

Capital Formation and Economic Growth



Part B

Accumulation of Human Capital

- ❖ For a long time in economics, it was thought that it was physical capital which played a crucial role in expanding production
- ❖ In recent years, a new concept of Human Capital has been evolved and emphasised
- ❖ By Human Capital meant the stock of people equipped with education, skills, good health etc.

Accumulation of Human Capital

- ❖ It has now been found that the rate of growth achieved in the developed countries cannot be wholly explained by the increases in physical capital and advances in technology
- ❖ A good part of economic growth has occurred due to the human capital
- ❖ It has now been realised that the human capital formation is as important in increasing production and productivity than an the physical capital formation

Importance of Capital Formation

- ❖ Capital Plays a vital role in the modern productive system
- ❖ Production without capital is hard for us even to imagine
- ❖ Nature cannot furnish goods and materials to man unless he has the tools and machinery for mining, farming, forestry fishing etc

Importance of Capital Formation

- ❖ If man had to work with his hands on barren soil, productivity would be very low indeed
- ❖ Even in the permeative stage, man used some tools and implements to assist him in the work of production
- ❖ Capital adds greatly to the productivity of worker and hence of the economy as a whole

Determinants of Capital Formation

- ❖ Savings are important for the capital formation, but in a monetary economy, savings do not directly and automatically result in the production of capital
- ❖ Savings must be invested in order to have capital goods
- ❖ In a modern economy where savings and investment are done mainly by two different classes of people, there must be certain means or mechanism whereby savings of the people are obtained and mobilised

Determinants of Capital Formation

- ❖ Therefore in the modern free market economy, the process of capital formation consists of the following three stages:
 - A. An increase in the rate of real savings so that resources that would have been devoted to the production of consumption goods should be released for the purpose of capital formation
 - B. Existence of a good financial system so that the available resources are obtained by private investors for capital formation
 - C. The act of investment itself so that resources are actually used for the production of capital goods

To be Continued...

Thank You