



Incremental Capital Output Ratio (ICOR)

INCREMENTAL CAPITAL OUTPUT RATIO (ICOR)

Measures additional units of cap-investment needed to produce an additional unit of output

ABOUT

- Explains relationship between - **Level of investment made** in the economy and **Subsequent increase in GDP**

EVOLVED FROM

- Harrod-Domar Growth Theory** in 1939 (which stresses the importance of savings and investment as key determinants of growth)

RELATION WITH PRODUCTION

- Determines a country's level of production efficiency
- Lower ICOR = More efficient production/capital** (implies that an economy can generate more output with a smaller increase in cap-investment)

While GDP gives information about the size of an economy, ICOR tells how efficiently it operates

INDIA & ICOR

- ICOR in FY12 - 7.5
- ICOR in FY22 - 3.5

CRITICISM

- Favours developing countries** who can still enhance their infra and tech unlike developed countries who are already operating at their highest level
- Intangible assets (designing, R&D etc) are more challenging** to include in investment levels and GDP

$$ICOR = \frac{\text{Annual Investment}}{\text{Annual Increase in GDP}}$$

ILLUSTRATION

For a Country 'A' investing in a product 'P';

Capital Investment: \$1,000,000
Change (↑) in GDP: \$500,000

Now, to calculate ICOR, use the above formula;

$$ICOR = \$1,000,000 \div \$500,000$$
$$ICOR = 2$$

Meaning -

- For every additional \$1,000,000 in cap-investment made in the economy, the economic output (or GDP) increases by \$500,000
- It takes \$2 of cap-investment to produce an additional \$1 of economic output.

Now, if A's ICOR was 4 last year, it means that A has become more efficient in its use of capital.



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