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Book Review — Digitized Version

[Book Review of] Reform, recovery, and growth: Latin America and the Middle East, Rudiger Dornbusch ... (eds.): Chicago, Univ. of Chicago Press, 1995

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only seven sentences, taking up no more than fourteen lines, the reader is confronted seven times with expressions such as “Anderson anticipates”, “Anderson emphasizes”, “Anderson stresses”, and statements like “financial asset media of exchange may thus give rise to a rising, falling, or constant level of prices” (p. 61) – an evocation of Cole Porter’s “Anything Goes” – or “Anderson applied an evolutionary approach to the analysis of financial evolution” (p. 139) convey no real information.

Hayek’s proposal to replace our present central banks by a system of free currency competition has provoked numerous speculations about how the private financial sector would change if the now prevailing legal restrictions were completely abandoned. For those who would like to gain an idea of the beneficial or detrimental consequences of a monetary deregulation along Hayek’s lines, the New Monetary Economics probably will provide the most expert conjectures. Cowen and Kroszner’s “most likely” scenario has obviously been inspired by the rapid growth of money market funds in the United States and elsewhere. There is, however, no scientific method available which allows us to predict whether or not the monetary sector would further develop along these lines.

M a n f r e d N e l d n e r

Dornbusch, Rudiger, Sebastian Edwards (Eds.), Reform, Recovery, and Growth: Latin America and the Middle East. A National Bureau of Economic Research Project Report. Chicago, London 1995, The University of Chicago Press. IX, 426 pp.

The twelve papers collected in this volume are the final product of a research project jointly organized by the National Bureau of Economic Research and the Inter-American Development Bank, presented at a conference in December 1992. The key issue dealt with in the volume is why macroeconomic and structural reforms have resulted in economic recovery in some countries, while per capita income has stagnated elsewhere. The subsequent questions are raised in the papers: What are the requirements for successful stabilization? What is the growth impact of structural reforms? How do reforms affect income distribution? In which way are the results influenced by the timing and sequencing of reform programs and by external conditions? The approaches in dealing with these questions differ considerably between the various contributions. The range is from rather descriptive evaluations of specific country cases to econometric cross-country studies and theoretical models. The experiences of Argentina, Bolivia, Brazil, Chile, Mexico, and Peru in Latin America, and Israel and Turkey in the Middle East figure prominently in the volume.

Following an introduction by the editors, the papers are grouped into five parts, though sometimes rather arbitrarily. The first part on trade policy, foreign investment and privatization consists of contributions by *Sebastian Edwards* and *Aaron Tornell*. The purpose of the former is to explore, from different perspectives, the relationship between trade liberalization and economic growth. Cross-country results support the view that more open economies tend to have faster rates of productivity growth. However, “designing a strategy for moving from a controlled to a liberalized economy is not an easy task” (p. 22). Therefore, transitional issues, including real exchange rate behavior during reforms, are discussed in some detail, mainly with respect to recent trade reforms in Latin American countries (among which Mexico is the most interesting case). As mentioned in the comments by *Miguel A. Savastano*, the critical question with regard to the sustainability of trade reforms remains what exactly Edwards’ request for a competitive real exchange rate implies in the light of the “real appreciation syndrome” (p. 51), e.g. in Argentina.

Tornell analyzes the puzzle why reforms in Mexico were implemented at a time of economic crisis, rather than at a time when the country could have dealt with short-term costs more easily. He presents some challenging ideas on the basis of a game-theoretic model of the interaction between the parastatal and the private sector elites. The basic argument is that the earlier "cohabitation equilibrium" between these two groups broke down, and it became profitable for the private elite to opt for trade liberalization, once the financing of traditional subsidies proved unsustainable with oil prices and fiscal revenues plummeting. Moreover, the new situation of the elites struggling with each other provided the government with greater autonomy to implement reforms.

It appears that *Tornell's* paper should have been the first candidate to be included in Part II of the volume, dealing with the political economy of reform. Political economy aspects figure less prominently in the two papers that are actually subsumed under this heading. *Mauricio Cárdenas* and *Miguel Urrutia* evaluate whether policies that have a built-in bias against large macroeconomic imbalances tend to be superior in terms of social progress as well, after controlling for the effects of macroeconomic stability on economic growth. The authors start from the reasonable proposition that adjustment costs "cannot be blamed on the adjustment process itself, but on the policies that made such adjustment inevitable" (p. 79). The major conclusion from their detailed empirical investigation is that macroeconomic stability is a necessary though not sufficient condition for achieving social progress. Favorable effects of public social expenditures that rely heavily on the inflation tax are completely undermined.

Raúl Labán and *Felipe Larráin* present a detailed account of economic policies pursued in Chile under Aylwin, and discuss the issue of continuity and change in the policy regime. It is shown that the country's transition from stabilization to growth took a significant amount of time and was not free from temporary setbacks. Increasing Chile's investment effort (in terms of physical and human capital), which requires more domestic saving, is considered to be among the major challenges for the future. In a sense, this paper represents the first broadly based country study in the volume, followed by four recent country experiences in Part III:

- *Eliana Cardoso*, *Ricardo Paes de Barros* and *Andre Urani* show that inflation and unemployment (rather than education) were major determinants of the deterioration of income distribution in Brazil in the 1980s. This is done by decomposing inequality into two elements, i.e., inequality within and between groups with the same number of years of schooling. Rather than commenting upon this politically delicate, though not very surprising result, *Rubens Ricupero*, the minister of finance of Brazil, obviously preferred to deliver a kind of luncheon address on a "rich and dynamic picture as that presented by Brazil today" (p. 173).
- *Gil Bufman* and *Leonardo Leiderman* assess the policy lessons from Israel's stabilization program. In order to facilitate a rapid transition from stabilization to growth, it is suggested to increase public investment in infrastructure already at the stage of disinflation. The question remains whether government consumption is flexible enough to remove serious fiscal imbalances. With regard to exchange-rate policy, the authors suggest a band regime with a preannounced crawling central parity rate.
- The potential threat of overvaluation is also discussed in *Rudiger Dornbusch's* progress report on Argentina. Because of the recent nature of reforms in Argentina, it is mainly this paper which suffered from the publication lag. Another progress report by the fairly sceptical author may be warranted after Argentina weathered out the financial crisis in Mexico, apparently without being affected by contagion effects to a significant extent.
- The sluggish growth performance of Bolivia, almost a decade after the defeat of hyperinflation, is the principal concern of the paper by *Frederico A. Sturzenegger*.

Price developments for minerals and the inflation rate are considered to be crucially important determinants of total factor productivity in this country. Similar to Bufman and Leiderman, the author stresses the need for properly financed (!) government expenditure on public goods and infrastructure in order to increase productivity, “homogenize the provision of human capital across agents” (p. 277), and reduce the option value of waiting of private investors.

Part IV deals with deregulation and tax reform. *Arnold C. Harberger* presents a survey of major issues of taxation. Uniformity of tax rates is considered a promising way to improve administration and compliance, and a radical reduction of distortions is preferred because “it never consciously sends a wrong-direction signal to any activity or sector” (p. 296). The author also evaluates the impact of tax coverage and enforcement on the degree of evasion. *Arturo M. Fernández* discusses the role of deregulation and institution building in Mexico’s reform program. He reviews various examples of the complex regulatory network that traditionally tended to strangle production, and concludes that deregulation can enhance growth. However, as noted by *Andrés Velasco* in his comments, it is sometimes difficult to decide on the basis of the “tales told by Arturo Fernández” (p. 337) in which area deregulation has positive growth effects, or rather a once-and-for-all effect on economic activity.

The final part on how to stabilize starts with another broadly based country paper. The case of Turkey, analyzed by *Anne O. Krueger*, is in striking contrast to Bolivia. While the latter stabilized successfully without having managed the transition to growth, the substantial liberalization of the Turkish economy stimulated export and GDP growth. Yet the sustainability of microeconomic reforms remained at risk because of the failure to control public finances and the ensuing acceleration of inflation in the late 1980s and early 1990s. *Miguel A. Kiguel* and *Nissan Liviatan* analyze recent efforts of Argentina, Brazil and Peru to eliminate hyperinflation and provoke an interesting debate on the comparability to the classic hyperinflations in Europe in the 1920s. According to the authors, the new phenomena are that (i) hyperinflation emerged as the final stage of a long process of increasing inflation, rather than being the result of a sudden explosion of budget deficits and seigniorage, and (ii) the process of restoring price stability tends to be more cumbersome than the classical examples suggest, because the credibility of Latin American governments was seriously undermined. Classic stabilization programs could thus have non-classic outcomes, unless “they frontally attacked the structural features that gave rise to an inflationary economy” (p. 395) and stabilization efforts are complemented by comprehensive microeconomic reforms. As noted by *William R. Cline*, however, it remains open to question whether countries such as Brazil have adequately applied the classical remedies to fight hyperinflation.

To summarize, the volume consists of a set of rather heterogeneous contributions. The analogy used by Harberger to motivate his paper, i.e., serving a bouillabaisse that includes fundamental though familiar ingredients (to make the soup nourishing) and somewhat exotic ingredients (to give it a special flavor), applies to the volume as a whole. The soup may have gained from some more of the latter. Nevertheless, most readers will find something especially interesting to them. They should be aware, however, that the headings of the five parts of the study are of limited help in making their choices. Those readers looking for recent developments in the economies under consideration will not only deplore the considerable publication lag, but may also prefer more focussed country papers.

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