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BOOK REVIEWS

International Money and Debt: Challenges for the World Economy. **By Rudiger Dornbusch and Steve Marcus.** San Francisco, California: ICS Press, 1991. Pp. x, 200.

The international debt crisis of the early 1980s was the confluence of a number of developments in a most extraordinary way, a coming-together of economic and political currents in a time-frame that could hardly have been more ill-starred.

First, there were the oil shocks of 1973 and 1978–79 which produced enormous net investible surpluses incurred by OPEC and other exporters, producing structural trade surpluses that till today have not yet been fully digested by all of the countries concerned. Even the ones that had the digestive power, such as Mexico, Nigeria and Venezuela, not only absorbed the oil bonanza but went beyond that to mortgage expected future revenues through massive external balance of payments and project borrowing. The flip-side of this issue was the enormous collective structural payments deficit striking oil importers such as Brazil, which had no chance of quick adaptation with energy imports both price- and income-elastic in the short-term. In between stood the banks, which took in the greater part of the investible surpluses in the form of Eurocurrency balances and financed most of the deficits through syndicated lending, both of which boomed during the decade of the 1970s.

Second were macroeconomic policies pursued by governments sometimes incompetent, sometimes corrupt, inevitably operating under conditions of very high social discount rates — with enormous political pressure biasing resource allocation against investment to build the foundations for sustainable economic growth towards immediate consumption and improved levels of living. The scenario is by now dismally familiar. Large public-sector deficits, financed by printing government securities that were subsequently monetized through sale to (non-independent) central banks, were followed by inflation and lower expected real interest rates, capital outflows, central bank intervention, imposition of exchange controls, and massive balance of payments financing, falling external reserves and rising external debt. The resulting overvalued currencies led to further trade deficits, capital flight, and erosion of all but a trickle of capital inflows. Rising external debt levels and increased bank perceptions of country risk in turn led to higher dollar interest spreads and shorter maturities, requiring more frequent rollovers and new borrowings.

Third was U.S. monetary policy, which drove up global real interest rates, notably the London inter-bank offered rate, the base rate for most syndicated lending. By slamming-on the monetary brakes to deal with unprecedented U.S. inflation after taking office in 1979, Paul Volcker jammed drove real rates to unprecedented levels. This stung any highly leveraged borrower, whether households, corporations or countries. The deep recession that followed — first in the United States and then in Europe — knocked the bottom out of commodity prices and export volumes for the very countries already reeling from the first two sets of forces.

And there were misguided policies in search of economic growth, on the part of planners in the

countries themselves and advocated by experts sent by the internal development agencies ranging from the World Bank to the regional development banks. Grandiose, capital intensive and foreign exchange intensive projects were favoured over private sector industry and small business. Import substitution continued to take precedence over export expansion for a surprisingly long time after it was dethroned among researchers as the key to market-driven development, and agencies like UNCTAD were still preaching time-warp nostrums like commodity cartels as against effective market-access for non-traditional manufactures and semi-manufactures.

Everything came together in 1982, beginning with Mexico and cascading through the system to produce a real threat of the financial equivalent of a nuclear melt-down.

So who was to blame? Everyone. OPEC greed. Technocratic incompetence. Lack of political fortitude and leadership. People wanting to live well beyond their means and let tomorrow take care of itself. U.S. macroeconomic policy, however necessary. Agricultural protection and market blockages in Europe. Myopic bankers suppressing risk concerns in favour of return considerations in a frenzy of competitive lending. Bank regulators lacking oversight and even elementary facts on who lent how much to whom. The structure of the syndicated lending process, pulling banks lacking substantive expertise or risk-assessment capability into deals with no idea where the cash flow to make debt service was going to come from; relying instead on the professionalism of the syndicate lead managers which succeeded only in leading the lemmings over the cliff. The use of sovereign guarantees creating a false sense that "countries don't go bust". Ordinary people in the industrial countries, enjoying some delightful years of export boom fuelled by mountains of debt.

And who has had to pay the bill? Again, everyone. Decision makers — bureaucrats, politicians and bankers alike — looking for work or prematurely put out to pasture. Shareholders of banks, losing most of a decade's earnings in endless rounds of debt renegotiations, interest capitalizations, forced lending, write-downs and write-offs producing depressed earnings, stock price losses and deteriorating credit ratings. Residents of the highly indebted countries themselves, suffering from severe austerity measures in an effort to work from under the debt mountain, often under IMF tutelage — already poor people confronting a veritable "lost decade". Taxpayers in the developed countries, forced to shoulder the tax-effects of the banks' financial troubles, provide more resources to the IMF, restructure government-to-government debt, and build up aid to the poorest among the heavily indebted countries.

Now, over a decade later, there is light at the end of the tunnel. Countries like Chile seem to be on a permanent track to impressive development. Others, like Mexico and Argentina, seem to have turned the corner, although it is a bit too soon to make a definitive judgment. Still, many have come back to market, and are finding eager investors and even lenders. And far better economic management — or a lack of borrowing capacity in the 1970s — in most of Asia more or less held the region immune from many of the problems (the Philippines excepted) turning the region into a booming bright-spot on the global scene from the mid-1980s on.

So what are the lessons? That is what this book is about. Written by eminent economists who have spent a good part of their careers worrying about these issues, in some cases contributing to the problem and in some cases prescribing cures. There is a brief introduction by the editors setting out the problem with admirable brevity and clarity, but mostly duplicative of the following paper by Stanley Fisher. There follow two excellent and perceptive essays by Anne Krueger, for a brief time chief economist of the World Bank, and Jesus Silva-Herzog, Finance Minister of Mexico during the most exciting period. Their "told you so" and *mea culpa* essays are among the highlights of the book — as is the analysis of the Colombian debt problem by Roberto Junguito. The final section of the book deals with the role of central banks (by Alexandre Swoboda), the role of exchange rates (Wolfgang Riecke), central

banks once again (Pierre Jacquet and Thierry de Montbrial) and economic policy co-ordination (by Jacob Frenkel, Morris Goldstein and Paul Masson). Again, much of this is highly repetitive.

While the book has a number of nuggets to tweak the interest of readers who are already reasonably familiar with the global debt issue, it is tough slogging trying to find them. On the other hand, people wanting a coherent overview of this sad episode in the world's economic history will have to look elsewhere since the papers — some of which appear to have been "recycled" from a previous work — don't hang together very well. This is always a danger in weakly-edited works where the authors are not kept on a short leash.

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Money in the People's Republic of China. **By Gavin Peebles.** Sydney: Allen and Unwin, 1991. Pp xiii, 289.

Gavin Peebles' book "Money in the Peoples Republic of China" comes at a time when most observers of China are wondering how the government is going to calm down an overheating economy that is socialist by nature but capitalist by growth figures. Last time these problems were on the economic planners' agenda in the mid 1980s, and their deliberations resulted in a harsh austerity programme that almost put the economy to a halt. Amongst others, an underdeveloped monetary system and a rudimentary capital market were identified as major reasons for the abrupt deceleration in the economy's growth at that time.

The key question today is whether policymakers in Beijing have gathered enough experience to steer their country in a less turbulent way. Peebles' answer is that planners are still in a learning phase. This is an ambiguous answer: on the one hand, it offers hope that they have improved monetary management: on the other it indicates that further changes in the institutional setting of the monetary sector are in the offing, thus increasing uncertainty. However, his book is helpful in that it offers readers interesting insights into the way Chinese policymakers think. It is divided into seven chapters which offer the reader a menu approach to a vast amount of information until recently only available to a small circle of China specialists. In the first two chapters, Peebles attempts to develop an alternative approach to the Quantity Theory of Money in order to explain China's monetary experience. Instead of focusing on aggregate stock data, he prefers to use a model based on flows of expenditure into and out of the consumer sector, analysing what he calls the resulting purchasing power imbalance (PPI). This special approach reflects the measure used by Chinese authorities: they were concerned with the ratio of monetary aggregates to the value of retail sales, as GDP would not have indicated the amount of goods available to consumers. As both available data and the resulting policy can only be understood in connection with the underlying methodology of the study, this is a sensible approach. However, readers with a Western economic education sometimes tend to get confused over particular expressions.

In his overview of the 1952–85 time span Peebles provides three remarkable findings:

1. There is a reverse short run relation between money and real income, unlike events in Western countries. However, in the long run the relationship is positive.
2. There is a positive relationship between inflation and money supply.
3. Real money demand increased in times of inflation and falling output, which again is in contrast to industrial countries' experience.

These findings have to be seen against the Chinese political background. From the 1950s onwards, the use of money was discouraged, only to be strongly favoured again in the 1980s. Still, Peebles argues that the monetary system was the same over the period 1953–85, as money was pumped into the economy via state enterprises.