Ragnar Nurkse’s Development Theory: Influences and Perceptions

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1. Introduction

The present discussion on a “rebirth” of systematic development economics (Herrera 2006) renders it appropriate to look more closely at its theoretical foundations before it became absorbed in an ad-hoc reasoning vis-à-vis the increasingly complex reality of (many) falling-behind and (few) catching-up processes, eventually falling into near oblivion for three decades (Krugman 1993). Undoubtedly, Ragnar Nurkse, the great Estonian-American economist, was undoubtedly one of the most rigorous theoreticians and therefore his contribution to the sub-discipline of development economics deserves special attention when discussing the relevance of classical development economics for today.

Ragnar Nurkse’s contribution to economics was in three areas, the later being an extension of the previous ones (for details on the bio-bibliographical background see Basu 1987, Kukk 2004, Bass 2007): The first period of his work (in the 1930s) was dedicated to research on international capital movements. In the middle period (in the 1930s/1940s), he additionally covered issues of international trade and finance. Finally (from the mid-1940s to his death in 1959), he considered the international commodity and factor movements and their financial framework as merely one aspect of a broader issue in the world economy, to which he then turned his attention: the overcoming of structural underdevelopment. His three most eminent publications are hallmarks of these three phases: Internationale Kapitalbewegungen (in German, 1935), International Currency Experience (1944), and Problems of Capital Formation in Underdeveloped Countries (1953).

The founding fathers of development economics, from Rosenstein-Rodan in his ground-breaking essay of 1943 to Hirschman’s 1958 publication considered ‘development’ as

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tantamount to output growth by industrialization. Contrary to the static idea of realising welfare gains by adhering to absolute or comparative advantages of a country – be it in agriculture, in minerals, or in labour – development economists thus promoted a dynamic diversification of an economy. This still appropriate, albeit already then somewhat ‘heterodox’ approach implied an active role of the state in changing the economic structure by generating and re-allocating rents (i.e. gains which the non-interfered market would not create).

On the other hand, early development economists shared some ‘orthodox’ views, which would soon prove to be shortcomings, when applied to development politics. The main issue was probably that the pioneers of development economics regarded the relation of the macro-economic aggregates (employment, consumption, saving, and investment) as the main or even sole determinant of underdevelopment or development. More than a decade was to pass before development economists became aware of other, and equally important aspects of development, such as access to food, health, and education, or issues of economic vulnerability, income distribution and spatial agglomeration. Dudley Seers’ (1967) emphasis on social issues represented as a turning point in development thinking: development economics became more specific. Eventually, the differentiation of the developing world – most prominently the emergence of newly industrialising countries and least developed countries respectively – triggered focussing on cultural country-specific factors as relevant determinants of development (Hofstede 1980). Finally, the Brundtland Report (WCED 1987) made clear that development had to be defined and approached on a global and inter-generational level, taking into account the long-term environmental balances. At about the same time Amartya K. Sen pointed to normative issues such as empowerment, freedom for people to lead the kind of life they value, and justice as integral elements of the development process (Sen 1999, with antecedents in the 1980s).

The development of the development doctrine (Thorbecke 2007, Nafziger 2007) finally culminated in such complex definitions of development as those underlying the ‘Millennium Development Goals’ (for a critical view of the arbitrary proliferation of the development goals: Vandemoortele 2007). Without doubt, all the above-mentioned considerations – social, cultural, environmental, value-related – were important amendments in framing development processes. Nevertheless, in spite of the enlargement of the
development idea, the notion of diversifying economic growth – by increasing the division of labour, i.e. by moving from subsistence agriculture to a diversified industrial society, and by sacrificing today’s consumption for tomorrow’s, i.e. by saving and investment – remains at the core of all development concepts, other aspects forming additional layers (the only exception being the ‘zero growth’ school (Daly 1996): here the core of the model remains hollow).

Under these circumstances the present author finds it most appropriate to aim at a *diachronical* “historical reconstruction” (Blaug 2001, 150-1) of Nurkse’s development theory rather than at an *anachronical* “rational reconstruction”. This paper therefore does not aspire to the “almost irresistible” temptation to reconstruct in the light of all we now know. It rather wishes to reconstruct one of the classical theories, Nurkse’s idea of the circular causation of a lack of real capital in poor countries, “as faithfully as possible to the times in which they were written” (Blaug 2001, 151).

It is in this attempt that we look at how contemporaries perceived the main ideas of Ragnar Nurkse in the field of development economics. This approach will also include a study of “the previous generation of thinkers in order to understand the context in which the economists in question were writing” (Blaug 2001, 151). In particular, the paper will trace the relation of Keynes and Schumpeter to Nurkse. Finally, it will look into Nurkse-inspired present thinking on the causes of persistent poverty in developing countries.

2. The Nurkse Model in the View of its Contemporaries

2.1 A Disciplinary Classification of the Nurkse Model

Given today’s increasing awareness of development thinkers and practitioners regarding the necessity of interdisciplinary approaches to their subject, it should be emphasized that Ragnar Nurkse’s diagnosis of ‘underdevelopment’ ² and his policy suggestions are strictly confined to economics. Contemporary book reviews already criticized Nurkse’s 1953 opus for neglecting non-economic factors in development, such as his failure to consider capital formation in education, skills and health (Richmond 1953, 467, thus anticipating ideas of the human capital

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² In fact, Nurkse himself was understandably not happy with this term: Nurkse, 1953, 1.
theory), even for “economic myopia” (Hagen 1955, 233). At various instances, however, Nurkse had commented on “educational investments” as one of the basic targets for capital formation (such as Nurkse 1957, 199). But why did Nurkse not make such factors of development explicit in his model?

Nurkse’s concentration on the formation of capital in the explanation of poverty and in the formulation of policies to overcome this was not so much because he was not aware of social and cultural determinants of poverty. He rather intended to deliberately confine himself to a problem, to the solution of which he as an economist could contribute most. This becomes apparent in the introduction to his 1953 book: “Economic development has much to do with human endowments, social attitudes, political conditions – and historical accidents. Capital is a necessary but not a sufficient condition of progress.” (Nurkse 1953, 1)

As an economist, Nurkse had been trained in Edinburgh and in Vienna in the tradition of the Anglo-American ‘formal’ school rather than in the tradition of the then still important German Historical School. Consequently, in development economics he refrained from subscribing to ‘substantivist’ approaches. This contributed to an abstraction from real-world societies to a degree that nearly no allowance was made for country-specific institutional factors in the ‘typical’ developing country as analysed in his studies – although he was definitely aware of such factors, particularly when it came to policies. However, “the question of method [of development; HB.] must be decided on the ground of broader considerations; on the ground especially, of the human qualities and motive forces existing in any particular society. The economist, as an economist, has no categorical imperatives to issue on this subject.” (Nurkse 1953, 16). In an unpublished note on ‘excess population’, Nurkse even amended this argument: “Low productivity is the problem […]. The econ.[omic] remedy for

3 For details regarding his studies at Edinburgh see The University of Edinburgh 2007 as well as the correspondence between Nurkse and Dr Rankin, such as Nurkse, unpublished 1941 and Nurkse, unpublished 1945.

4 Formalist economics argues that economics is the study of utility maximisation under conditions of scarcity and therefore it is about making choices – be it Robinson on his island or the globalised world of the 21st century. Substantivists argue that economics is about societies organizing their production, distribution and consumption. A society’s strategy as an adaptation to its environment and its resources may or may not involve utility maximisation (Polanyi 1944). Probably Nurkse and Polanyi knew each other: Karl Polanyi was at Columbia University in New York from 1947 to 1953 (teaching general economic history) – while Nurkse worked at Columbia from 1945 to 1958.
the problem is capital creation (though I [...] readily agreed that non-economic remedies may be more important)” (Nurkse unpublished [n.d., a]).

2.2 Nurkse’ Poverty Trap Model

From the idea that in poor countries poverty as under-consumption results from under-production of material commodities (which in the light of A. K. Sen’s ‘entitlement’ theory is not at all trivial), Nurkse identifies the lack of real capital as the main bottleneck in economic development. Lack of real capital is both the starting point and the end of a causal chain.

Nurkse analyses the deficiency of real capital both from the supply side and from the demand side. The supply of capital is determined by the ability and the desire to save. In poor countries saving is restricted due to low income, which mainly has to be used for consumption (‘Engels’ Law’). In addition, low income countries save little because of the demonstration effect not only valid inside a country, but also between countries: higher standards of living elsewhere encourage levels of consumption which are higher than feasible. Low income, on the other hand, results from low labour productivity, which again is a result of deficient capital. Thus the circle is closed on this side. The demand for capital depends on the propensity of enterprises to invest. They invest little in a country with low purchasing power, which is the case, as the real income is low – thus closing this part of the circle.

The system’s condition thus described has two characteristics: the economy is in a state of stable equilibrium, and the equilibrium is sub-optimal. Nurkse chose the term underdevelopment equilibrium, analogously to the underemployment equilibrium analysed by Keynes. We may also call it a ‘poverty trap’ (see Bowles/Durlauf/Hoff 2007), as no endogenous forces exist to overcome poverty. Consequently, Nurkse rejected the market optimism of the liberal school: “Economic progress is not a spontaneous or automatic affair” (Nurkse 1953, 10). According to Nurkse, nor could monetary and fiscal policy measures alone, such as those advised by Keynes to increase monetary demand in a state of cyclical economic stagnation, overcome the vicious circle of deficient real capital and poverty in developing countries. What would rather be necessary would be an extraordinary effort, aiming directly at the provision of real capital: the big push.

5 The term in its narrower sense was originally coined by Duesenberry, but later, with respect to the international dimension, often ascribed to Nurkse.
As investment for an individual entrepreneur is ruled out due to the small size of markets, it becomes necessary that enterprises all at once create demand for all others. Only by “a wave of capital investments” (Nurkse 1953, 13) would it be possible to overcome the stationary equilibrium, to get a self-enforcing growth process off the ground and to turn the *vicious circle* into a *virtuous circle*.

The process should be sustained by private investment, encouraged by growing markets. To initiate this process, Nurkse thought that governmental mobilisation of ‘virtual’ domestic saving, especially in the form of disguised rural unemployment, could be feasible, such as the use of rural surplus labour for the construction of capital goods, especially infrastructure. A further source of initial capital was seen in the form of credit provided by international organisations. If there were enough initial investment, an avalanche of private investment would be set in motion.

It is interesting to note that Nurkse thus did not consider the developing countries as poor in resources, forever dependent on the development aid flow of rich countries to overcome their development bottleneck. He rather stressed that the mobilisation of their own resources would have to be the starting point for development.

With regard to the industries this avalanche should be directed towards, Nurkse argued for “a balanced pattern of investment in a number of different industries, so that people working more productively, with more capital and improved techniques, become each other’s customers” (Nurkse 1962, 247). While Paul N. Rosenstein-Rodan, W. Arthur Lewis and others shared this idea, Nurkse was undoubtedly its most influential advocate.

### 2.3 Critical Debates on the Nurkse Model

Contemporary critical debates on the Nurkse model refer to various issues, including the industrialisation strategy (balanced vs. unbalanced growth), the coordination agency (state vs. markets), and the international implications (free trade vs. import substitution).

(1) A major debate in early development economics was on the subject of balanced vs. unbalanced growth. Contrary to the Balanced Growth adherents, contemporaries such as Albert O. Hirschman, Paul Streeten and others argued that due to the lack of capital in developing countries investment projects had to be selected according to the strength of their backward and forward linkages (‘unbalanced growth’). The empirical fact of sectoral and/or
regional polarisation in economic development rather than presuming equalisation has a long history in (heterodox) economic thinking: probably commencing with the ideas of Joseph Schumpeter and continuing to Paul Romer’s New Growth Theory, in which knowledge as a factor of production with increasing marginal productivity is responsible for cluster generation, and to the Gravity Theory of International Trade. Why was it that Nurkse not only showed no awareness of this thinking, but actually argued for a strategy counter to the factual development? Basically, he was afraid that the Hirschman approach would only allow for progress at a snail’s pace. According to Nurkse, the vertical transmission of growth impulses along the value chain would take longer than a strategy starting from the demand for a multitude of consumer products, thus the argument for a horizontally oriented approach to finally achieve “diversification”. Some of Nurkse’s remarks show that he became obsessively involved in a rather sterile debate on ‘balanced vs. unbalanced growth’ strategy in his latter years. In fact, “the similarities between the balanced and unbalanced growth theses are more important than their apparently different prescriptions” (Thorbecke 2007, 9).

(2) Another issue discussed among contemporaries concerned the role of markets or the state as possible coordination mechanisms. As Nurkse considered a balanced pattern to be one where investment would be according to the income elasticity of demand for the final products, he did not want to rule out market forces in determining the growth pattern of an economy – but rather assist their realisation (for different understandings of balanced growth see Scitovsky 1987).

There are, of course, specific demands of the balanced-growth model regarding planning. Nurkse even stated: “From the technical viewpoint of capital theory, the case for socialism is that it cuts the connection between investment activity and consumption change; all investment becomes autonomous.” (Nurkse 1959, 297). Nevertheless, Nurkse should not be considered as an unconditional follower of central planning methods: “as regards the mechanics I am inclined to be ‘liberal’, accepting as alternative possibilities: central planning; […] spontaneous advance on a wide front; or the ‘disequilibrium’ method of zigzag growth” (Nurkse 1962, 80). Actually, Nurkse can be best addressed as an advocate of a “mixed” economic system: “To rely merely on the price system for the structural changes that constitute development may not be enough. But mere “programming” […] is probably not
enough either. In the last resort we must rely on the acts of faith that spring from enterprise private or public, or both.” (Nurkse 1957, 2)

The propagation of a mixed economic system did not only refer to the coordination mechanisms, but also to property rights: Nurkse considered independent collective bodies to be the main agents for the accumulation of overhead capital: “some independent and continuous body, unaffected, if possible, by shifting cabinets and parliamentary fortunes.” (Nurkse 1953, 154). Overall, this is a non-dogmatic approach (see also Hancock 1954, 315).

Nevertheless it is obvious that an application of this model in reality could not have abstained from complex planning techniques, the adherence to which was much in accordance with what Stiglitz had called the first (state-optimistic) phase of development thinking on the relation between state and markets (Stiglitz 1998) with India as a role model – but which, as von Hayek argued, is an effort in principle doomed to failure due to the unpredictability of consumer decisions.

It is interesting to note that Eugenio Gudin, a Brazilian, i.e. an economist with first-hand experience of the actual situation of a developing country, was particularly critical in this respect of Nurkse’s state-optimism:

The big-push model cannot very well avoid a bias toward Government action. It is not quite conceivable as a joint and simultaneous procedure of a group of entrepreneurs. And in countries of a precarious level of political education such as these Government’s intervention in the private economic sector has proved very harmful indeed. On the other hand I do not think that the spirit of enterprise and private initiative lacks in these countries. What lacks is “know-how” and what is excessive is “industrial protection”, these two factors together being largely responsible for the comparatively slow pace of development. (Gudin, unpublished, n.d., 5)

(3) Another much-debated issue was the presumed consequences of balanced growth on the international division of labour. Would it demand dissociation from the world economy to carry out investments in such a planned manner? And would horizontal diversification of production run contrary to specialisation in absolute and comparative advantages and thus abstain from urgently needed efficiency gains?
The issue was targeted by balanced growth adherents by pointing to the fact that classical trade theory is static: welfare effects will originate from specialization only once and cannot be replicated if there is no change in the production structure – or economic development. According to Nurkse, a balanced-growth model could best produce such dynamics of superseding cost advantages: “Balanced growth is the best friend that international trade can have” (Nurkse 1961, 257). Nurkse definitely did not see trade as an engine of growth – but probably as an additional device. A successful integration of developing countries into the world economy, however, demands security in the planning framework: this would be the case when following a further model, to the temporary realisation of which Ragnar Nurkse had contributed substantially: an international regime of fixed exchange rates.

From these contemporary discussions one might conclude that the Nurkse model was remarkably coherent albeit not a completely convincing concept. Some blind spots may be seen with hindsight and misdirections taken by development policies in the following decades seem to have been inherent in the views of the early development economists, including Nurkse: the alleged direct link between growth and poverty reduction (which was rejuvenated only recently by the ‘revisionist’ school, cf. Dollar and Kraay 2001) and, closely connected, a disregard of “pre-modern” forms of production (small-scale family-based agriculture, rural industry) partly due to an imperturbable belief in the ubiquitous existence of increasing economies of scale and of utility-maximizing behaviour of economic agents. This becomes particularly clear when reading Nurkse’s comments on the Indian Development Plan (Nurkse 1957), arguing in favour of a concentration of land holdings, in favour of urban agglomeration and against cottage industry. There are also scattered comments on Russia and China in his work pointing in the same direction.

Yet it has to be noted that the disasters of the Stalinist and Maoist collectivising of agriculture had not yet surfaced: Nurkse commented on Russia before historians began to unearth the truth about the Ukrainian famine of 1932/33 and other results of collectivising in agriculture, before China had even set out on the Great Leap Forward (1958/59), before state-owned enterprises around the world had collapsed – but also before the dynamics of the informal sector had been discovered (Hart, ILO, de Soto) and agriculture-led industrialisation had been discussed as an option (Adelman). However, an early hint on the neglect of
agriculture connected with the Nurksean assumption that peasant livelihoods should be limited in order to direct ‘virtual’ saving [in the form of disguised unemployment] to capital construction projects can already be found in Condliffe (1954).

3. **Looking back: Theories Influencing Nurkse’s Circular Model**

The general idea of a circular causation of poverty, a vicious circle, does not originate in Nurkse, for whom it was already “a phrase that crops up frequently” (Nurkse 1953, 5) – the idea that in a precarious situation everything is blocked by everything is obvious. However, Nurkse did not intend to create a formula covering all aspects of poverty generation, but to analyse the circular causation of a lack of real capital. Here, particularly influences by Keynes and by Schumpeter can be discerned.

Schumpeter and Keynes are, to a considerable extent, antipodes (for a comparison of Keynes and Schumpeter published during Nurkse’s lifetime see: Smithies 1951). Keynes argued that abstaining from consumption could not only lead to decreasing demand for consumption goods but also to a decrease in demand for investment goods. Saving could thus set a depression spiral in motion. Schumpeter on the other hand argues that saving provides capital for innovation (although only of secondary importance after creation of money by bank credit). Innovations provide new production opportunities, which set off an expansive process. And while Schumpeter’s interest is in the advantages in the long run (i.e. techniques of production changing), Keynes argues with the problems of the present (i.e. techniques of production unchanged). How can such differences be reconciled by Nurkse? The answer lies in his holistic view of the underdevelopment situation.

Furthermore, Nurkse could build on similarities in Keynes’ and Schumpeter’s approach. Both deviate from the (neo-)classical opinion of equilibrium: Keynes analyses the fact that an equilibrium can exist without the clearance of markets, Schumpeter defines the disequilibrium as the normal situation of capitalism. As a consequence for Nurkse in view of the problems of the developing world, scepticism toward market forces and optimism regarding central planning seemed to be in place. ‘Balanced Growth’ was therefore the correct answer in terms of economic policies to what had been analysed in terms of economic theory.
3.1 Nurkse and Keynes

Nurkse was well acquainted with various aspects of Keynes’ (1883-1946) oeuvre: during his student days in Edinburgh (1929-1932) Nurkse had already been introduced to the work of Keynes and had carefully read, as proven by his exercise books (Ragnar Nurkse Papers, Box 3, Public Policy Papers, Department of Rare Books and Special Collections, Princeton University Library), books such as “Indian Currency and Finance” (1913) and “A Treatise on Probability” (1921). Nurkse also seems to have met Keynes personally during the Bretton Woods conference, and also took a great interest in the publishing process of Seymour E. Harris’ “The New Economics” (1947) – the first book to provide a complete picture of ‘Keynesianism’ immediately after the death of its hero in 1946.

In the second phase of his own work, Nurkse made explicit implications of Keynesian theory for international economic relations, while he enlarged Keynesian theory in the formation period of development economics, to which Nurkse contributed in the third phase of his own oeuvre.

Nurkse elaborated on Keynes’ theory in his 1947 contribution to the book by S. E. Harris on “Domestic and International Equilibrium”. While Nurkse considered the (neo)classical theory of international economic relations to be concerned with the compositional or allocation aspects of international trade only, Nurkse applied Keynesian macroeconomics (“Keynes gave us no positive and systematic account of international relationships in his system”, Nurkse 1947, 284) to the results of imports and exports on the volume of national income (Nurkse 1947, 268), and aimed at providing links between international trade theory and business cycle theory (Nurkse 1947, 264).

The international division of labour – rather than being at the centre of economic analysis and economic policy to realize (static) welfare gains – became instrumental in Nurkse’s view of how to generate employment: “Just as free trade by itself cannot ensure full employment, so the suppression of trade, though it might increase employment numerically, can never bring real prosperity. It is utterly senseless to create employment by reducing the level of economic efficiency. There are other ways of solving the employment problem.” (Nurkse 1947, 276).
This already foreshadowed Nurkse’s idea that the balanced-growth strategy is supplemented rather than questioned by the specialisation of regions and nations according to comparative advantages.

Another interesting foreshadowing of Nurkse’ later ideas can be seen in the idea of *simultaneity*, which is also used as a reference to Keynes in his assessment of Keynes’ contribution to the problems of international economics. Keynes is quoted by Nurkse regarding the notion that policies to overcome national equilibria-cum-unemployment should be safeguarded by a simultaneous proceeding of many countries in order to avoid pressure from outside:

> We should attach great importance to the simultaneity of the movement towards increased expenditure. For the pressure on its foreign balance which each country fears as the result of increasing its own loan-expenditure, will cancel out if other countries are pursuing the same policy at the same time. (Keynes, *The Means to Prosperity* 1933; quoted in Nurkse 1947, 281)

This idea becomes juxtaposed in Nurkse’s later writing to overcome the international problem of (relative) underdevelopment by balanced growth. Nurkse’s 1947 article can therefore also be understood as an important step in his deviation from the subject of international economics to the emerging subject of development economics.

Undeniably, Nurkse appreciated Keynesian economics: “Keynesian economics is a powerful and flexible tool of analysis. At any rate formally, it can be adapted to all kinds of different situations.” (Nurkse 1953a, 148). However, in spite of being labelled as a ‘Keynesian’, as Haberler for instance can be understood (“like most economists of his generation, Nurkse was quickly drawn into the stream of Keynesian thought”, Haberler 1962), a somewhat anti-Keynesian position in terms of criticising the Keynesian “bias against saving and in favour of spending” by Nurkse was discovered by book critics of Condliffe (1954, 454) and particularly Bronfenbrenner (1954, 176).

In my opinion, Nurkse actually stood aloof from Keynesian economics and in fact there are various arguments in his development theory which are not in accordance, if not in contrast, to Keynes’ argumentation – Nurkse either elaborating on differences between the monetary sphere and the real sphere, considering different time frames, seeking a middle way
between classical and Keynesian views, or classing Keynesian arguments as biased or peripheral:

(1) In contrast to a crisis in industrial countries when mass unemployment and overcapacities exist but cannot be overcome by the market forces, Nurkse argues that the underdevelopment equilibrium is structural, and that it is caused by deficiency of real capital and real demand and not just by a deficiency of monetary demand (‘effective demand’), which is shown by the fact that inflation in underdeveloped countries is the rule rather than the exception. There is a lack of real demand (‘purchasing power’), as there is too little to be offered in exchange – resulting from low productivity, which in turn results from the lack of real capital (i.e. the reverse side of the vicious circle) (cf. Nurkse, 1953a, 17). On the international level, Nurkse’s argumentation runs along the same lines: although he agrees with the view that the volume of international trade in the short run is a function of employment and thus the effective demand in the main trading countries, he argues that in the long run supply-side conditions are more fundamental: the level of productivity and (thus) the size of the market (Nurkse, 1953a, 21).

(2) In the underdeveloped countries of the 1950s, Nurkse considered consumption and investment neither in a (classical) trade-off nor in a (Keynesian) synergetic relationship, but as isolated from each other. That Nurkse did not agree with either view (neither classical nor Keynesian) can best be explained by the fact that in spite of Nurkse’s mostly theoretical reasoning he was implicitly aware of the historic limitations of both theories: “Neither the economics of business enterprise nor the Keynesian theory of employment nor the Anglo-centric views developed a hundred years ago by Marx were designed to take account of India’s overcrowded peasant economy.” (Nurkse 1957, 203).

The (British) classical economists wrote after the near completion of the 17th/18th century agricultural revolution, when such means as the enclosures of commons had not only allowed for productivity gains in agriculture but had also reduced the basis for gaining a livelihood for the rural poor, thus turning them into ‘surplus’ population. In this situation, industrial capital formation seemed only possible by exploiting this cheap labour, i.e. by keeping their consumption to a bare minimum. Thus the theory that industrial investment was only possible by forced saving (i.e. forced limitation of labourer consumption) sprang into the minds of the classical economists. On the other hand, during the Great Depression of the
1930s, idle factors of production – both already existing industrial capital and experienced and skilled industrial labour – provided the material basis for the idea of the possibility of simultaneously expanding both (additional) capital formation and consumption.

In the underdeveloped countries of the 1950s, however, Nurkse seems to have seen a situation which was similar to the one prior to the 17th/18th century agricultural revolution in Britain: the marginal productivity of agricultural labour was (around) zero. Keeping the consumption of the labour population (both agricultural and newly industrial) more or less constant would allow the use of labour directly to build up capital goods – thus more or less forcibly turning ‘virtual’ saving by disguised (rural) unemployment immediately into (industrial) investment. Of course, in the present day perspective this is a rather limited view, as this is only possible in terms of very specific projects, such as the Chinese-type building of dams and irrigation systems in the 1950s by mere manual work (which is not possible of course with more complex capital goods).

With regard to policy instruments, Nurkse, contrary to, for instance, W. Arthur Lewis, considered instruments in the ‘real’ sphere of the economy rather than ‘monetary’ instruments to be feasible for actualising the saving potential of the rural sector:

I referred to the Japanese land tax, to the Russian collective farms, to some form of requisitioning (where I had in mind the Sudan’s wartime experience [...]). [...] I would agree with the view that it cannot be done without some inflation [...] which is not the same as saying that it can be done only by inflation); I would accept inflation as a necessary evil, not as the prime instrument of forced saving. (Nurkse 1952, 1-2)

(3) Given a sceptical view of Keynes on perspectives of investment opportunities in industrial economies, Keynesians saw investment abroad as a means to reducing the capacity effect of investment while at the same time making use of its income effect. Nurkse, however, considered this problem from the much more pressing point of view of a capital-lacking underdeveloped world as important:

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6 The idea of ‘disguised’ unemployment can be traced at least to Keynes’ disciple Joan Robinson 1936.
7 It is interesting to note the qualification of this argument in a letter by Nurkse to Jacob Viner: “I wonder who has maintained that disguised unemployment is prevalent in Brazil. For my own part, of course, I excluded Latin America. [...] The fragmentation of peasant holdings typical, for instance, of Indian farming may be viewed as being, to some extent, a reflection of surplus farm labor.” (Nurkse, Unpublished, 1956)
The employment effect of foreign investment, which Keynesian economists tended to stress, is an incidental and unimportant effect; unimportant because, as Keynesian economics itself showed, it could be equally well achieved by domestic policies. Concern with employment tended to obscure the much more important developmental aspects of international investment. (Nurkse, Unpublished, 1951; see also Nurkse 1953a, 129)

Obviously, the reason for Nurkse’s distance in development theory to the Keynesian approach is rooted in the holistic approach of his circular theory.

3.2 Nurkse and Schumpeter

Ragnar Nurkse was also well versed in Schumpeter’s (1883-1950) ideas. Excerpts can already be found in Nurkse’s University notes from Edinburgh, for example on Schumpeter’s business cycle theory (such as Ragnar Nurkse Papers, Box 4, Public Policy Papers, Department of Rare Books and Special Collections, Princeton University Library). While Nurkse to a certain extent had borrowed the demand-orientation of his model from Keynes (‘the money-income effect’), he focused on the supply side along with Schumpeter: “this real-income effect […] is indeed the sum and substance of long-run economic progress” (Nurkse 1953a, 13, emph. H.B.). When it comes to Schumpeter’s influence on Nurkse, also the issue of the big push is also a focal point.

The notion of Schumpeter as being relevant for development economics has long been rejected (exceptions are Hans W. Singer and Tsuru Shigeto): Developing countries were (and often still are) considered as a “non-Schumpeterian world“ (a term used by Singer 1953, albeit a Schumpeter disciple himself) – economically characterized by stagnation and the passive adoption of technical and commercial achievements from outside. The main reasons are said to be the lack of entrepreneurial potential and the lack of innovation opportunities (see for instance Rimmer 1961; only recently have there been more differentiating opinions particularly under the consideration of abundant entrepreneurial activities in the ‘informal sector’ economy and under the impression of Neo-Schumpeterian studies of the East Asian innovation systems, which in the catching-up process focussed on the dynamics of accumulation of incremental innovations: Reinert 1994a, Reinert 1994b, Bass 1999, Bass 2003).
Ragnar Nurkse was also in accordance with the first objection against the application of Schumpeterian theories to underdeveloped countries: “We can never take it for granted that the human qualities of enterprise and initiative, with which the American economy has been so amply supplied, are present in the same degree elsewhere.” (Nurkse, unpublished, n.d., 4; similar: Nurkse 1953, 17). More specifically, he argues: “In communities afflicted with mass poverty the qualities of enterprise and initiative are usually in short supply” (Nurkse 1953, 10). However, Nurkse writes: “Schumpeter’s theory seems to me to provide the mould which we must use, although we may use it with slightly different ingredients.” (Nurkse 1953a, 12).

What does this mean and what are the differences?

(1) First, Nurkse – in contrast to other contemporary economists – refers to what he called the ‘real’ Schumpeter, i.e. Schumpeterian theory with regard to the long-term development rather than to the short-term theory of business cycles along the development trend.

(2) Secondly, while Schumpeter’s main concern is with the individual entrepreneur who starts a ‘new wave’, Nurkse’s main concern is with the wave, or – the (various) Big Pulls in economic history:

Schumpeter’s creative entrepreneurs achieved a process of Balanced Growth, albeit with cyclical setbacks, through the spontaneous action of private initiative in the past, by carrying out waves of new investment on a wide front. [Celso] Furtado is sceptical about the usefulness of Schumpeter’s theory for the underdeveloped countries of the present day – and here I entirely agree with him. […] I suggested, by contrast, that the problem is, at least in theory, capable of solution through Balanced Growth […] in the domestic economy […]. This is, conceptually, a process whereby capital is applied more or less simultaneously to a wide range of complementary industries, so that increased productivity in each of these industries creates an expanding market for the others. (Nurkse, unpublished, n.d., 4-4a)

(3) Thirdly, while Schumpeter allegedly sees only the entrepreneur as the agent of economic change and growth, according to Nurkse: “It may be that in other types of society [other than Western capitalism] the forces that are to defeat the grip of economic stagnation have to be deliberately organized to some extent, at any rate initially.” (Nurkse 1953a, 15).
Japan is – referring to the work of Schumpeter’s Japanese disciple Shigeto Tsuru – quoted as a case in point: “In the early industrial development of Japan […] the state was the great innovator and the industrial pioneer on a wide front.” (Nurkse 1953a, 15). In particular, in a letter to François Perroux on his book on Schumpeter (Perroux 1951), Nurkse commented on “Schumpeter’s failure to consider the springs of innovation in a socialist economy” (Nurkse 1953b). However, it should be noted that Schumpeter had already provided for this case: “Every social environment has its own ways of filling the entrepreneurial function.” (Schumpeter 1951, 255).

3.3 Beyond Keynes and Schumpeter

As a development economist, Nurkse, as most of the first generation (Toye 2007), is often understood to have argued in the footsteps of John Maynard Keynes. This is true at least as far as Nurkse explains what he regards as the central factor in underdevelopment, the lack of capital, not only from the supply side but also from the demand side. In this way, Nurkse avoids the one-eyed view of neo-classical thinking. He also gives due consideration to the role of expectations and the time-consuming nature of adjustment processes. Nurkse’s contribution to development economics, however, exceeds the borders of conventional Keynesian theory in at least two respects: first, the analysis of sub-optimal equilibria is transferred from short-term to long-term analysis (i.e. from unemployment to underdevelopment equilibrium). Secondly, while Keynes was a market-pessimist with regard to the short-term adjustment task, as a consequence of the shift of focus, Nurkse was a central-planning optimist regarding the long-term task: the balanced-growth approach.

Interestingly, Nurkse also made positive notion of the second ‘giant’ in the field of economics in the 20th century, Joseph A. Schumpeter. In contrast to Keynes, Schumpeter is widely considered to have overstressed supply-side factors in economic development as well as market forces in the adjustment process. Thus, Schumpeter's view of disequilibria as the ‘normal’ situation in capitalist development seems incompatible with Nurkse's balanced-growth concept. There are, however, good reasons for Nurkse's stance: the long-term perspective and the focus on big-push development processes (as materialised in the upswing phase of the Kondratieff-waves) turned Schumpeter the ideal King's evidence against the non-interventionists and the gradualists in development thinking.
By analysing the influence of Keynes and Schumpeter on Nurkse's contribution to development thinking it becomes clear that Nurkse's approach is abound with originality and individuality.

4. Looking Ahead: Nurkse’s Circular Model Influencing Modern Poverty Theories

As argued in the first section, the heyday of ‘classical’ development economics as a consistent theoretical body had ceased by the late 1950s and a period of diversified approaches came into being. In the field of international organisations, however, after a state-optimistic view of development policy in the 1950s and the 1960s, the neo-liberal turn in the 1970s to 1980s became the most influential, probably best summarized in the Washington Consensus formula.

Shortcomings of the neo-liberal approach have led development thinkers to a more complex view of the issue in recent years. It is no wonder that under these circumstances circles of mutual and cumulative causation of persistent poverty have come to the fore. The World Development Report of 2000/2001 ("Attacking Poverty") set up a model where in one circle extreme levels of material poverty lead to poor risk management capacity and vulnerability, which then leads to limited savings, investments, and livelihood opportunities from self-employment, in turn leading to extreme levels of material poverty – while other parts of the model refer to the circular causation of poor health and poverty, or social exclusion and poverty (The World Bank 2000a).

To provide one more of a number of examples, The World Bank and other international organisations in their important document on the perspectives for Sub-Saharan Africa (The World Bank 2000 b) proposed a model consisting of four circles of mutual and cumulative causation of development: “improving governance and resolving conflict; investing in people; increasing competitiveness and diversifying economies; reducing aid dependence and debt and strengthening partnerships” (The World Bank 2000b, 39).

Based on this model, the publication identified various areas of policy intervention to spur the catching-up process of economies in sub-Saharan Africa and to provide the level of per capita growth in output necessary to overcome poverty. The authors argued for improved governance; a directly targeted reduction of poverty and inequality; better education; enhanced physical, financial and informational infrastructure; rural development; diversified
external economic relations; and strengthened external partnership. The central message of the document is that only when simultaneously succeeding in these tasks, will Africa be able to claim the new century and “to overcome the development traps that kept it confined to a vicious cycle of underdevelopment, conflict, and untold human suffering for most of the 20th century” (The World Bank 2000b, x).

Causal connections and points of intervention in some of the above-mentioned policy areas have recently been discussed in development economics on a particularly controversial level, especially the growth-to-poverty transmission. Beyond all doubt, sustained economic growth is considered essential to overcome poverty in Africa, as there is only a small basis for re-distributive efforts. An important factor in generating economic growth, however, is seen in the formation of human capital, which in turn depends on better health care and schooling. Also the financing of physical capital accumulation by domestic saving is seen as based on social conditions, such as an accelerated demographic transition by lower child mortality and higher female education. These causality chains provide a strong argument for direct anti-poverty policies: “reducing poverty and improving social conditions are not simply consequences of development – they are essential components of any viable development strategy” (The World Bank 2000b, 84). In addition, economic growth is considered to be less effective for poverty alleviation in the face of massive inequality. As according to the sceptical view of the authors of this document, the macro-economic reforms of the 1990s did not benefit all poor groups to the same degree, targeted public services and public spending are considered necessary: “Growth that translates into rising consumption is thus essential for poverty reduction. But growth is not sufficient, given Africa's low incomes and high inequality and exclusion.” (The World Bank 2000b, 91). Key ingredients of the proposed poverty reduction strategy are a growth rate of output of more than 7 per cent per year (a big push?) as well as funds allocation directed at geographically marginalized areas.

In spite of the much more complex nature of these models, partly reflecting a better understanding of the subject, partly a more complex reality, a certain inspiration of this approach by Nurksean thought cannot be overlooked.

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II Publications


