of more capital goods as machines, tools, factories transport equipments, materials, electricity etc., which are all used for further production of goods

What is Capital Formation?

- Professor J R Hicks remarks, “the way which capital equipment is increased is the use of some part of the community’s productive power during a period for the construction of new equipment (investment)”
- It is thus evident that in order to accumulate capital goods some current consumption has to be sacrificed

Widening of capital and Deepening of Capital

- A community could just go on building more transport facilities, more source of power more factories of the existing type
- This process of duplicating capital of the existing technique is called “widening of capital”.
- In contrast with “deepening of capital” which implies use of more capital-intensive techniques

Widening of capital and Deepening of Capital

- In fact, capital accumulation and technological progress go hand in hand
- Technological improvement is virtually impossible without capital accumulation
- No nation which is not willing either to save or to get foreign aid for greater investment will enjoy the fruits of the advanced techniques and capital accumulation

To be Continued…

Thank You