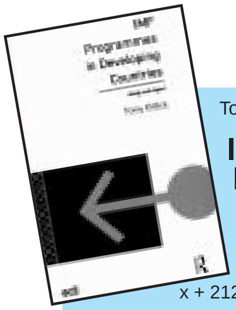
BOOKS



Tony Killick

IMF Programmes in Developing Countries (Design and Impact)

Routledge, London, 1995, x + 212 pp., £13 (paper).

Killick has written a responsible and well-researched critique of Fund-supported programs. After surveying the literature on the effects of Fund-supported programs and the methodological problems involved, Killick presents the results of his own research. As in all such studies, the existence of a program seems to have little statistically identifiable impact on outcomes. In fact, Killick finds a more significant positive effect on a number of variables than has most previous research, including that done within the Fund.

At first sight, the weakness of this relationship is surprising, since an agreement with the Fund on a program is considered a major event by the parties involved and by third parties, both public and private. The reason for the weakness of the relationship is probably that models do not capture the rather complex interactions between the Fund and the country during the implementation of the program. In this process, the decision to approve an arrangement with the country is only one, albeit an important, element. Fund-supported programs are not missiles that, once launched, have a pre-ordained trajectory. The more interesting questions are whether the Fund is helping a member country to adopt the right policies and whether the institution is using its undoubted influence wisely.

Among Killick's serious concerns with the structure of Fund-supported programs is that the bulk of the cut in absorption is typically borne by investment. In defense of Fund-supported programs, it could be noted that, if a shock is temporary and external financing constrained, it may be more rational and welfare-enhancing to cut investment rather than consumption. There is also a tendency for private investment to slump after a period of macroeconomic instability as investors wait to see whether stability has been restored before making irreversible investment decisions. Thus the fall in investment directly associated with Fund-supported programs may not reflect excessive tightness.

Killick's concern with the cuts in investment feeds, however, into his critique that the Fund's integration of growth into the design of programs is more rhetoric than reality. He suggests that programs should normally incorporate a growth target at least 1 percent above the rate of population growth, and that sufficient financing for this should be mobilized. In my view, the real problem is to ensure that the basis is laid for high-quality and sustainable growth. The recovery of growth may often occur only after the expiration of the program, and often it will be impossible to avoid a period of retrenchment as the negative consequences of past policies are overcome.

Killick recognizes the increased incorporation of safety nets in Fund-supported programs but argues that more can and should be done. He notes that it is very hard to come by data on the effects of Fund-supported programs on income distribution, but the urban poor as a group are probably often adversely affected. Killick does note that both income-distribution outcomes and cuts in public investment may reflect the priorities of the governments involved, rather than those of the Fund.

Killick finds no evidence for Fund financing as a catalyst for other financing, particularly as far as private sector flows are concerned, and he describes this "catalytic role" as a myth. By contrast, the Fund staff has found a strong link between aid flows and loans under the enhanced structural adjustment facility (ESAF), and the experience of mobilizing resources through consultative groups would also indicate such a link with regard to official financing. Fund-supported programs are certainly intended to lead ultimately to finer borrowing terms and better market access. Killick's failure to find this relationship may lie in the estimating techniques used: simple before-and-after analysis will often show reduced inflows. Programs usually aim for an improvement in the current account and thus less reliance on foreign borrowing than in the immediate past. But Killick may be identifying a real problem reflecting the lags associated with the restoration of cover by export credit agencies.

Killick strongly criticizes the intellectual underpinnings of performance criteria and calls for radical change. While there is more variation in performance criteria than Killick gives the Fund credit for, it is true that the core constellation of financial performance criteria has not changed much over the years. A number of valid criticisms of credit ceilings and other criteria are presented, but he does not suggest any alternatives. From the Fund's point of view, it is crucially important to link the authorities' policy commitments to operationally important magnitudes controlled by the central bank and the ministry of finance.

Killick's book is a balanced assessment of Fund-supported programs and a valuable and independent contribution to the literature on the Fund. The Fund can only benefit from the scrutiny that he gives its record and would be well advised to continue the debate. Finally, the book contains helpful suggestions for improvements in the Fund's operations that should be taken seriously within the institution.

Mark Allen

Yegor Gaidar and Karl Otto Pöhl

Russian Reform/International Money

MIT Press, Cambridge, Mass.,1995, 146 pp., $25.00 (cloth).

This volume reproduces the 1993 Lionel Robbins Memorial Lectures given by two figures who played crucial roles in shaping the major economic events of recent times. Yegor Gaidar launched economic reforms in Russia in 1992, while Karl Otto Pöhl was at the center of German efforts to control inflation in Europe in the 1970s and 1980s and to lay the framework for enhanced monetary cooperation among industrial countries.

Gaidar's essay provides a fascinating and candid insight into the unprecedented policy challenges facing a small group of reformers as the Soviet Union collapsed in late 1991. He argues very persuasively that given the previous failed attempts at reform, traditional theoretical arguments about shock treatment versus gradualism were largely irrelevant. The only option was to liberalize prices immediately and introduce market mechanisms as quickly as possible. While most observers—or, at any rate, those outside Russia—supported this approach, there was much debate, both at the time and afterward, about whether an additional element, tight monetary and fiscal policies, was essential for it to work.

Gaidar makes a strong case that, in addition to liberalization, steps (drastically slashing military spending and subsidies) were taken to stop the very real threat of hyperinflation—to him, this achieved the "maximum" program of the reformers. To be sure, keeping monthly inflation to no more than 10 percent in the first half of 1992 was considered a failure by some, but it should not be forgotten that, at the time, many observers had predicted much worse outcomes. Actually, inflation later accelerated somewhat, as Gaidar's political influence began to wane. But by then the reformers had begun to push radical privatization, which Gaidar rightly regarded as an essential means of creating a class whose members would not tolerate hyperinflation.

Gaidar's personal account is essential reading for anyone wishing to understand the political and economic pressures of those tumultuous times. Notwithstanding the current uncertainties about the future course of Russian reform, his legacy will not be easily overturned.

While the monetary policy crises faced by industrial countries were much less dramatic than those in Russia, Pöhl's insider's view of the German role nevertheless makes for absorbing reading. In discussing the events leading up to the collapse of the Bretton Woods system, he leaves no doubt that the German authorities were more strongly committed to maintaining domestic monetary stability than to maintaining fixed exchange rates. Pöhl stresses again and again the (by now fairly obvious) point that "exchange rate stabilization cannot work if underlying economic fundamentals do not converge."

This philosophy also pervades the second part of Pöhl's essay, which deals with Europe's experience on the road to economic and monetary union. For a long time, Pöhl and the Bundesbank were skeptical about the possibility of a convergence of low inflation policies within Europe. But gradually this skepticism was overcome, and by the time the Maastricht Treaty was signed, Pöhl appeared willing to give other countries the benefit of the doubt. He felt that, first, most politicians (and their electorates) had come to accept the basic arguments for price stability and against debasement of the currency, and, second, the increased integration of world financial markets had already begun to impose severe constraints on countries' ability to pursue truly independent monetary policies. But Pöhl remained cautious, stressing repeatedly that the institutional structure of a European monetary union must protect monetary policy against political pressures. An appendix provides an interesting critique of the alternative approaches that seemed possible at the time.

Pöhl's account is a well-argued statement of the classic German approach to monetary policy and of the importance he attaches to the independent role of the Bundesbank. However, one omission is somewhat striking: there is virtually no discussion of the upheavals in the European Monetary System resulting from the effects of German unification—an episode suggesting that matters may not be quite as clear cut as Pöhl would wish.

Donal Donovan

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Adrian Wood

North-South Trade, Employment and Inequality

Changing Fortunes in a Skill-Driven World

Oxford University Press, New York, 1994, xii + 505 pp., $24.95 (paper).

The rise in wage inequality between skilled and unskilled workers in industrial nations in the 1980s has brought forth a wide literature whose authors are seeking explanations for this phenomenon. The generally accepted view is that a relative decline in the demand for unskilled workers overwhelmed the long-term decline in the relative supply of them. The principal dispute in the literature is about the causes of this relative decline. Two explanations are usually offered: one involves the greater penetration by developing countries of the global market for manufactured goods and the other involves skill-biased technical change.

In his book, *North-South Trade, Employment and Inequality*, Adrian Wood argues strongly in favor of the first explanation. Using factor-content analysis, he estimates that changes in trade with developing countries reduced the demand for unskilled labor relative to skilled labor in the industrial nations by 20 percent. Moreover, he finds that the differential between the wages of skilled and unskilled workers, using various measures, lies between 10 and 21 percent. Therefore, assuming a relative labor demand elasticity equal to 1, he concludes that the growth of trade with developing countries is sufficient to explain all of the increase in the wage differential.

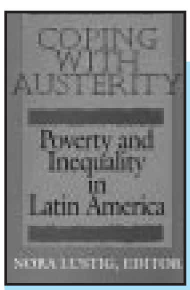
In the final section of the book, Wood offers various policy options to address the rise in wage inequality. He argues that an appropriate policy response would be to combine improvements in education and training for new labor force entrants, with a system of income supplements for low-wage workers in the United States and with a progressive payroll tax in Europe. The different prescriptions for the United States and Europe reflect the differing degree of wage flexibility in both regions. The flexibility of wages in the United States has led to much greater income inequality than in Europe, where policies have buttressed the bottom of the wage distribution, at the cost of higher unemployment. Therefore, the policy prescriptions attempt to reduce income inequality in the United States and to stimulate the employment of unskilled workers in Europe.

Wood's explanation of the rise in wage inequality relies on the validity of his estimate of the factor content of trade. To derive his estimate, he makes various adjustments to the standard way of calculating the cumulative reduction in the demand for unskilled labor. First, he uses labor-input coefficients for developing countries rather than those for developed countries (the latter coefficients are used in the standard methodology) because developing countries export different (and noncompeting) goods than developed countries. Second, he corrects for defensive unskilled-labor-saving innovation and spillover effects on the nontraded sector. Both these modifications raise the standard calculation of the factor content of trade by a multiple of 10. While the corrections that are made by Wood go in the right direction, their magnitude is subject to debate. It seems more reasonable to attribute part of the rise in wage inequality to greater exposure of developed country markets to manufactured products from developing countries and the remainder to the competing explanation of skill-biased technical change.

Wood's general policy prescriptions are not dependent on whether the falling demand for unskilled labor is caused by trade or by new technology, and they can therefore be assessed independently of the position taken on the relative importance of both explanations. The argument that providing education and training to new labor force entrants will raise the supply of skilled workers over time and hence reduce the skilled wage differential is debatable. The recent US experience of training programs targeted at youths has been unfavorable, and a number of commentators have suggested reassessing education policy earlier in the life cycle of labor force entrants.

In general, the presentation of the facts of wage inequality and rising penetration of the global market for manufactured goods by developing countries is clear and cogent. Moreover, the exposition of the factor content of trade is comprehensive and original. For those interested in understanding the potential causes of, and remedies for, the rise in wage inequality in the 1980s, this book should certainly be high on their list of publications to read.

Alun Thomas



Nora Lustig (editor)

Coping with Austerity

Poverty and Inequality in Latin America

Brookings Institution, Washington, 1995, xviii + 460 pp., $39.95 (cloth), $18.95 (paper).

The authors of this volume explore the following interlinked and fundamental issues: What has been the lot of Latin America's poor during the "lost decade" of the 1980s? What has been the impact of structural adjustment programs on their well-being? And, what kinds of programs and results have governments implemented to mitigate the impact of structural adjustment?

The first four chapters explore various thematic issues—they describe what actually happened to poverty in a group of Latin American countries and explore the underlying determinants of poverty. Although there can be little doubt that the "head-count ratio" (the ratio of persons whose incomes fall below the poverty line) rose in most Latin American countries during the 1980s, it is also clear that information on poverty in the region is still incomplete. The authors tackle the intractable issue of the impact of structural adjustment per se (i.e., as opposed to the impact of the crisis environment that makes it necessary) on the poor. In the final thematic chapter, they provide an excellent discussion of the ways in which poverty programs, such as food distribution, can be evaluated in a reasonably systematic way even without the benefit of a rigorous analytical model. This reader felt, however, that the analyses of Bolivia's experience with the Social Emergency Fund and Jamaica's with food aid programs could have been a bit more pointed.

These chapters are followed by case studies on the relationship between the

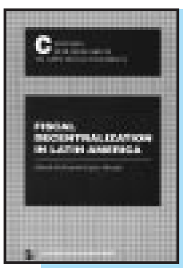
economic crisis of the 1980s and the social safety net programs in Argentina, Brazil, Chile, Mexico, Peru, and Venezuela. These country case studies deal, with varying degrees of thoroughness,with issues such as the origins of the country's macroeconomic problems, the impact of the crisis on the prevalence and depth of poverty, and governments' efforts to safeguard existing social programs or introduce new ones to alleviate poverty. The most comprehensive treatments are those of Chile and Venezuela; the chapter on Peru has seen its major thesis overtaken by events. The Venezuela study is notable for its concise discussion of the macroeconomic background to the late 1980s crisis and for its analysis of the opposition to fundamental reform in various areas by diverse vested interests. In the case of social expenditure, the authors argue, it is the public sector unions that resist the reorientation of, for example, health and education expenditure from the tertiary to the primary sectors, because of its impact on jobs. The chapter also clarifies how the targeted nature of programs introduced in early 1989, after the riots, distinguishes them from those already in place.

The Chilean study provides an exhaustive account of the country's social programs. Chile sought to contain education and health expenditures mainly by squeezing teachers' and health workers' salaries, and by postponing capital expenditure. The government did, however, try to increase the share of primary expenditure and of targeted special programs for mothers and infants. The authors argue that this resulted in undue neglect of others in need, and that, given Chile's demographic and epidemiological profile—"older" than that of other Latin American countries, and with fewer diseases of malnutrition and less bad sanitation—it was misguided. This seems debatable given the importance of early care and attention for future health and productivity. On the discussion of the decline in total public expenditure, the authors could have explained more carefully the role of devolution of such expenditure to the municipalities—it is not clear whether total expenditure includes expenditure at this level or not. Chile's experience contrasts markedly with those of Argentina and Venezuela, whose politically different governments were unsuccessful (at least in the 1980s) in achieving fundamental change in the structure of public expenditure.

The vexing issue of the counterfactual could be more clearly handled by the country studies. Thus, one feels that structural adjustment is "blamed" for the increase in poverty when, in reality, one should ask what would have happened in the absence of adjustment. The Chilean study argues that the impact of the boom-and-bust cycle is asymmetric: the increase in poverty that occurs during the recession is not eliminated fully during the recovery. This is an important argument, but one that needs to be developed.

These criticisms notwithstanding, this volume is a worthwhile read—not just for regional specialists, but for anyone interested in the issues it raises. Would that there were similar studies for other parts of the world.

George A. Mackenzie



Ricardo López Murphy (editor)

Fiscal Decentralization in Latin America

Inter-American Development Bank, Washington, 1995, 297 pp., $18.50 (paper).

The concept of the nation-state is not dead, but it has come under increasing pressure from two sides. First, the significant advances in regional and global integration and coordination over the last few decades—like the European Union or Mercosur—have demonstrated conclusively that regional arrangements can be an effective mechanism for carrying out policies traditionally in the realm of the nation-state. Second, increased decentralization of national decision making to subnational levels of government, a process that has paralleled the advance of democracy around the world, has revealed a significant potential for efficiency gains. Further decentralization seems inevitable, but major questions remain as to what government functions should be decentralized and in which sectors and regions; to what extent and how decentralization should be implemented; and how macroeconomic stabilization objectives can be safeguarded in this process.

This book examines fiscal aspects of decentralization in Latin America, a timely topic that has gained much prominence in the context of the sweeping democratization processes in the region. It contains four case studies—Argentina, Chile, Colombia, and Peru—and an overview chapter that synthesizes the lessons learned from the case studies. All of the studies are based on the hypothesis that a high degree of centralization may be wasteful, as it prevents local or regional features and advantages from being taken into account.

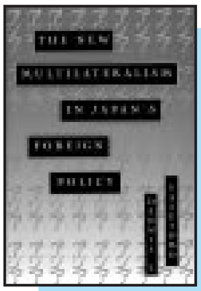
Decentralization, when badly done, however, may increase regional disparities, jeopardize macroeconomic stability, and undermine economic efficiency. The authors recognize this by emphasizing that fiscal decentralization without adequate institutions (for example, a strong tax administration and expenditure management system) at all levels of government, clear rules governing revenue and expenditure assignments and responsibilities, and a well-designed system of transfers between different levels of government actually reduces fiscal accountability and creates macroeconomic and allocation problems that may lead to severe economic crises.

A major strength of this book is that it provides concrete, detailed policy advice. Indeed, it could even serve as a blueprint for reforming intergovernmental fiscal relations in these four countries, given its dazzling range of policy recommendations. These recommendations cover enhancing the efficiency of institutional, administrative, and regulatory structures; restructuring revenues, expenditures, and intergovernmental transfers; addressing income distribution problems; and safeguarding macroeconomic stabilization objectives within a decentralized fiscal system. The book convincingly shows how a well-designed decentralized fiscal system would improve the effectiveness of government expenditure in each of the four countries and, most important, how this could be achieved without compromising hard-won macroeconomic stability.

Of course, reform needs differ from country to country. Take, for example, macroeconomic stabilization. Chile is probably the most centralized of the four economies, and it already has a strong arsenal of stabilization tools, ranging from funds that keep fluctuations in copper revenues from destabilizing the budget, to a constitutional framework that prevents the legislature from making upward adjustments in the calculation of available resources, to strict controls over the power of subnational levels of government to incur debt. In contrast, Argentina, the most decentralized of the four countries, has an elaborate revenue-sharing system with a strong procyclical bias and traditionally has had insufficient controls on provincial finances. The book argues that these remain weak points in the otherwise successful stabilization program now under way. The same features, however—a relatively powerful central government in Chile, and fairly powerful but inefficient provincial administrations in Argentina—make for important differences in the reforms needed to obtain the efficiency gains that a decentralized fiscal system potentially promises.

Unfortunately, the book's coverage of countries is not as broad as its title suggests, and, in particular, one wishes the diverse experience of large federal states like Brazil and Mexico had been included. Also, the book could have benefited from more meticulous editing to highlight the main policy lessons. While it requires a rather patient reader who does not mind getting immersed in overwhelming detail, its careful analyses and detailed policy recommendations make it an invaluable source for policymakers and researchers interested in intergovernmental fiscal relations.

Gerd Schwartz



Dennis T. Yasutomo

The New Multilateralism in Japan's Foreign Policy

St. Martin's Press, New York, 1995, x + 130 pp., $39.95 (cloth).

Japan's emergence as the world's second largest economy has been one of the most significant events of the postwar period. While the bulk of its economic development was financed by domestic savings, it should not be forgotten that in 1960, Japan shared with India the status of top recipient of World Bank loans. It received its last loan from the Bank in 1966 and did not finish repaying all of its loans from the Bank until 1990.

While Japan's economic development has been extraordinary, its international role in influencing foreign affairs and in providing global leadership has been, until recently, quite muted. Postwar regional animosity toward Japan, as well as constitutional limits on its military capabilities, resulted in a risk-avoiding diplomacy that separated economic development from international politics. This was reinforced by Japan's reliance on military protection from the United States, which still causes friction today. As its economic strength has increased in both absolute and relative terms, however, and as global military tensions have abated, Japan has been belatedly but increasingly speaking with a louder international voice—one that is no longer automatically aligned with that of the United States.

In this well-organized and clearly argued book, Professor Yasutomo examines Japan's evolving foreign policy as expressed through its membership in multilateral development banks. He argues that, given constitutional and geopolitical constraints, it is official development assistance (ODA) and not military activities that has been Japan's contribution to the world community. Tracing Japan's contributions from its membership in the Colombo Plan in 1954, followed by its first bilateral loan (to India) in 1958, Yasutomo characterizes Japan's aid policy in the 1950s and 1960s as largely commercially based, with an explicit separation of politics from economics, and almost exclusively focused on its Asian neighbors.

Yasutomo states that in the 1970s, following the normalization of US-Chinese relations and the end of the Vietnam War, Japanese aid policy became increasingly diversified and politicized. ODA terms and conditions were softened, amounts were increased, and new aid forms and new recipients, including Mongolia and Vietnam, emerged. Thus, while economic interests remained paramount, the political dimension was increasingly apparent (though yet to be acknowledged). These changes in policy were also visible in Japan's introduction of aid to the Middle East and Latin America, which was part of an attempt to secure and diversify its energy sources.

In the 1980s, the emergence of Japan's sizable and persistent external surpluses simultaneously with the global debt crisis resulted in renewed appeals to Japan to further increase ODA. Japan responded with three debt-relief plans totaling $65 billion over 1986–89, with increasingly heavy emphasis on intermediation through multilateral institutions. Yasutomo argues that four major developments have characterized Japanese ODA policy in the 1990s—the political and strategic use of ODA has become explicit; the country's Asian ODA policy has changed, as some recipients have graduated and others (especially from the former Soviet Union) have emerged; a new ODA philosophy, reflected in Japan's recently adopted ODA charter, has arisen; and multilateral aid has expanded into new areas and received new emphasis.

Yasutomo discusses Japan's evolving foreign aid policy through detailed examinations of its activities in the World Bank, the Asian Development Bank, and the European Bank for Reconstruction and Development. In addition to examining Japan's increased financial contributions to the multilateral development banks, Yasutomo discusses Japan's heightened desire to increase the share of Japanese personnel in these institutions. He also highlights Japan's ODA policies in the 1990s with a chapter examining the multilaterialization of Japan's dealings with the former Soviet Union. In addition, he argues that Japan has become increasingly vocal in its view—which is shared by other Asian governments and academics—that the prevailing development strategy is excessively narrow and ignores the government's role in recent "miracles" in East Asian economic growth. This perception resulted in the Japanese-financed study, *The East Asian Miracle: Economic Growth and Public Policy*, by the World Bank in 1993.

While the debate about whether or not there have been miracles (with strong doubts cast by Paul Krugman and Alwyn Young) is far from over—and, if so, what their causes have been—there is no doubt that Japan will continue to influence the multilateral development banks in ways that are more in line with its economic strength.

Mark S. Lutz