

PIERRE-RICHARD AGÉNOR / PETER J. MONTIEL

DEVELOPMENT

An abstract geometric artwork featuring a series of overlapping, translucent planes and lines that create a sense of depth and movement. The colors are predominantly dark blue and purple, with some lighter, almost white, highlights that define the edges of the geometric forms. The overall effect is one of a complex, multi-layered structure, possibly representing a modern architectural design or a mathematical concept.

MACROECONOMICS

DEVELOPMENT MACROECONOMICS

Pierre-Richard Agénor and Peter J. Montiel

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TO OUR FATHERS,

The late Frédéric, and Pedro,_____

FOR THEIR SUPPORT AND GUIDANCE

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Foreword

THIS BOOK on “emerging market” macroeconomics could not be more timely. Around the world, from the transition economies of Europe, Russia, and China to the developing economies of Latin America and Africa, students want to understand, professors want to teach, and policy makers want to address the same kinds of macroeconomic issues. But all too often the answer to their problems is a homegrown refrain: “This country is different, professor. You don’t understand.”

True, developing economies have market structures and institutions that fundamentally affect the way macroeconomic policies work, and these may in fact make them different. Yet, giving in to the notion that they are different—worse, each uniquely different from any and all others!—throws overboard a vast amount of knowledge and experience that could be brought to bear on solving real problems. The very notion that each country is unique and thus so are its problems is, of course, ridiculous. Major inflation experiences have a vast amount in common, as do stabilization experiences or experiences of trade liberalization or currency overvaluation. In fact, how could one seriously address these problems without looking across the world and asking just how they presented themselves elsewhere? The battle cry “this country is different” is ultimately a scoundrel’s plea for protecting outdated interpretations or politicized policy advice from intellectual import competition.

As a guide to the macroeconomics of developing economies, Agénor and Montiel’s book uniquely fills the role of bringing together the useful knowledge and evidence of decades of research. It strikes a balance between the recognition that these countries are, in fact, different in interesting and important ways that are relevant to policy making and the recognition that in some deep ways the problems are about the same everywhere. In so doing, the book opens up this area of macroeconomics to an international competition of ideas and professional standards that will enable young researchers, who are willing and able to invest in the requisite skills, to break the control of established pundits who have all too long held a monopoly on interpreting events and mechanisms.

For the past decade, the World Bank and the International Monetary Fund have had the good fortune of having a number of great research directors—Anne Krueger, Stan Fischer, Larry Summers, and Michael Bruno at the Bank and Jacob Frenkel and Michael Mussa at the Fund. They and their colleagues have encouraged active, systematic, and modern research on the macroeconomic problems of developing countries and emerging market

economies. The need to fill the vacuum was essential both to guide the institutions in their own policy thinking and to make them more effective partners in local dialogue. In doing so, the research departments of the Bank and the Fund have welcomed a talented group of researchers from around the world who have come as senior visitors or brand new staffers. In addition, there is increasingly more research being done in developing economies themselves; returning Ph.D.s as well as students who have not even gone abroad are joining the game. They use modern methods and models to test just what the relationships are, and how important, in fact, special institutions or features turn out to be. In the process, more often than not, they confirm the view that there are striking similarities across borders.

This book takes one step further the progress in cross-border research on developing economies. It systematically integrates the literature and in so doing opens it up to generations of students—both in developing economies and in advanced economies. In using the modern language of formal models, it immediately widens the applicability of an argument across countries, challenges researchers or students to identify their own local counterpart of a variable or structural feature, and highlights the need to adapt or change a particular piece of the model. It thus brings discipline to the question of whether and how a country might differ from a stylized case. Importantly, it shows how opening up, deregulating, or modernizing will change an economy's structural relations, and it specifies where the change will show up.

Of course, the basic question is whether developing economies really are different from the industrialized world. Agénor and Montiel accept the premise that there are at least four important ways in which developing economies differ from stylized advanced countries. First, there is a significant difference in the productive structure. Specifically, the terms of trade play a very important role. That is obvious for a country which is significantly involved in commodity production—Nigeria in oil or Chile in copper, for example. Favorable terms of trade shocks show up as a trade surplus, an income shock for businesses and households, and an improvement in the budget. In principle, the same is true for advanced economies; however, with the exception of oil, no commodity plays a significant enough role to deserve special attention. But maybe even that is wrong—the sharp decline in commodity prices of the past decade may well have played a large role in the relatively painless disinflation among rich countries.

The second special feature of developing economies is the segmentation of markets for capital, labor, and goods. In the capital market, financial repression is the counterpart of a search to control credit and the easily overplayed ability to finance deficits cheaply. In labor markets, the duality of formal and informal markets is a prominent element. In goods markets, protection and the resulting loss of thorough competition are a key feature of price formation. In foreign exchange markets, various forms of exchange control limit market integration and open up the possibility (and often the

illusion) of a newfound degree of policy flexibility. These segmentation factors are, indeed, part of the reality of an emerging market. Yet, with the arrival of reform, openness, and deregulation, they are also all on the way out. Even so, there is good reason to pay attention to them, because it will take a while for them to disappear altogether, and the transition itself involves important policy issues. Removing capital controls, deregulating banks, or opening trade cannot be done just as an isolated step; it needs to be part of a more comprehensive macroeconomic package. Trade opening, for example, needs as a countermeasure a real depreciation. Without that, a Mexican- or Chilean-style payments crisis is just a few years off.

Third, the book highlights the open economy aspect of macroeconomics in ways that differ substantially from treatments in the texts written for advanced countries. In the latter, the open economy even today is relegated to a sideshow, despite the fact that it is a key part of what makes up the mechanism and the constraints under which policy operates. Thus, this book might be a more useful guide for students in, say, Spain or Italy than are their usual texts.

Finally, political economy is far more prominent in the macroeconomic operation of developing countries than in established industrial countries. If markets are segmented, the institutional counterpart of that segmentation is often a bureaucracy that benefits from the implicit regulatory power along with economic agents who, by way of factor prices or privileges, enjoy advantages from the status quo. Understanding that link between political economy and structure is the first step in engineering successful reform. It has been said of the Holy Roman Empire that more money was made in the few hundred years of its decline than in the thousands of years of its existence. In a compressed time frame, much the same is strikingly underway in the developing world and in the former socialist countries, as evidenced, for example, by the Mexican billionaires or the appearance of Russia's super rich. If there were nothing special about the macroeconomics of developing and emerging market economies and their transformation, these vast changes in wealth would not have come about.

Agénor and Montiel have done a great job in shaping this book. *Development Macroeconomics* fills an obvious gap, and it does so in a masterful way. Rather than focusing on formal, self-satisfied theory, the book is centered on the analytical foundations of policy formulation. That makes it especially effective as a teaching instrument and useful as a guide to policy makers and their advisors. For their work and effort, Agénor and Montiel deserve congratulations. They have created a wonderful book and will come away with the satisfaction and reward of great teachers.

Rudiger Dornbusch
Massachusetts Institute of Technology

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