Capital Formation and Economic Development.

Q. = Almost all economists lay emphasis on capital formation as the major determinant of Economic growth.

= The meaning of capital formation is that society does not apply the whole of its current productive activity to the needs and desires of immediate consumption, but directs a part of it to the making of capital goods: tools and instruments, machines and transport facilities, plant and equipment - all the various forms of real capital that can so greatly increase the efficacy of productive effort. .

Nurkse = Accumulation of material capital and neglect of human capital.

Singer = capital formation = both tangible goods like plants, tools, and machinery and intangible goods like high standard of education, health, scientific tradition and research.

Importance

1. To Break the vicious circle of poverty.

= low income → low demand → low investment → low production. This results in the deficiency of capital goods which can be removed by capital formation.

= Supplies of machines, equipment increase → scale of production expands → social and economic overheads are created → fuller utilisation of available resources → output, income and employment increases.

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2. Investment in capital equipment not only increases production but also employment opportunities.

3. Capital formation leads to expansion of market.

4. Capital formation and population growth

= In U.D.C. the increase per capita output is related to the increase in capital-labour ratio.
= C-L ratio falls with increase in population so that large net investment is needed to overcome the dimi-
-nution of capital labour ratio.
= When population increases, it becomes difficult to have sufficient saving for required quantity of investment.

5. U.D.C. faces BOP problem because they mostly export primary products like raw-materials and agricultural products and import finished manufactured and capital goods. Domestic capital formation is the only solution.

6. Capital formation helps in making a country self-sufficient and reduces the burden of foreign to debt.

7. During inflation ~~is~~ capital formation is helpful.

8. Capital formation increases the economic welfare of a country.

9. Capital formation raises the level of national income.