REVIEW ESSAYS

DEBT AND ADJUSTMENT

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LATIN AMERICAN DEBT AND ADJUSTMENT: EXTERNAL SHOCKS AND MACROECONOMIC POLICIES. Edited by Philip L. Brock, Michael B. Connolly, and Claudio González-Vega. (New York: Praeger, 1989. Pp. 261. $49.95.)

INFLATION STABILIZATION: THE EXPERIENCE OF ISRAEL, ARGENTINA, BRAZIL, BOLIVIA, AND MEXICO. Edited by Michael Bruno, Guido Di Tella, Rudiger Dornbusch, and Stanley Fischer. (Cambridge, Mass.: MIT Press, 1988. Pp. 419. $27.50.)

ADJUSTMENT WITH A HUMAN FACE: PROTECTING THE VULNERABLE AND PROMOTING GROWTH. By Giovanni Andrea Cornia, Richard Jolly, and Frances Stewart. (Oxford: Oxford University Press, 1987. Pp. 319. $55.00 cloth, $17.95 paper.)

DEBT AND CRISIS IN LATIN AMERICA: THE SUPPLY SIDE OF THE STORY. By Robert Devlin. (Princeton, N.J.: Princeton University Press, 1989. Pp. 320. $35.00.)

REAL EXCHANGE RATES, DEVALUATION, AND ADJUSTMENT: EXCHANGE RATE POLICY IN DEVELOPING COUNTRIES. By Sebastian Edwards. (Cambridge, Mass.: MIT Press, 1989. Pp. 371. $32.50.)

ANALYTICAL ISSUES IN DEBT. Edited by Jacob A. Frenkel, Michael P. Dooley, and Peter Wickham. (Washington, D.C.: International Monetary Fund, 1989. Pp. 415. $26.50.)

ECONOMIC CRISIS AND POLICY CHOICE. Edited by Joan M. Nelson. (Princeton, N.J.: Princeton University Press, 1990. Pp. 378. $45.00 cloth, $14.95 paper.)

ESTABILIZACION Y AJUSTE ESTRUCTURAL EN AMERICA LATINA. Edited by

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Santiago Roca. (Lima: Escuela de Administración de Negocios para Graduados, 1987. Pp. 534.)

The fields of international debt and adjustment policy have recently witnessed an explosion of scholarly activity. The eight titles chosen for review here will be useful reference works on specific topics. All of them, however, are typical of academic literature on the broader subject in that debt and adjustment are not tightly integrated, that is, these studies offer no coherent discussion of the specifics of a debt-induced adjustment.[1] My goals in reviewing them are not to reconstruct their reasoning but to achieve more modest ends: to outline a framework for organizing their respective contributions, to provide a glimpse into their contents, and to suggest research areas that remain relatively unexplored.

In the Latin American context, international debt is the sum of all obligations to pay that are incurred by the residents of the debtor (Latin American) country to residents of foreign countries. The residents in either category may be private or official. The debt was incurred over time by borrowing from abroad (net of any lending to foreigners) to finance current-account deficits. Borrowing also obligated the borrower to repay the sum or service its debt on a fixed schedule in the future. At first, international borrowing represented a net transfer of resources to the borrower because total borrowing at that time exceeded the debt service owed to creditors. Such borrowing, however, can lead to an exponential increase in the stock of debt because it must be sufficient to finance current debt service as well as any resource transfer. Since 1982 in Latin America, new borrowing in any year has been insufficient to pay even the debt service owed to creditors, thus creating a net transfer of resources out of these economies toward the creditor countries.[2] Consequently, most Latin American countries have become debtor countries, although currently they are tightly circumscribed in their ability to be borrower countries. I will return to this distinction later.

Adjustment is the reallocation of resources in response to a changed external environment.[3] Such adjustments may be made by the private sector directly, or they may be made via government policies and thus cause adjustment in the private sector indirectly. The focus of these eight

1. Sachs (1989) is a recently published collection of studies that begins this process of integration. It was reviewed in this journal in Golub (1991) and will not be referred to further here.

2. This development has led to confusion in discussions with commercial bankers. It has become the rule to refer to new lending by creditors that is insufficient to cover existing debt-service payments as "new money." Lending in excess of the existing debt-service payments has thus been coined "new new money."

3. I refer here explicitly to changes in the variables affecting an economy's interactions with foreign economies. Adjustment could also occur in response to internal shocks (such as earthquakes or civil wars), but these possibilities are not germane to this review.

books is on economic adjustment and policy. For the most part, they do not consider the adjustments in the political, social, or cultural spheres in response to a changed external environment. Adjustment is a temporal process, often characterized as having three stages: short-term stabilization, medium-term structural adjustment, and long-term economic development. The length of each stage may vary, but the important distinction between stabilization and structural adjustment seems to be that an adjusting economy can accept recession and a falling standard of living during the stabilization period. That outcome would be uncharacteristic of the structural adjustment period in that unemployed resources would be reallocated to more efficient uses.

The debt burden of developing countries has been a major issue for policymakers in debtor and creditor countries since Mexico requested rescheduling of its loans in late 1982. The creditor countries have mostly followed a common strategy during this period, although the strategy has gone through three phases often associated with the last three U.S. Secretaries of the Treasury, Donald Regan, James Baker, and Nicholas Brady. The first phase (call it "the Regan nonplan") was that of muddling through. Creditor governments, following the lead of the Reagan administration, declared the debt difficulties to be matters between commercial banks and debtor countries. Creditor government intervention was limited to providing temporary "bridge" lending until those actors could "reschedule" or draw up new debt contracts that would allow the debtor to repay the loans over a longer period. The second phase was defined by the Baker Plan: creditor governments espoused the goal of economic growth in debtor countries. These creditor governments took a more active role in advising commercial banks to extend new lending to debt-burdened governments and the debtor governments to undertake market-oriented reforms in the interests of stimulating economic growth. The Brady Plan has defined the third phase, with creditor governments expanding on their position defined by the Baker Plan to advocate reduction of the debt burden. The Baker and Brady plans have depended on voluntary agreements for new financing and debt reduction, respectively: under each, the creditor governments have suggested a "menu" of possible options to creditors and debtors that could be included in a voluntary agreement.

Two of the books under review focus almost exclusively on the international debt of developing countries and are organized around complementary themes. Robert Devlin's *Debt and Crisis in Latin America: The Supply Side of the Story* examines the preconditions and historical evolution of the massive indebtedness in Latin American countries, while *Analytical Issues in Debt* takes the present indebtedness of developing countries as a given and examines various facets of the interactions between debtor and creditor in the present financial markets.

Devlin's *Debt and Crisis in Latin America* offers an excellent analysis of the factors that contributed to the chronic borrowing by Latin American countries in the 1970s and the consequent run-up in the international debt to its present heights. According to his hypothesis, events in the international debt market during the past two decades can be explained by two phases in commercial bank behavior. In the initial phase, competition among commercial banks led to opportunities for Latin American countries to obtain loans at irresistibly low interest rates. The banks had a seemingly inexhaustible supply of funds from Eurocurrency markets and offered preferential rates for returning borrowers. The second phase was one of credit rationing: once a country crossed the line of having "too much debt," the banks were very reluctant to lend further money.[4] This line was not clearly drawn, however. Initially, credit rationing appeared only when a country could not meet its contractual payments (as with Bolivia and Peru), but later such rationing appeared for nearly all debtors after Mexico asked to reschedule its debt in late 1982. This shift in commercial bank behavior was a shock of tremendous proportions to prospective borrower countries and triggered the dilemma of adjustment policy examined in many of the books under review.

Devlin's discussion of the debt crisis ends by documenting the net-resource transfer out of Latin America toward the creditor countries. He addresses briefly the proposals for reforming the international lending system and for retiring existing debt. The strength of *Debt and Crisis in Latin America,* however, lies in its chronicling of the genesis and manifestations of the debt burden. Devlin intentionally restricts his attention to the behavior of commercial banks and only discusses Latin American motivations for borrowing in sketchy fashion. This imbalance will leave some readers wondering precisely what endowed the banks' shift in phases with such tremendous impact on the borrower countries. The other books to be reviewed explain this impact nicely and thus complement Devlin's study in this regard.

Debt and Crisis in Latin America presents the relevant economic concepts concisely yet with all the appropriate conceptual detail. More important, Devlin supports his thesis with a wealth of information on commercial lending to Latin America, with special focus on Peru and Bolivia.

Analytical Issues in Debt is a collection of research papers written for the International Monetary Fund and edited by Jacob Frenkel, Michael Dooley, and Peter Wickham. Taking the present debt burden of developing countries as a given, the essays investigate the implications of various proposals for retiring the debt that have been advanced under the Baker and Brady plans. Although several of the contributions will be accessible

4. The banks did lend "new money" in order to avoid the debtor country's default on the loans.

only to academic economists, the collection also includes well-written, less technical discussions of proposals for reducing debt and creating an international debt facility.

On the face of it, there appears to be little hope for the Brady Plan's suggestion of voluntary debt reduction. Why should creditors reduce the value of existing debt? A recurring theme of *Analytical Issues in Debt* is that creditors have already reduced their expectations of debt service from existing debt to a level below the value of contractual debt service. This divergence between contractual and expected debt service can be detected most clearly in the secondary market for debt contracts, where creditors sell their debt contracts to other purchasers. Such debt contracts typically sell for less than the discounted value of contractual debt-service payments and in some cases trade for as little as pennies per dollar of discounted value. In such instances, creditors should be indifferent as to whether they keep the present stock of debt contracts or exchange them for a debt contract that specifies the expected debt service as equal to the contractual debt service. The menu items for debt reduction discussed in these papers—buy-backs, debt-equity swaps, asset exchanges, an international debt facility, and others—use access to this secondary market to enhance contractual debt reduction.

To the contrary, the essays in *Analytical Issues in Debt* suggest that although creditors should be indifferent to this swap of debt contracts, they will not be. Two major reasons are advanced for this view. First, although creditors may expect only a fraction of the debt contract to be honored, they recognize that the debt contract gives them a claim on a much larger sum should external events improve the debt-service capacity of the debtor. This principle has been demonstrated by the recent rise in the price of oil: creditors holding the debt of oil-exporting countries were able to revise their expectations upward on servicing capacity. Had they converted their contracts to reflect the expected value ex ante, they would have had no claim on this windfall. Second, such a conversion requires a degree of coordination among creditors that appears impossible without duress. In the absence of a concerted conversion of debt to expected value, each creditor can gain by not participating while the others convert their debts. The rewards for such "free-rider" behavior encourage a standoff with no conversion.

Finally, if both debtor and creditor expect debt service to be less than the contractual amount, then why is debt reduction important? A third theme in these essays is that debt imposes harmful distortions on the debtor's economy. For example, servicing debt requires a fiscal obligation by the debtor government that translates into taxation of domestic producers, and such taxation can discourage physical investment and other activities necessary for economic growth. Debt reduction will reduce that obligation and the tax on domestic producers.

Analytical Issues in Debt will be of interest to two groups. Academic economists will find the articles a useful introduction to the contemporary analysis of international debt questions by a number of the best-known theorists and practitioners in the field. Also, those with an exclusively practical interest in current debt strategy and negotiations will find an excellent overview of the issues, concise description of the menu options likely to be found in recent and new debt agreements, and careful analysis of these options in terms of their effects on both debtor and creditor.

Apart from their theoretical discussions of the distorting effect of international debt on the debtor economy, however, Devlin's study and *Analytical Issues in Debt* have little to say about the adjustment process in indebted countries. Conversely, the remaining six books focus on aspects of this process for developing countries but provide little linkage between the existence of debt and this adjustment process.

International borrowing (not debt) and adjustment are substitutes in an economy's response to a change in its external environment. This substitutability is most clearly seen in an adaptation of Richard Cooper's (1968) treatment of the external constraints on an economy. Suppose that an economy's expenditure on external goods and services exceeds its external revenues from goods and services. This imbalance can be rectified through external borrowing, stabilization, structural adjustment, or some combination of the three. Note also that the duration of the imbalance is important in the choice of policy. Structural adjustment policies work through alteration of the institutions and incentives residents face and thus take longer to achieve the desired effect. Initial responses to external shocks will by and large rely on either borrowing or stabilization policy.

Countries can then avoid adjustment through borrowing or use borrowing to lessen the amount of adjustment necessary in any period. The salient aspect of the recent adjustment in developing countries, which all six of the remaining books touch on, is that since 1982 the developing countries have with few exceptions faced restrictions on international borrowing as well. This limitation fundamentally alters the policy responses available to the developing country: instead of choosing a combination of the three possible options, the government is forced to choose from only stabilization and structural adjustment. Further, given the timing lag in eliciting a structural-adjustment response, the developing country's immediate response is confined to macroeconomic stabilization policy. This restriction in the policy set leads to the economic crisis studied by Joan Nelson and her colleagues and to the necessity for adjustment policies examined by the other five studies. In other words, the crucial characteristic of these countries has not been that they are debtors but that they experienced a precipitous shift from having the option of borrowing to not having that option. This change resulted from the shift in commercial-bank behavior noted by Devlin. Its precipitousness is also significant in that there was no time ex ante to phase in structural adjustment policy and thus the initial brunt of adjustment was borne through macroeconomic stabilization.

At this point, the literature on adjustment intersects with one of the most distinguished debates in Latin American development theory. Macroeconomic stabilization policy must be based on a theory about how the macroeconomy works, and two paradigms have competed for application over the years. The orthodox school associated with the University of Chicago has based its policy prescriptions on a classical vision of the macroeconomy as one of flexible wages and prices and well-functioning, competitive markets. The structuralist school has questioned each of these characteristics in the Latin American context and proposed that policy should be founded instead on recognizing the rigidities inherent in these economies. Thus Latin America became a laboratory for implementing both types of stabilization experiments in the last two decades. The empirical results of these experiments are now being used to test the relevance of the two paradigms for economic stabilization in four edited volumes under review here (those edited by Brock et al., Bruno et al., Nelson, and Roca).

Latin American Debt and Adjustment: External Shocks and Macroeconomic Policies contains the papers of a 1986 conference examining how external shocks have affected adjustment policies in Latin America in the 1980s. This collection was edited by Philip Brock, Michael Connolly, and Claudio González-Vega. Although debt is mentioned in the title, the shocks considered come from a variety of sources: terms of trade, trade volumes, world interest rates, and domestic policy changes. Even under that broad topical umbrella, the essays are a diverse group. A recurring, although unstated, theme is the evaluation of orthodox (market-based) policy reform in the Latin American context. To that end, the empirical work is concentrated geographically: four of the fourteen contributions address the Chilean experience, while only cursory attention is given to the policy experiments in Argentina, Brazil, Peru, and Mexico. International debt is an important theme in only three of the essays.

This volume has two strengths. The first is the detailed clarity of its empirical examinations for the Chilean and Central American economies of the transmission of external shocks to domestic labor, goods, and financial markets. The second is an introductory essay by Robert Mundell that highlights the two transfer issues introduced into policy response by the combination of international debt and nonborrowing: the external transfer of resources through debt service from the government to foreign creditors and the internal fiscal transfer from private sector to public sector to make that external transfer possible. Mundell's essay notes that the present debt burden places Latin America in a position analogous to that of Germany after World War I: now that the borrowed funds have been spent, the net-resource transfer out of the debtor economies mimics the effect of the reparations paid by the Germans. Now, as then, only part of the problem is finding foreign exchange to make the external transfer; the other part is the problem faced by the debtor governments in raising funds internally to make that transfer. The three complementary ways of raising such funds are increasing the tax rates, reducing government expenditure, or expanding the tax base. Mundell stresses that the third way could be achieved through structural-adjustment policies (he calls them "supply-side policies") and that this option would be the least painful for the debtor economy.

Latin American Debt and Adjustment is a readable collection that is mostly accessible to non-economists interested in the region. Although it does not fulfill its title's promise of an overview of Latin American debt and adjustment policies, this work does provide a stimulating critique of economic policy and performance through the orthodox optic.

While *Latin American Debt and Adjustment* employs and tests orthodox theory in analyzing adjustment efforts, *Inflation Stabilization* studies the more structuralist (here called "heterodox") economic policies employed in Argentina, Brazil, and Bolivia. These policies were chosen not in direct response to an external shock but rather to curtail the persistent and elevated inflation (or hyperinflation) raging in each country. The essays evaluate these countries' varying degrees of success in eliminating inflation during 1985–86 and compare that success with the policies employed in Israel during the same period. The volume also forecasts the usefulness of heterodox policies emphasized in Mexico during that period. Many of the contributors come from the countries under consideration, while extended critiques are provided by academic and "practical" economists. This collection was edited by Michael Bruno, Guido Di Tella, Rudiger Dornbusch, and Stanley Fischer.

The orthodox diagnosis of inflation has been that it is a budgetary problem of the government. A government budget deficit ex ante must be financed in some way, and many countries have created money to do so. As money is created, inflation occurs and serves as a tax on those holding money so that the budget is balanced ex post. With a persistent budget deficit, this process recurs in each period. As residents learn how the inflation tax works, however, they hold onto less and less domestic currency, and inflation must therefore accelerate to yield the same tax "revenue" to the government ex post.

Latin American economists have not subscribed to the orthodox diagnosis but have advanced instead a number of structuralist explanations for inflation such as supply rigidities, class conflict over government expenditures, and mistaken efforts to use the nominal exchange rate to stimulate exports. Actors within the inflationary economy also institute channels for indexing their returns to the inflation rate, thus introducing a strong inertial element to inflation. Heterodox anti-inflation policies are those that address the structuralist elements of inflation generation. One common element is the freezing of wages and prices to dislodge the inertial element of inflation through shock treatment, with wages and prices set at levels that protect class income shares. In such policies, the nominal exchange rates are fixed as well. A number of countries have introduced new currencies (the Argentine *austral,* the Brazilian *cruzado,* and the Peruvian *inti*) to emphasize the commitment to price stability under this new regime.

The essays in *Inflation Stabilization* present fascinating detailed descriptions of the inflationary period and the introduction of heterodox policies in Argentina, Brazil, Bolivia, and Israel. Although features of the success of these programs differ, the contributors reach two major conclusions: that the heterodox policies work in their shock effect, and that to be effective in the long run such shocks must be coupled with an orthodox balancing of the government budget.

Stabilization policy alone is central to this discussion of inflation suppression. Rosemary Thorp makes the intriguing assertion in her commentary that heterodox policies are antithetical to success in structural adjustment. In her view, freezing wages, prices, and income shares will achieve income-distribution goals but will not encourage a more efficient allocation of resources. In other words, it will not allow a supply-side effect that could foster economic growth. This assertion could be restated as "those who practice heterodox policy are condemned to repeat it." As already noted, in the absence of borrowing, stabilization must bear the burden of response in the short term while structural adjustment policies phased in immediately will be effective only in the medium term. Thorp suggests that the heterodox stabilization policy works at cross purposes with structural adjustment policy and that in the heterodox case, policy choice collapses to stabilization. Consequently, the future becomes a succession of short-term responses because the medium-term response associated with structural adjustment is not allowed to operate.

Although the events of 1985–86 may now seem like ancient history to Latin Americanists, the detailed chronicle of the Bolivian, Argentine, and Brazilian experiments provide an important resource in studying economic adjustments in those countries. By and large, *Inflation Stabilization* is accessible to the non-economist, with mathematical appendices that can be skipped without loss of comprehension of the important issues.

Another volume that provides useful but dated information is *Estabilización y ajuste estructural en América Latina,* edited by Sergio Roca. It brings together papers from three seminars on stabilization and structural adjustment that were held between 1983 and 1985. This collection also stresses the unfortunate structural-adjustment implications of stabilization policies. Their working at cross-purposes is summarized in a number of contributions by analyzing the high real interest rates observed in many Latin American countries at that time, rates that discouraged physical investment and thus impeded economic growth. This volume includes both theoretical and empirical explanations of high interest rates. These analyses proceed from both orthodox and structuralist paradigms, indicating that the problem is not limited to heterodox policies.

An essay by Andrés Bianchi summarizes nicely the joint responsibility of Latin American and developed-country economies for achieving renewed growth in Latin America. Although a number of Latin American economic policies must be reformed, success in achieving economic growth with repayment of external debt depends as well on lowering international real interest rates and expanding the world economy to generate demand for Latin American exports.

When analyzing the debt crisis, developed countries often neglect the difference in size between developed and Latin American economies. The U.S. savings and loan crisis provides a convenient comparison. The proposed bailout for insolvent savings and loans in the United States is now forecast to cost more than two hundred billion dollars over the next few years. Theatrics aside, the internal transfer necessary to meet that goal will be minor for the United States. Latin America's outstanding debt provides a total of similar magnitude, but the requisite fiscal transfer in any Latin American country would have disastrous consequences. Similarly, relatively minor changes in U.S. trade and financial policy will have major consequences for Latin America's ability to service its debt.

The volume edited by Roca also reflects the tensions existing among Latin American economists throughout the 1980s. The collection includes papers advocating both orthodox and structuralist stabilization responses to external imbalances. For example, while the Bianchi essay advocates an outward orientation of Latin American economies, another by César Peñaranda suggests an inward orientation through industrial integration of these same economies. Three essays on Peru display diverse approaches: one takes an orthodox perspective, another the heterodox-structuralist perspective of the García administration, and the third an intermediate "mixed" perspective that combines the recessionary effects of stabilization policy with inducements to invest in order to stimulate structural adjustment. Given the present state of disarray in the Peruvian economy, it is tempting to conclude that the structuralist approach was wrong, but readers will be struck nonetheless by the logic and coherence of all three ex ante views.

Economic Crisis and Policy Choice, edited by Joan Nelson, takes an empirical look at the workings of stabilization policy in response to external crisis in developing countries via a set of case studies of thirteen production in the economy. It is one policy on which orthodox and heterodox programs often disagree sharply, with orthodoxy advocating depreciating the nominal exchange rate to stimulate production of traded goods and heterodoxy advocating fixing the exchange rate as an "anchor" against inflationary pressure. Even the otherwise orthodox Chilean adjustment program had a fixed exchange rate as one feature, an aspect that Edwards has criticized in his previous writings.

The key to reconciling the two lies in a conceptual distinction: the real exchange rate—not the nominal exchange rate—is the important variable for structural adjustment. The real exchange rate is the price of traded goods relative to nontraded goods in an economy and is crucial in providing the correct incentives for producers and consumers so that the economy can grow out of an external imbalance. The real exchange rate is closely related to the nominal exchange rate, however, because the prices of traded goods are linked to the foreign prices of the same goods through trade. The link between these two is the nominal exchange rate. Substantial agreement now exists that external imbalances are associated with appreciation of the real exchange rate. The orthodox prescription calls for depreciating the real exchange rate through continually devaluing the home currency's nominal exchange rate vis-à-vis the U.S. dollar, while the heterodox view often suggests a onetime rise in the nominal exchange rate followed by a freeze in domestic prices.

Logic dictates that two conditions must exist for the nominal exchange rate to be an important component of adjustment policy. First, movements in the nominal exchange rate must influence the real exchange rate. Second, the real exchange rate must be an important determinant of economic growth and other indicators of this adjustment. Most orthodox economists take these conditions on faith, infuriating structuralist economists. Edwards's *Real Exchange Rates* provides a detailed analysis of the logical and empirical support for these articles of faith. He demonstrates that a clear empirical link exists between nominal and real exchange rates for the developing countries he examined. This link is a temporary one, however. As the home currency's exchange rate with the U.S. dollar is increased, then the real exchange rate in that period rises nearly one for one in the short run. This increase is counterbalanced in subsequent years by the rise in the domestic prices of traded goods that also follows an increase in the home currency's exchange rate with the dollar. Thus onetime devaluations, even of the maxi variety, will have only a temporary impact on the real exchange rate. Edwards also demonstrates a corollary: other policies that push domestic prices upward cause the real exchange rate to appreciate even if the home currency's exchange rate with the U.S. dollar is fixed. Thus expansionary fiscal policies eventually reverse the gains made in international competitiveness from nominal devaluation.

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Edwards's study does not provide a direct test of the second article of faith, investigating instead the impact of movements in the nominal exchange rate on economic growth in the short run. He finds empirical evidence that nominal devaluations are associated with reduced economic growth in the same period and those immediately following it. Edwards examines cases of external crisis and stabilization programs, however, and as he points out, this association may well be due to the effect of the external crisis leading to reduced growth as well as to a nominal devaluation. His data suggest that the choice of devaluation is better than the alternative of exchange controls in these crises and that nominal devaluation must be combined with fiscal balance to be truly effective.

Real Exchange Rates offers carefully researched theoretical and empirical discussions of the interactions among nominal exchange rates, real exchange rates, and measures of economic performance. I found the essays investigating the empirical linkages between exchange rates and between them and economic performance the most attractive feature of the book. Researchers seeking historical data on external crises and economic responses in developing countries will find this work a valuable resource.

The preceding studies mainly examine adjustment policy as it has occurred, and they assume that stabilization and possibly aggregate economic growth were the goals. An important exception is *Adjustment with a Human Face: Protecting the Vulnerable and Promoting Growth* by Giovanni Andrea Cornia, Richard Jolly, and Frances Stewart. This study presents adjustment policy as it should be and details the divergence between what actually has been achieved and what should be achieved. The authors of this collection of essays begin by addressing the hypothesis that adjustment policy has achieved all desirable development goals. They then reject it decisively, presenting extensive evidence that the adjustment process to date has had insidious effects on income distribution, health provision, educational attainment, and a number of other indicators. Their recommendations center on a larger role for the state in reallocating resources toward those who are most in need.

The authors put forward their strategy of "adjustment with a human face" as a supplement to the strategies of orthodoxy or structuralism. In this way, they explicitly reintroduce the considerations of "basic human needs" of the 1970s into the present policy debate. Indeed, their argument resembles that of *Redistribution with Growth,* a 1974 World Bank publication by Hollis Chenery and his colleagues that married the strategies of development of basic human needs and economic growth.

It is difficult to argue with the authors' diagnosis. Less clear are the proper adjustment policies for emerging from this crisis. The task of the Chenery team was easier because at that time the economies were growing in per capita terms, and the recommendations represented ways of redistributing the gains from economic growth toward basic human needs. The task of Cornia, Jolly, and Stewart is more difficult in the present climate of stagnant or declining per capita income, and they recognize that growth is a precondition for the success of their adjustment program. Their recommendations therefore include more expansionary fiscal and monetary policy by the government as well as governmental interventions through expenditures, price supports, and tax incentives to expand the purchasing power of the poorest citizens. This expansion could occur either directly or through fostering growth in rural and small-scale enterprises. These proposals fly in the face of the orthodox stabilization policy in their implications for inflation and persistent external crisis. The reconciliation comes from two assumptions maintained by the authors. First, assistance from international organizations and bilateral donors should be forthcoming. Second, supply-side economics of a basic kind will be at work with these reforms as those aided by the redistributive policies become more productive participants in the economy. To oversimplify, the authors suggest omitting the stabilization component and shrinking the responses to some combination of borrowing and structural adjustment. This scenario is certainly an attractive one, but more evidence is needed that it is feasible.

Adjustment with a Human Face should be required reading for economists and others who debate adjustment policy on the basis of abstract theories. The portrait of desolation painted for the developing countries serves as a dramatic backdrop to the curves of supply and demand. Ten case studies (including four of Latin American countries) provide the book's empirical base and have been issued in a separate volume. The statistics themselves are dated because the case studies were first presented at a conference in 1985. The critique of adjustment policy has lost little of its force, however. A worthy extension would be to evaluate the policy components of "adjustment with a human face" in terms of the most recent period in Latin America.

Notwithstanding the title of this review essay, the books discussed here are concerned either with debt or with adjustment, and I would suggest that what is lacking is an explicit linkage of the two. What is unique to an adjustment brought about by an external debt burden? I have already suggested one useful distinction: debt-based adjustment versus "borrowing-less adjustment." The latter has been much more important in the most recent period and is viewed in many of these books as the external shock that has necessitated adjustment. Yet "borrowing-less adjustment" places greater weight on stabilization policy because it requires a sudden switch to ensure that a country can "live within its means," and structural adjustment policies require time to register their gains.

In contrast, the debt burden is more central to the process of economic growth and structural adjustment for a number of reasons. First, the existence of debt introduces uncertainty about net-resource transfers. The debtor country must in most cases "roll over" its debt periodically and thus must negotiate a new interest rate. The resulting debt-service stream fluctuates over time, and the economic structure of the economy will adjust to minimize its impact. Second, as noted in the Frenkel volume, the fiscal responsibility associated with an outstanding debt will imply a tax on productive activities that can discourage investment and production domestically and encourage capital flight. Third, the need to service existing debt will cause a depreciation in the real exchange rate that will increase the outward orientation of the economy. When the government services the debt and the private sector produces the exported goods, this increased outward orientation must develop through a combination of real-exchange-rate depreciation and fiscal austerity. Fourth, comprehending the political economy of reparation-like resource transfers is central to understanding the impact of debt on adjustment. The government faces both external and internal obligations, and its fiscal receipts can be used interchangeably in each category. As noted in different contexts by Cornia, Jolly, and Stewart and in the volume edited by Nelson, countries at times must renege on their external obligations when internal obligations become pressing (for example, to remain in power or to redistribute income). This decision opens the government to external sanctions. Thus a political balancing act is involved that remains only vaguely understood but is unique to debt's nature as an external obligation.

Another feature of the debt-adjustment nexus that requires further study is the complementarity of stabilization and structural adjustment policies. The timing of implementation is often cited, but it may be a nonissue: if the two are implemented immediately, only the stabilization policies will have immediate positive results. It may be that structural adjustment policies would worsen the external imbalance initially by requiring even more austere stabilization policies than would otherwise be necessary (with the obvious example being liberalization of import markets). These areas require more examination, both analytical and empirical, by researchers in all disciplines.

In sum, each of these books can be recommended to academics as well as to practitioners interested in the evolution of the debt crisis and the process of economic adjustment in Latin America. Although some of the books are dated in their coverage, each provides useful insights into facets of the adjustment dilemma. International debt is in a sense a measure of the nonadjustment undertaken by Latin American economies during the 1970s and early 1980s, and the most recent years have confronted these economies with the dual responsibility of paying for that nonadjustment through debt service and paying for the present structural adjustment programs through new investment and policy reform. Each of these books attests to the fact that Latin American debtors and others have honored the first responsibility, often at the expense of economic growth and structural adjustment. The consequences have been dire, and the outlook remains uncertain. Research can play a useful role by further clarifying the interrelationships of these issues.

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