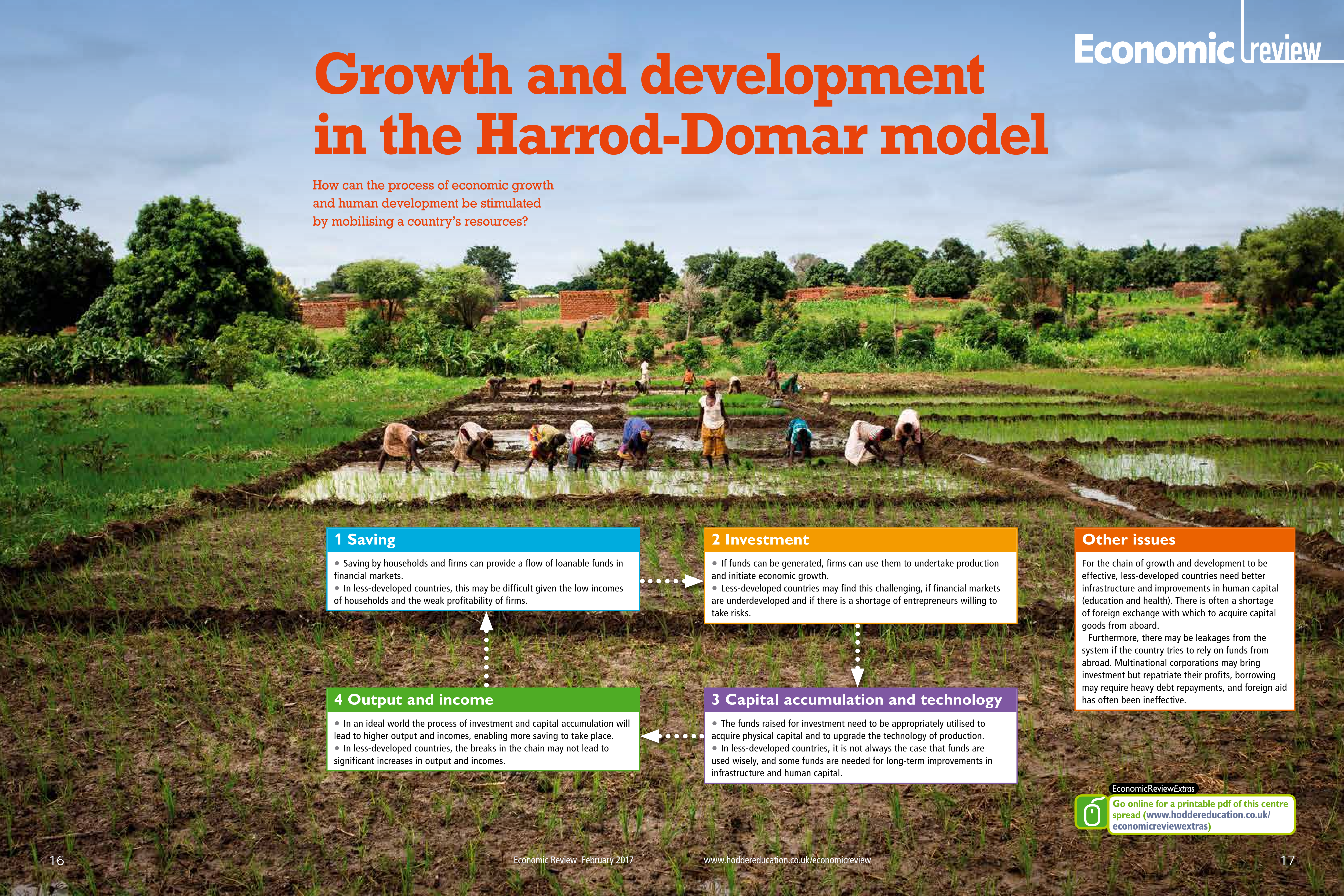
Economic review

Growth and development in the Harrod-Domar model

How can the process of economic growth and human development be stimulated by mobilising a country's resources?



1 Saving

- Saving by households and firms can provide a flow of loanable funds in financial markets.
- In less-developed countries, this may be difficult given the low incomes of households and the weak profitability of firms.

2 Investment

- If funds can be generated, firms can use them to undertake production and initiate economic growth.
- Less-developed countries may find this challenging, if financial markets are underdeveloped and if there is a shortage of entrepreneurs willing to take risks.

3 Capital accumulation and technology

- The funds raised for investment need to be appropriately utilised to acquire physical capital and to upgrade the technology of production.
- In less-developed countries, it is not always the case that funds are used wisely, and some funds are needed for long-term improvements in infrastructure and human capital.

4 Output and income

- In an ideal world the process of investment and capital accumulation will lead to higher output and incomes, enabling more saving to take place.
- In less-developed countries, the breaks in the chain may not lead to significant increases in output and incomes.

Other issues

For the chain of growth and development to be effective, less-developed countries need better infrastructure and improvements in human capital (education and health). There is often a shortage of foreign exchange with which to acquire capital goods from aboard.

Furthermore, there may be leakages from the system if the country tries to rely on funds from abroad. Multinational corporations may bring investment but repatriate their profits, borrowing may require heavy debt repayments, and foreign aid has often been ineffective.

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