

Nunnenkamp, Peter

Book Review — Digitized Version

[Book Review of] International money and debt,
Dornbusch, Rudiger ... (eds.): San Francisco, ICS Press,
1991

Weltwirtschaftliches Archiv

Provided in Cooperation with:

Kiel Institute for the World Economy – Leibniz Center for Research on Global Economic Challenges

Suggested Citation: Nunnenkamp, Peter (1992) : [Book Review of] International money and debt, Dornbusch, Rudiger ... (eds.): San Francisco, ICS Press, 1991, Weltwirtschaftliches Archiv, ISSN 0043-2636, Mohr, Tübingen, Vol. 128, Iss. 2, pp. 368-370

This Version is available at:

<https://hdl.handle.net/10419/28680>

Standard-Nutzungsbedingungen:

Die Dokumente auf EconStor dürfen zu eigenen wissenschaftlichen Zwecken und zum Privatgebrauch gespeichert und kopiert werden.

Sie dürfen die Dokumente nicht für öffentliche oder kommerzielle Zwecke vervielfältigen, öffentlich ausstellen, öffentlich zugänglich machen, vertreiben oder anderweitig nutzen.

Sofern die Verfasser die Dokumente unter Open-Content-Lizenzen (insbesondere CC-Lizenzen) zur Verfügung gestellt haben sollten, gelten abweichend von diesen Nutzungsbedingungen die in der dort genannten Lizenz gewährten Nutzungsrechte.

Terms of use:

Documents in EconStor may be saved and copied for your personal and scholarly purposes.

You are not to copy documents for public or commercial purposes, to exhibit the documents publicly, to make them publicly available on the internet, or to distribute or otherwise use the documents in public.

If the documents have been made available under an Open Content Licence (especially Creative Commons Licences), you may exercise further usage rights as specified in the indicated licence.

ship role in the GATT, this is the right emphasis, but it does let other G7 nations off the hook for their contributions to unfair trade legislation and to regionalism.

Finally, readers of *Protectionism* will be pleased to see Bhagwati's stylistic virtuosity is undiminished. Apart from the above quotes, several old favourites return (e.g. the diminished giant syndrome, the spider's web phenomenon, and the giant among Lilliputians). The biggest surprise is the absence of explicit reference to the Dracula Effect, since Bhagwati's latest book is evidence that exposing fallacious populist arguments to the light of reason reveals their lack of logical content.

Richard Pomfret

Dornbusch, Rudiger, Steve Marcus (Eds.), International Money and Debt. Challenges for the World Economy. An International Center for Economic Growth Publication. San Francisco 1991. ICS Press. X, 200 pp.

During the 1980s, the world economy was challenged by uncertainties stemming from protracted multilateral trade negotiations, the debt overhang of many developing countries, and an international monetary system characterized by highly volatile exchange rates. Recently, economists and policy-makers appear to be preoccupied with analyzing and managing the economic transformation of post-socialist countries, and their concern has shifted towards the perceived shortage of global savings and fiercer worldwide competition for scarce capital. The recent upheavals in the world economy have not rendered irrelevant the problems that emerged in the 1980s. To the contrary, the persistent uncertainties with respect to trade, debt and exchange rates add to the difficulties of integrating successfully the new partners into the world economy.

A critical review of the progress made in resolving the central issues of the 1980s is, hence, not only of historical interest, but may also help improve the chances to meet the new challenges of the 1990s. The volume edited by Dornbusch and Marcus is intended to provide such a stocktaking for two of the three topics mentioned above, i.e. the debt problem and the instability of the international monetary system, which continue to be major stumbling blocks to a smooth functioning of worldwide economic relations. Most of the essays in this book were originally prepared for a conference held in December 1988 (!) under the auspices of the Israeli International Institute for Applied Economic Policy Review. The major objective was to "provide important insights to aid future management of the debt crisis and development of cooperative and stabilizing international monetary policy" (p. X).

The volume consists of an introduction by the editors and two more parts. In Part 2, four authors develop their views on the world debt problem, *Anne O. Krueger* and *Stanley Fischer* as former chief economists of the World Bank, and *Roberto Junguito* and *Jesús Silva-Herzog* as former ministers who were directly involved in managing and negotiating the debt of Colombia and Mexico. The third part comprises four papers that focus on the role of central banks in an exchange rate system in which volatility and misalignment, halfhearted coordination, as well as policy intervention appear to be the rule rather than the exception. The contributions come from different perspectives, ranging from the academic field (*Alexander K. Swoboda* as well as *Pierre Jacquet* and *Thierry de Montbrial*) and the Research Department of the IMF (*Jacob A. Frenkel*, *Morris Goldstein* and *Paul R. Masson*) to the Deutsche Bundesbank (*Wolfgang Rieke*).

To introduce the subsequent essays, *Dornbusch* and *Marcus* offer some broad considerations on the dollar and debt problems. According to the authors, the suspicion is pervasive that the significantly increased volatility of exchange rates since 1973 is

“contrived rather than of an equilibrium variety” (p. 5). The hypothesis of informed rational speculation is rejected. Of course, the suggestion to look for immediate remedies and limit financial speculation in one way or another remains controversial, unless a better model is available. Similarly, it is hard to rationalize a plan for policy coordination unless the equilibrium model is replaced by a convincing alternative paradigm. As concerns the debt problem, the current policy, including the Brady Plan, is criticized for not putting the emphasis on the relevant issues. In Latin America, tax reform, privatization of state companies and human-capital formation are deemed to be of utmost importance. The reader wonders, however, whether the required “priority for policy makers . . . to trigger the virtuous cycle of normality, prosperity, and stability” (p. 14) is well defined by these reform elements.

In his evaluation of recent debt developments, *Fischer* draws a more optimistic picture than the editors did before. The Brady Plan is regarded as real progress in creating a framework that enhances many debtor countries’ prospects for growth and creditworthiness. In addition, the existing tools in addressing the debt crisis may need to be improved and expanded, and alternative sources of financing have to be found by developing countries. One of the questions which remains open is whether foreign direct investment can play a significant role unless debt-related investment risks are overcome. *Krueger* discusses analytical and conceptual issues of decision-making at the outset of the debt crisis. Though there is hardly anything new in the paper, the history of the debt issue reveals that it took long to realize that payment problems had much to do with domestic economic policies within the debtor countries. Consequently, a number of decision problems were not – and some have not yet been – satisfactorily resolved, including the linkage between external financial support and internal policy reform as well as the creation of a worldwide trading environment that helps overcome the adjustment pessimism of debtor countries.

The two subsequent papers deal with the specific policy-making process in Mexico and Colombia. *Silva-Herzog* underlines the point made by *Krueger* that myopia prevailed during much of the debt negotiations, both within and outside Mexico. The fundamentals underlying the growing internal and external disequilibria were ignored, and massive short-term borrowing was due to the wrongly perceived transitory character of payment problems. Even if it were true that “debt negotiations have been dominated by the creditors”, *Silva*’s call “to look for better-shared leadership, with greater participation by the ones that have to pay and that have borne the heaviest part of the debt burden, and to establish leadership that is more coordinated, less isolated” (p. 60) would have missed the basic point. It would have been more interesting to learn about the former finance minister’s assessment of the recent economic policy reforms implemented by the Salinas administration. More practical lessons are provided by *Junguito*’s discussion on why Colombia succeeded to prevent major debt problems. The focus is on the critical question of policy consistency and appropriate sequencing of economic reforms. The major conclusion is that fiscal adjustment and tight monetary policies before starting an accelerated exchange-rate crawl succeeded in real devaluation, without resulting in excessive inflation which was so common in other Latin American countries. In fact, *Junguito*’s contribution is by far the most interesting in terms of policy conclusions in the volume’s part on debt.

The discussion of the international monetary system in Part 3 starts with the contribution of *Swoboda* who reviews the coordination of monetary policy since 1959, considers current international macroeconomic imbalances and their origins, analyzes the use of monetary and fiscal policy under alternative exchange-rate regimes, and offers proposals for improved coordination of macroeconomic policies. In contrast to the Bretton Woods system in which coordination focused on maintaining fixed exchange rates, a new set of coordination goals has emerged subsequently, in particular

the minimization of spillovers from national macroeconomic policies, the sustainability of current account balances, and the prevention of grossly misaligned and volatile exchange rates. According to Swoboda, the assignment problem has to be solved in the first instance in order to establish some rudimentary rules for coordination. The assignment of monetary policy to the current account, as proposed for exchange-rate target zones, "is clearly inappropriate" (p. 95). The major obstacle to stabilizing exchange rates is considered to be the lack of fiscal discipline.

Rieke argues that the case against coordination is weakened by the experience of the EMS in stabilizing exchange rates at reasonable levels. However, this regional cooperation approach also reveals that "cooperation between sovereign countries cannot be expected to compensate for lack of sound national policies, commonly agreed rules, and a key currency anchor" (p. 102). The lack of one or more of the latter elements may well explain the problems confronting *global* stabilization efforts. In particular, early attempts to restore a worldwide system of fixed exchange rates are bound to fail unless the United States practices fiscal self-discipline. *Jacquet* and *de Montbrial* take an outsiders' look at the role of central banks in the process of international monetary policy. Their contribution includes a typology and a critical review of some examples of international economic cooperation. Successful cooperation is considered more likely under crisis than under normal conditions, but "the idea of Pareto-improving coordination . . . hardly fits a world of independent nation states that focus on domestic more than international concerns" (p. 128). The authors are also pessimistic about the prospects to provide international public goods through "systemic" cooperation, i.e. an agreement on the institutional policy framework rather than the policy itself, because policy-makers and central bankers enjoying their power clearly lean toward discretion and ad-hoc solutions. In the current context of massive imbalances in budgets and current accounts, it is hardly to be disputed that too much is expected of central bank policies. However, the authors' suggestion to constrain the independence of central banks to achieve *domestic* coordination of economic policies in the first place remains highly debatable.

The final chapter by *Frenkel*, *Goldstein* and *Masson* discusses the scope, methods and effects of international policy coordination. The presumption that there are valid reasons for international policy coordination is established by referring to the existence of spillover effects of national policies and public goods. Though welfare improvements are not automatic, the barriers to coordination should not be overestimated according to these authors. The paper proceeds by surveying the pros and cons, for example, of multi-issue versus a narrow approach to coordination, episodic efforts versus a regular coordination process, small versus large size of the coordinating group, and alternative methods of coordination. As concerns the latter, the discussion focuses on rules versus discretion, single versus multi-indicator approaches, and hegemonic versus symmetric systems. One of the controversial conclusions is that the gains from policy coordination may even increase when there is a lack of knowledge about the effects of policies. Moreover, even though the policy-makers may disagree on the correct model of the world economy, the authors "*believe* that . . . coordination is likely to lead to good domestic policies and for that reason is a valuable mechanism for promoting global welfare" (p. 162; emphasis added).

In summary, the contributions on the international monetary system underline the editors' introductory statement that the discussion of the problem of policy coordination has rapidly come to the point where it must be recognized that there is no easy answer. Nevertheless, it is mainly this part of the volume which provides an interesting debate on how to resolve major international policy challenges. Readers who are rather interested in the resolution of the debt crisis will probably find the book less useful.

Peter Nunnenkamp