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Class-M.A Sem-IV

Harrod & Domar Model Of Economic Growth

The Harrod Domar Model suggests that the rate of economic growth depends on two things:

1. **Level of Savings** (higher savings enable higher investment)
2. **Capital-Output Ratio**. A lower capital-output ratio means investment is more efficient and the growth rate will be higher.

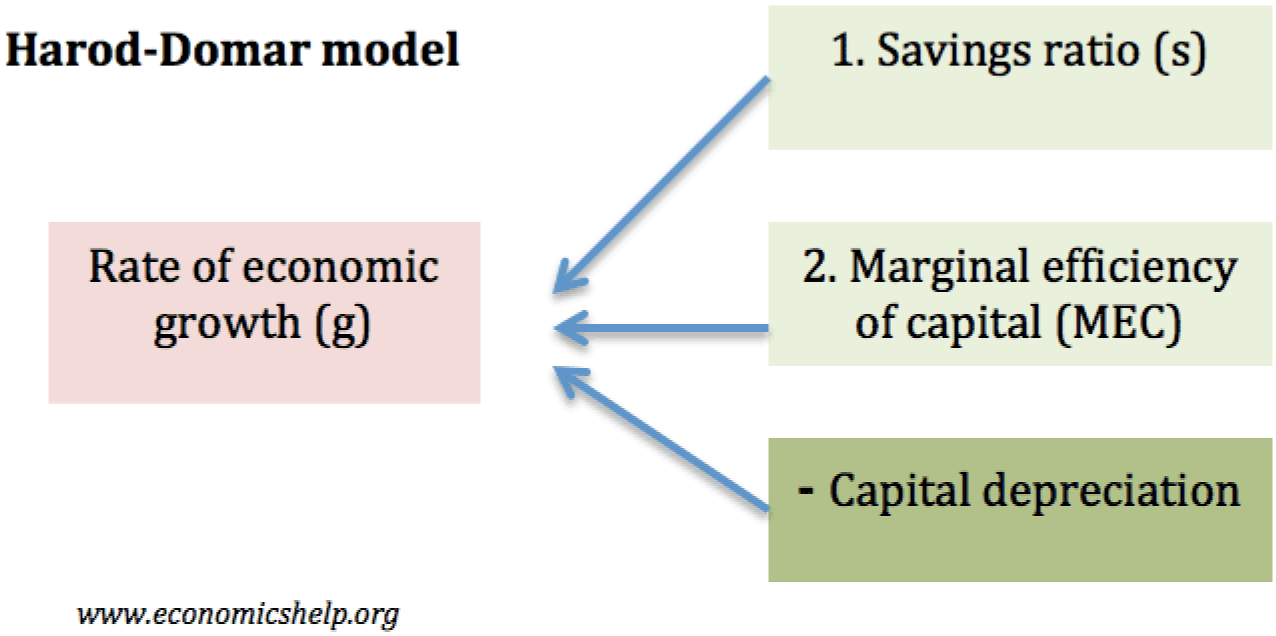
A simplified model of Harrod-Domar:

$$\text{Rate of economic growth (g)} = \frac{\text{Level of savings (s)}}{\text{Capital ouptut ratio (k)}}$$

Harrod-Domar in more detail

- Level of savings (s) = Average propensity to save (APS) – which is the ratio of national savings to national income.
- The capital-output ratio = 1/marginal product of capital.
  - The capital-output ratio is the amount of capital needed to increase output.
  - A high capital-output ratio means investment is inefficient.
  - The capital-output ratio also needs to take into account the depreciation of existing capital

Main factors affecting economic growth



- **Level of savings**. Higher savings enable greater investment in capital stock
- **The marginal efficiency of capital**. This refers to the productivity of investment, e.g. if machines costing £30 million increase output by £10 million. The capital-output ratio is 3
- **Depreciation** – old capital wearing out.