



“Summary of article by Ragnar Nurkse: The Standard of Living and the Capacity to Save” in Frontier Issues in Economic Thought, Volume 2: The Consumer Society. Island Press: Washington DC, 1997. pp. 183-186

Social Science Library: Frontier Thinking in Sustainable Development and Human Well-being

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Many poor nations face a vicious cycle that prohibits development: a very low income level provides little basis for savings; without savings there is little capital and therefore low productivity; and low productivity perpetuates low income. "Outside help" in the form of foreign assistance is often seen as the only viable way to interrupt this cycle. However, both the absolute and the relative level of real income determine the capacity to save; as such, income disparities among nations may create additional problems that can render this option ineffective. This paper applies the economic theory of the "demonstration effect" to explain why many poor nations are not generating the sufficient capital to have productive economies.

A NEW THEORY OF CONSUMPTION AND SAVING

James Duesenberry's theory of consumer behavior is relevant in the context of both the individual consumer and international economic relations. Duesenberry states that consumers become dissatisfied with their current goods when they learn about superior modes of consumption. When this dissatisfaction arises, new wants are triggered and the propensity to consume shifts upward. This "demonstration effect" could have a profound affect on the choice between consumption and saving. According to Duesenberry, a consumer's savings is not only a function of his or her absolute income, but it also may be dependent on the ratio of personal income to the superior income level of peers. Therefore it can be assumed that greater income inequality may reduce, rather than increase, savings ratios.

GROWING AWARENESS OF ADVANCED LIVING STANDARDS

The consumption levels of individual countries may be interrelated in a similar way, whereby the demonstration of superior modes of consumption in some countries can lead to the imitation of those modes of consumption in others. Thus, the awareness of new goods and new modes of consumption tends to raise the general propensity to consume. Whether these new goods are imported or produced domestically, they become part of the nation's standard of living.

This phenomena is most evident in the widespread imitation of American consumption patterns. This could be, at least in part, a function of American advertising ("the art of creating new wants"). America's influence through the demonstration effect is particularly felt in the poorer two thirds of mankind, but it is also evident in places such as Western Europe.

The international demonstration effect is a product of two factors: the size of the disparities in real income and consumption levels, and the level of awareness of those income disparities and consumption levels. Discrepancies in living standards are vast, but just as important are individual's increasing awareness of them. American cinema, radio, and travel technology have accelerated this awareness, especially among urban upper income groups (thanks to mass media and education).

Imitation of American consumption patterns can, however, limit the supply of investible funds – which are required in order to copy production methods – by curbing people's willingness to save. Some might argue that new wants would motivate people to work harder and produce more, thereby making necessary funds available). However the demonstration effect suggests that the extra units of output would in fact be used for immediate consumption, rather than saved.

EFFECTS ON THE PROPENSITY TO SAVE

The international demonstration effect can hinder the development of lower income nations by adversely affecting both voluntary personal savings rates and an entire nation's ability to utilize taxation as a means of compulsory savings. When both the relative and the absolute level of real income is considered, it is clear that diminishing the income gap between nations, not the injection of foreign aid and investment, may prove to be the best way to aid underdeveloped countries. However, one must also consider the possibility that even if the income gap between nations remains constant, a rise in the living standards of individuals in both poorer and richer countries may increase the level of communication between the two, thus strengthening the demonstration effect.

Saving is made even more difficult in underdeveloped nations because of the international disparities in income that cause individuals to consume immediately (because of the tension, impatience, and restlessness that result from the demonstration effect), rather than postpone that consumption in the form of saving. The conventional economic view of the demonstration effect would be a positive one, implying that the knowledge and imitation of superior modes of consumption would make prosperity spread. For the reasons outlined above however, "A high income and consumption level in an advanced country can do harm in that it tends to reduce the domestic means of capital formation in the underdeveloped countries; it puts extra pressure on countries with relatively low income to spend a high proportion of it." (68)

EFFECTS ON THE BALANCE OF PAYMENTS

Balance of payments disequilibria are indirectly related to levels of productivity. The demonstration effect suggests that there could be a natural tendency for disequilibrium between countries with wide income differentials. This is not, as might be assumed, because an advanced country's high productivity allows it to export cheaply, thus giving it a comparative advantage; rather it is because the poorer country's propensity to consume (as explained by the demonstration effect) is greater than its ability to produce. International income gaps can therefore have a direct impact on the balance of payments because the demonstration effect in such cases greatly increases the demand for imported goods.