

**A decade lost and found:
Mexico and Chile in the 1980s**

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Great Depressions Conference
Federal Reserve Bank of Minneapolis

Mexico and Chile in the 1980s

crises in 1982

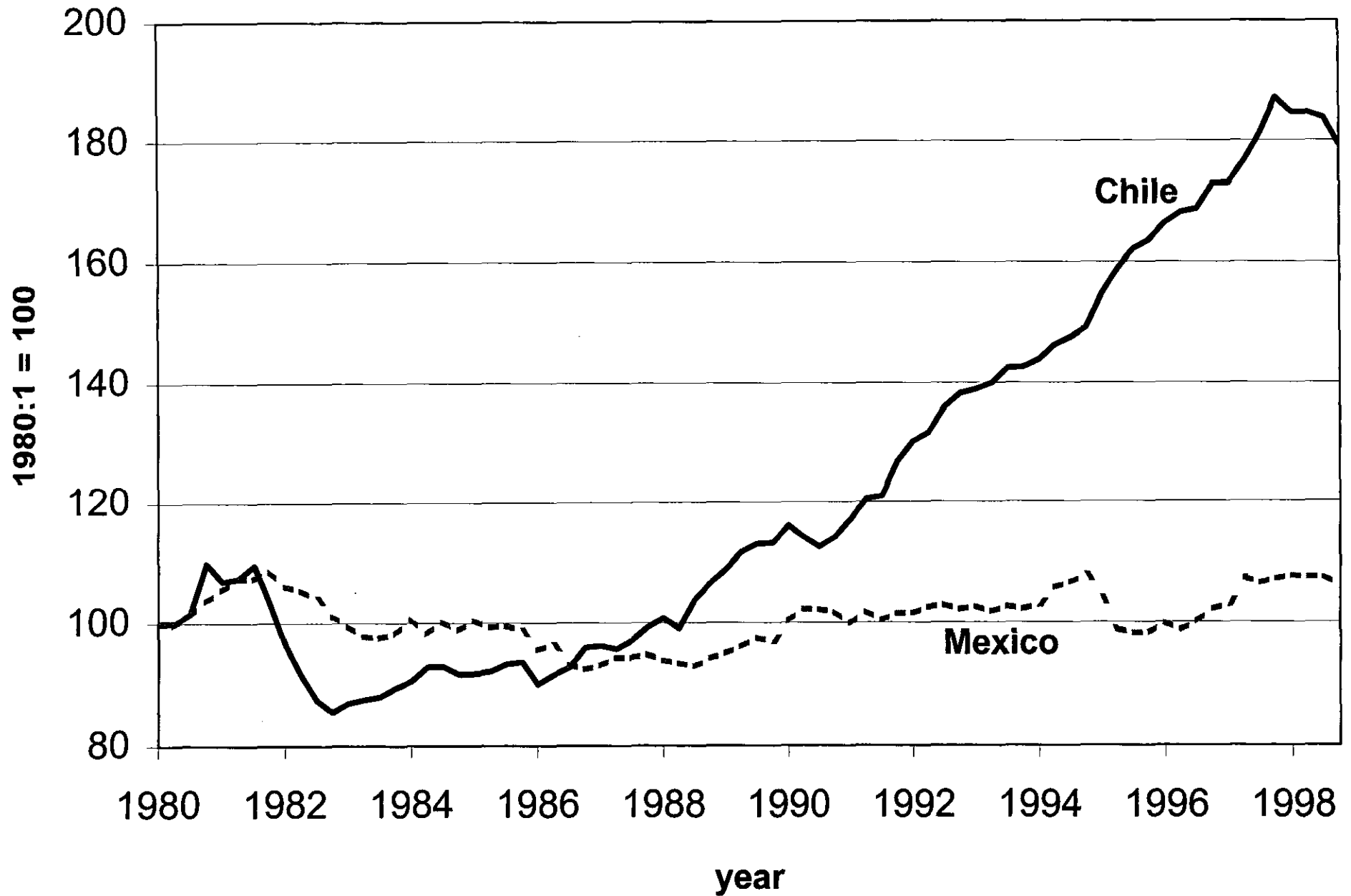
- Chile more severe than Mexico

different recoveries

- Chile faster than Mexico

why different pattern?

GDP per capita



Similar crises

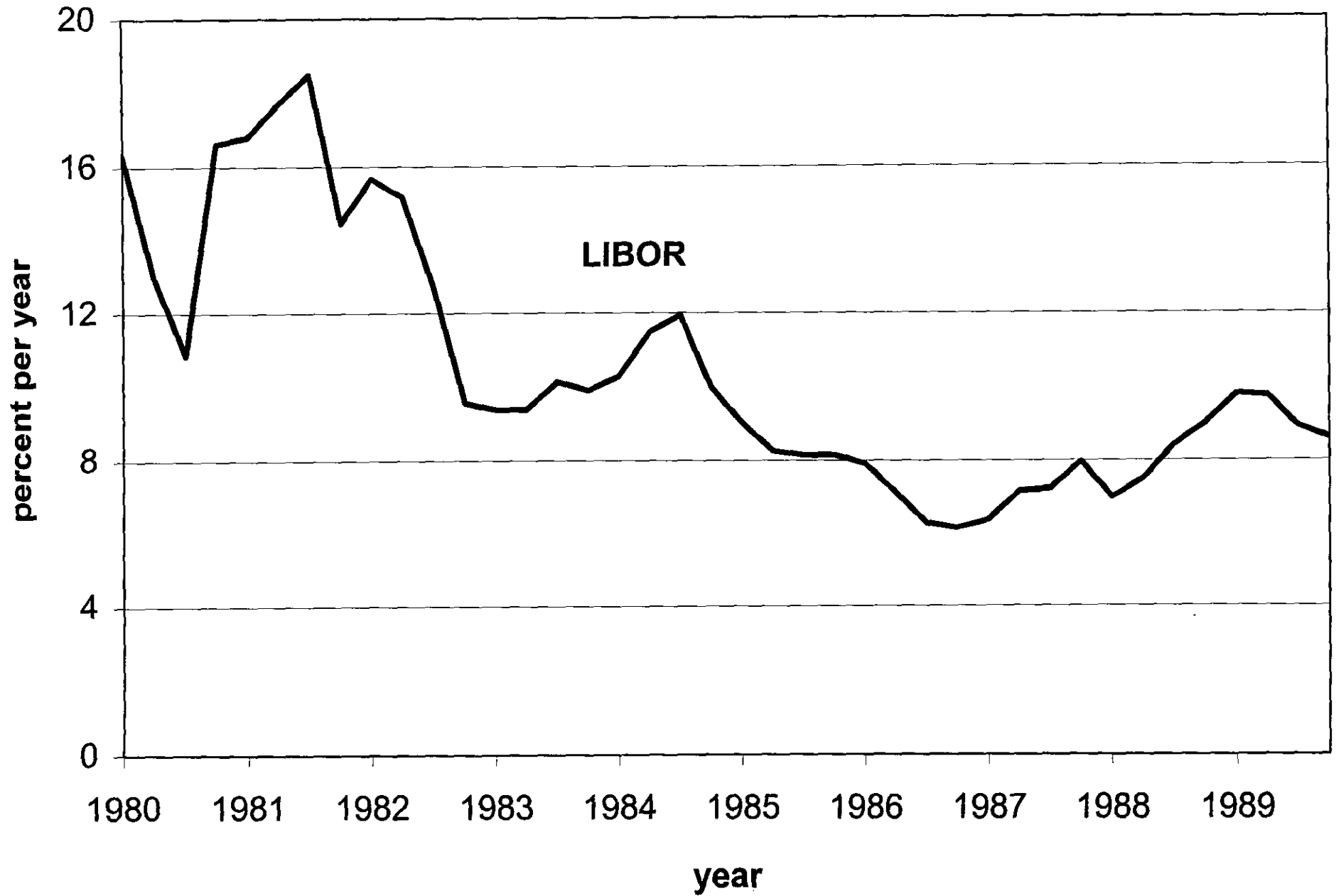
initial conditions

- large foreign debt
- appreciating real exchange rate
- large trade deficit
- banking problems

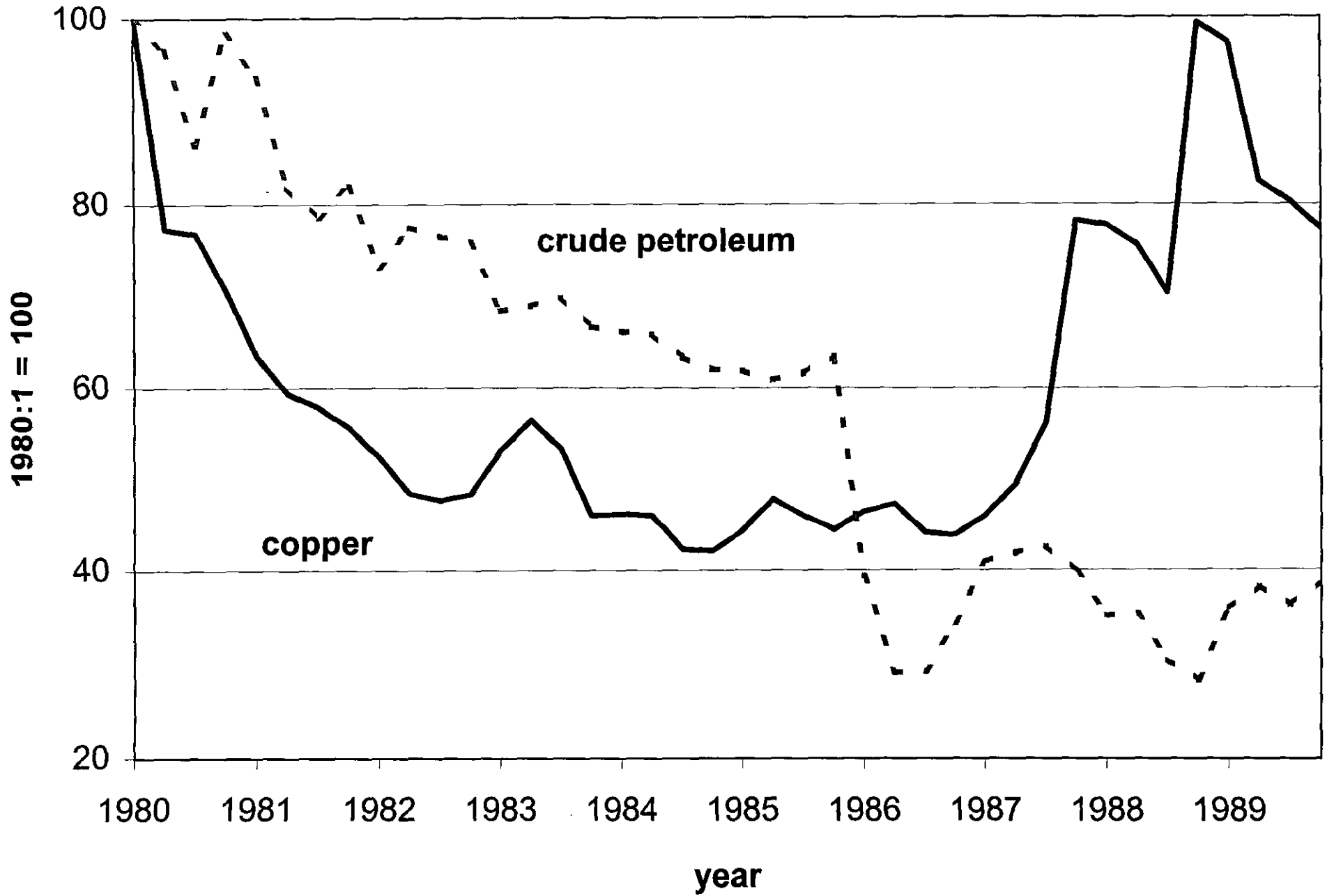
shocks

- jump in world interest rate
- plummet in copper and oil prices
- cutoff in foreign lending

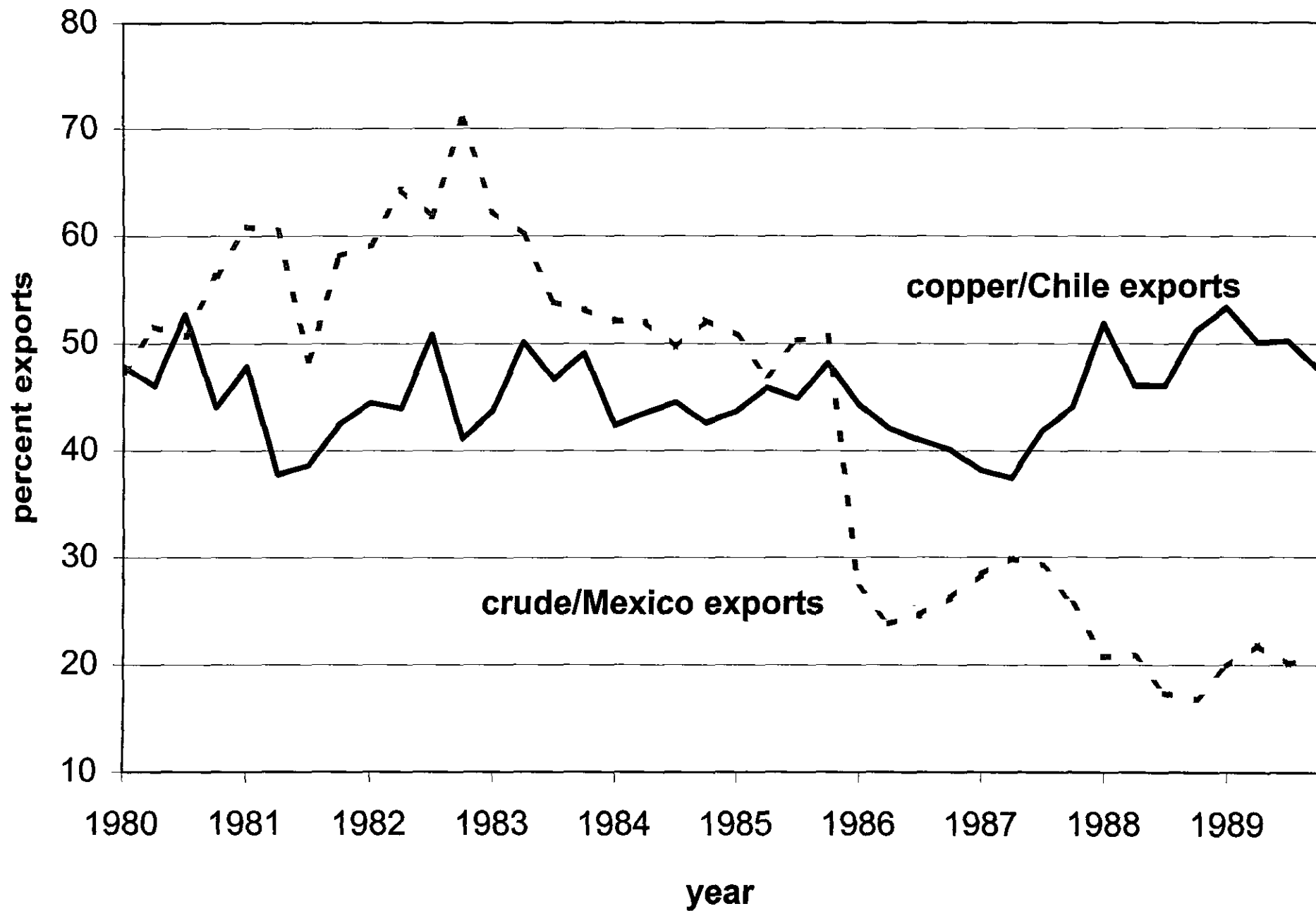
World interest rate



Real commodity prices



Commodity exports



Stories for different recoveries

standard monetarist story

- different money growth rates induced different real responses

Corbo-Fischer story for Chile's fast recovery

- sharp depreciation of real exchange rate generated export-led growth

Sachs story for Mexico's slow recovery

- debt overhang deterred investment

structural reforms story

- Chile reformed in 1970s
- Mexico much later (1980s and 1990s)

Monetarist story

monetary contractions

⇒ depressions

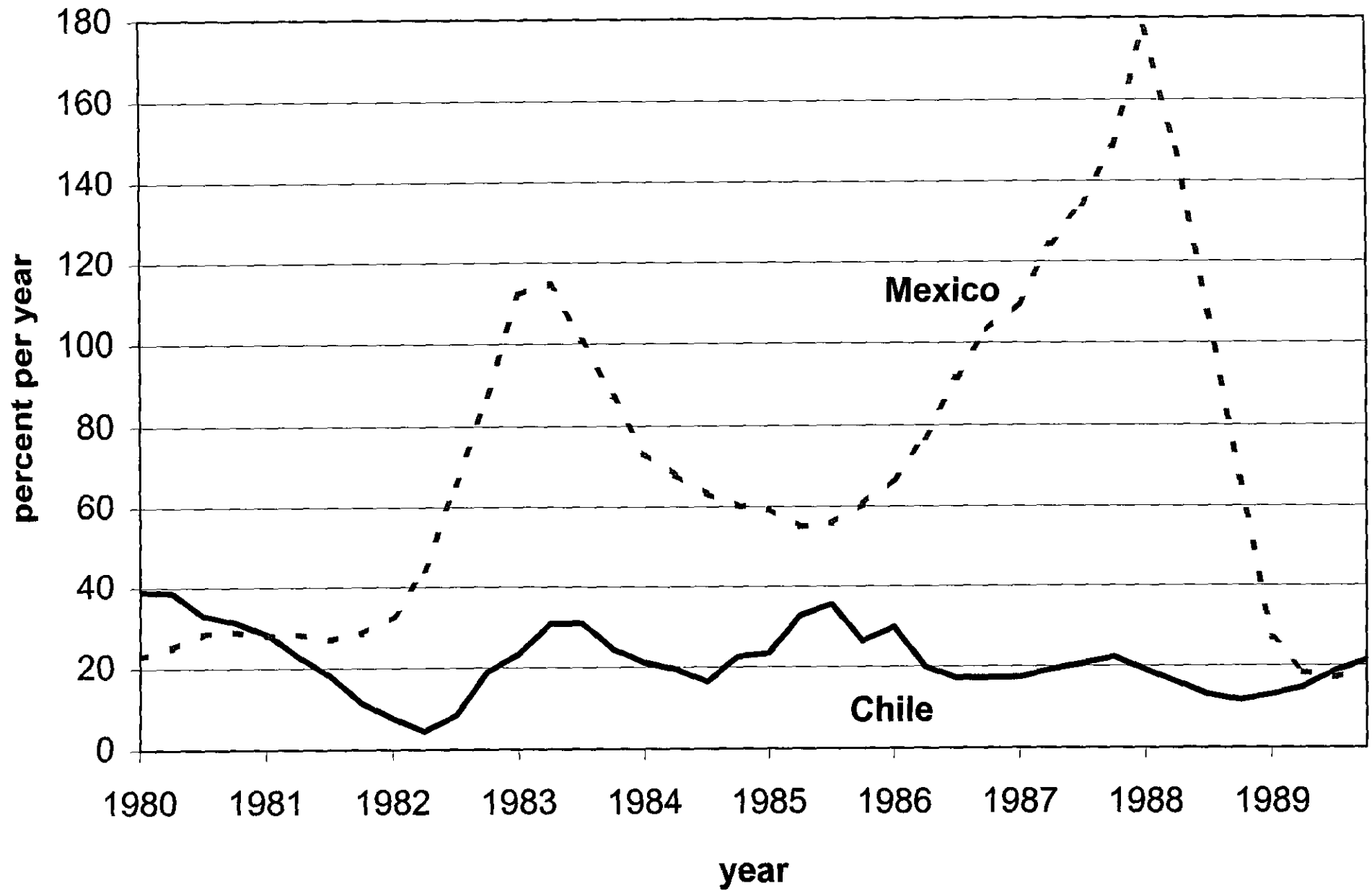
monetary expansions

⇒ rapid recoveries

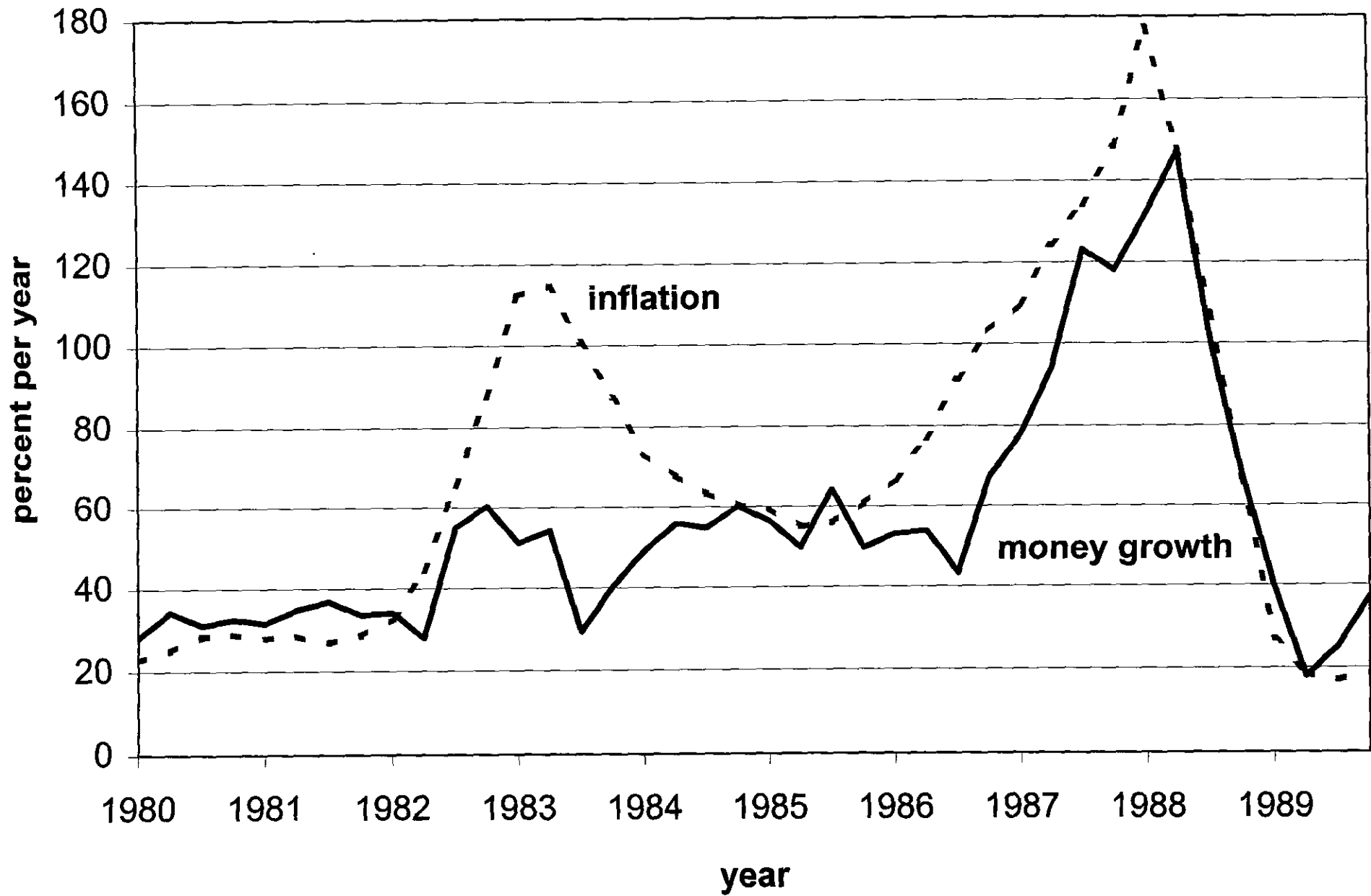
short of inducing hyperinflation, the
more rapidly a country in a depression
reinflates, the better

what happened in Mexico and Chile?

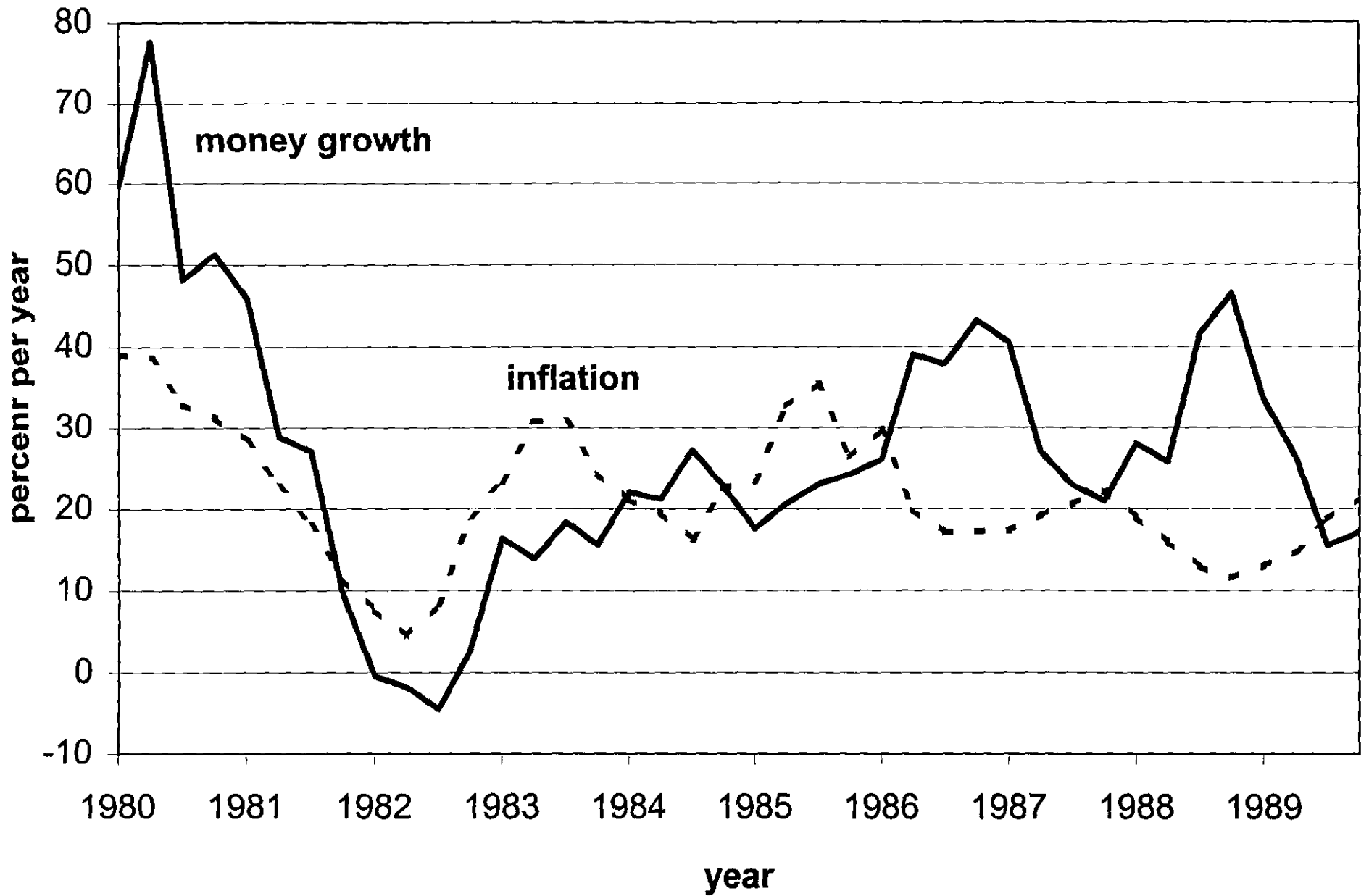
Consumer price inflation



Consumer price inflation and money growth in Mexico



Consumer price inflation and money growth in Chile



Annual Growth Rates 1984:1 – 1989:4

	Chile	Mexico
money	28.0	68.3
CPI	20.3	80.4
GDP/capita	4.2	-0.2

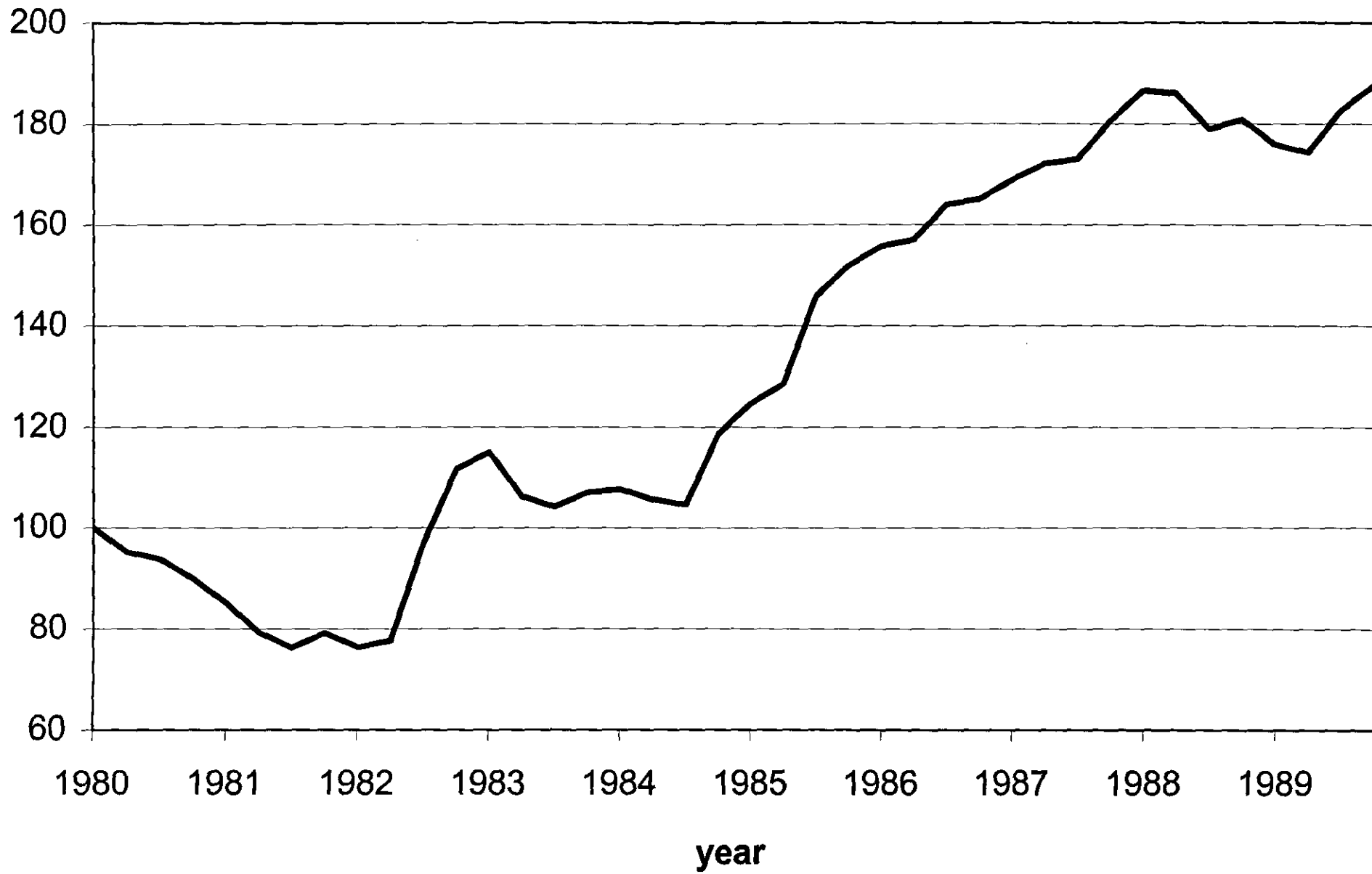
Corbo-Fischer story for Chile

- sustained real depreciation
- decline in real wages

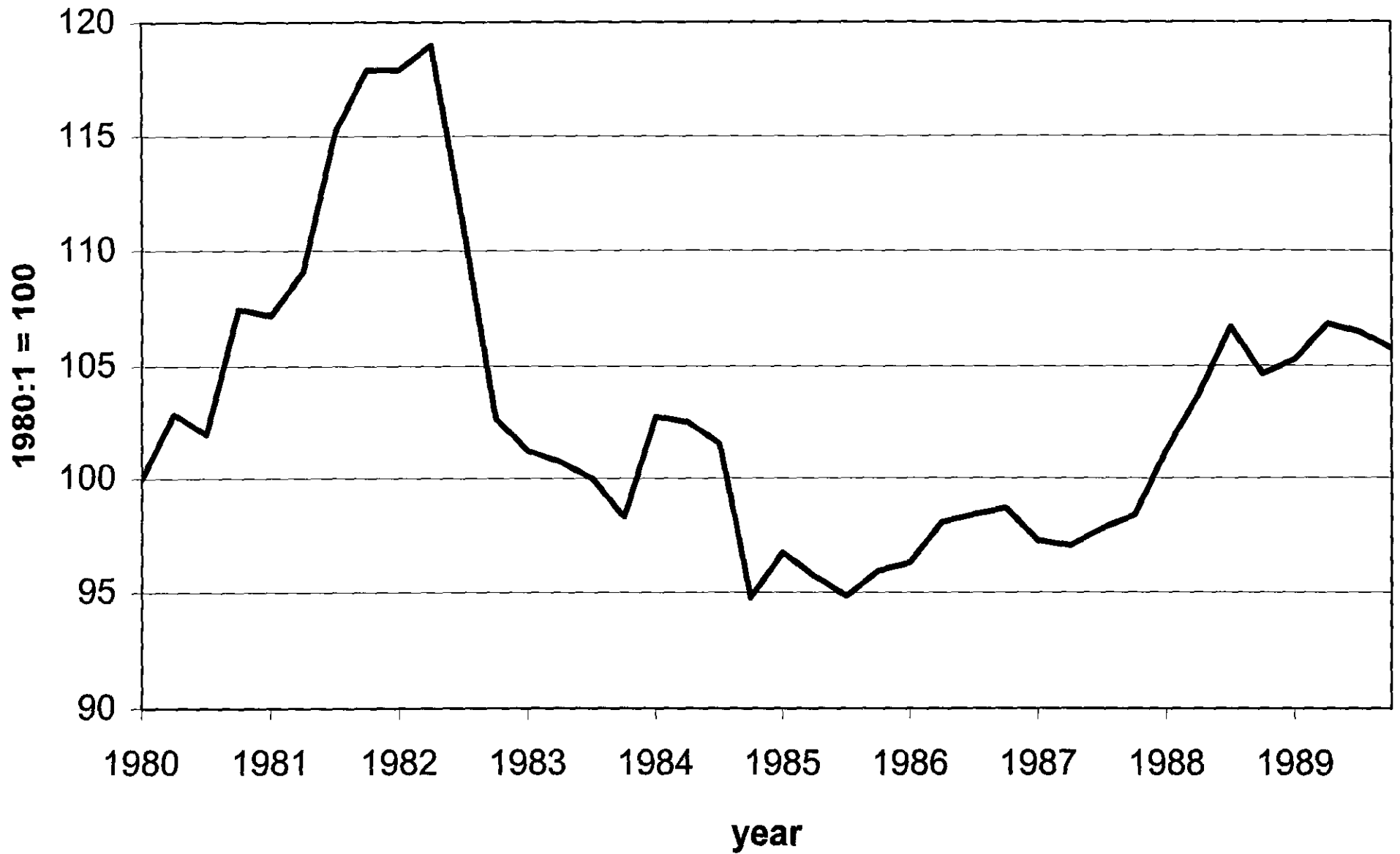
⇒ export-led growth in Chile

Real exchange rate - Chile

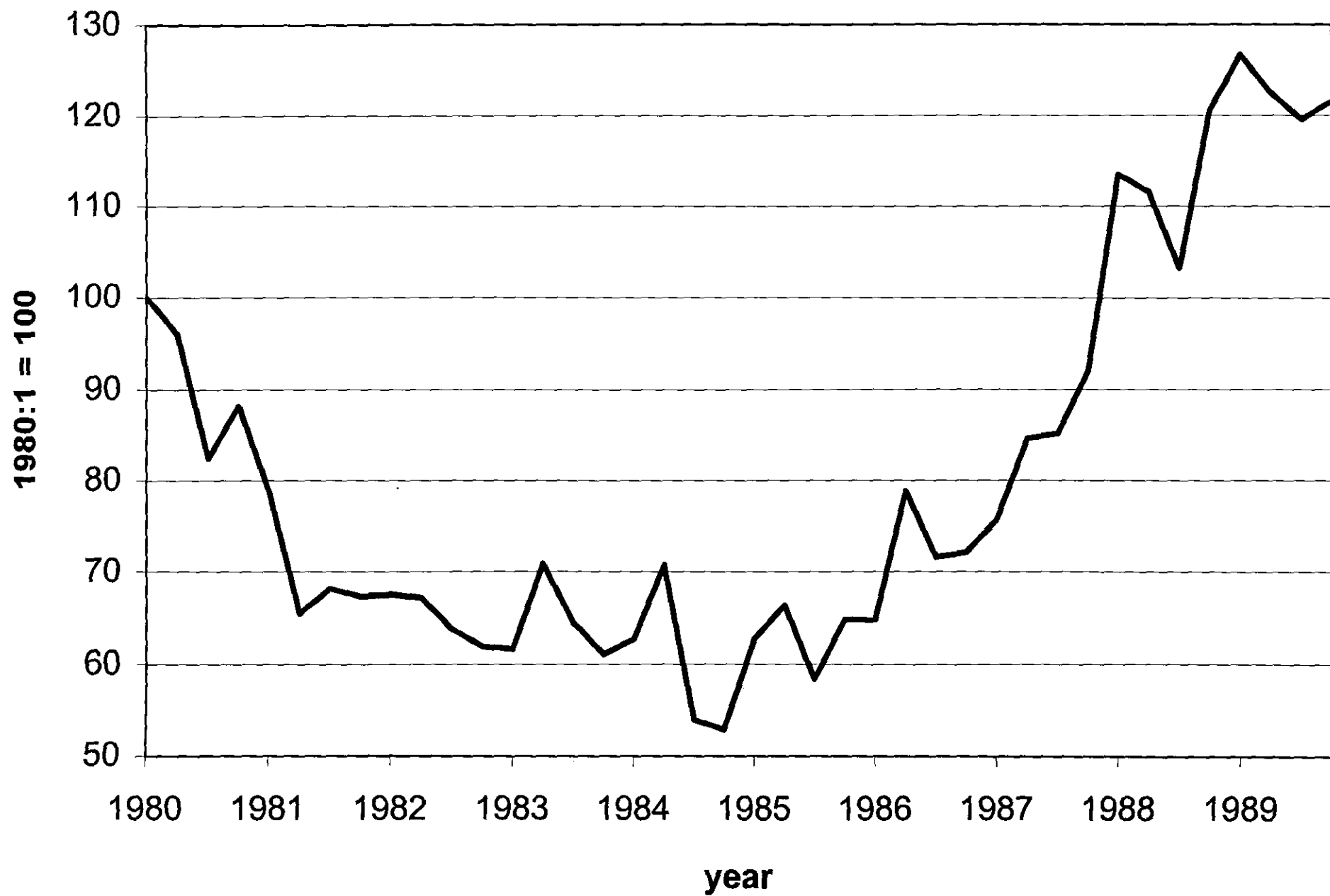
(increase is depreciation)



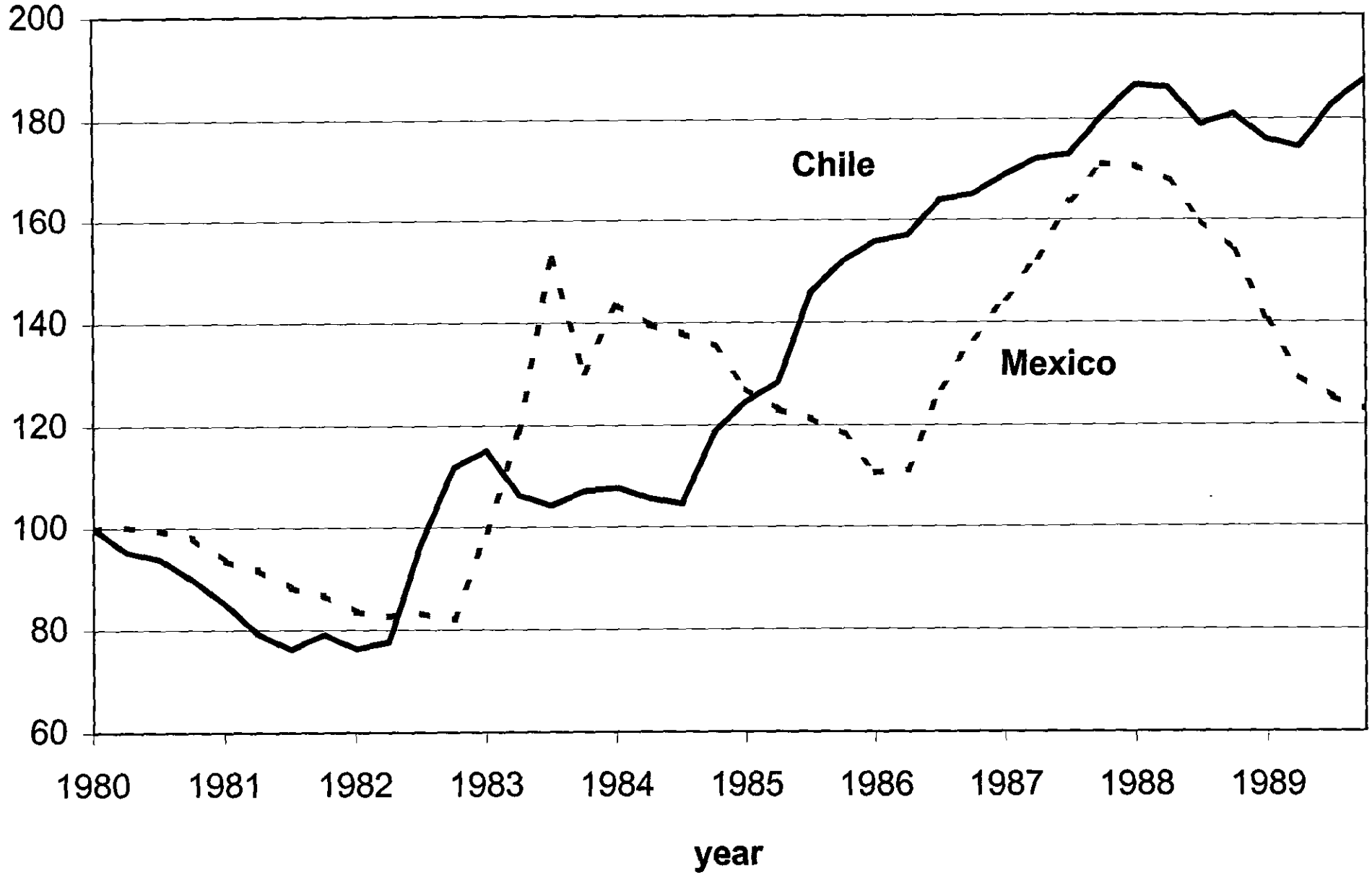
Real wages - Chile



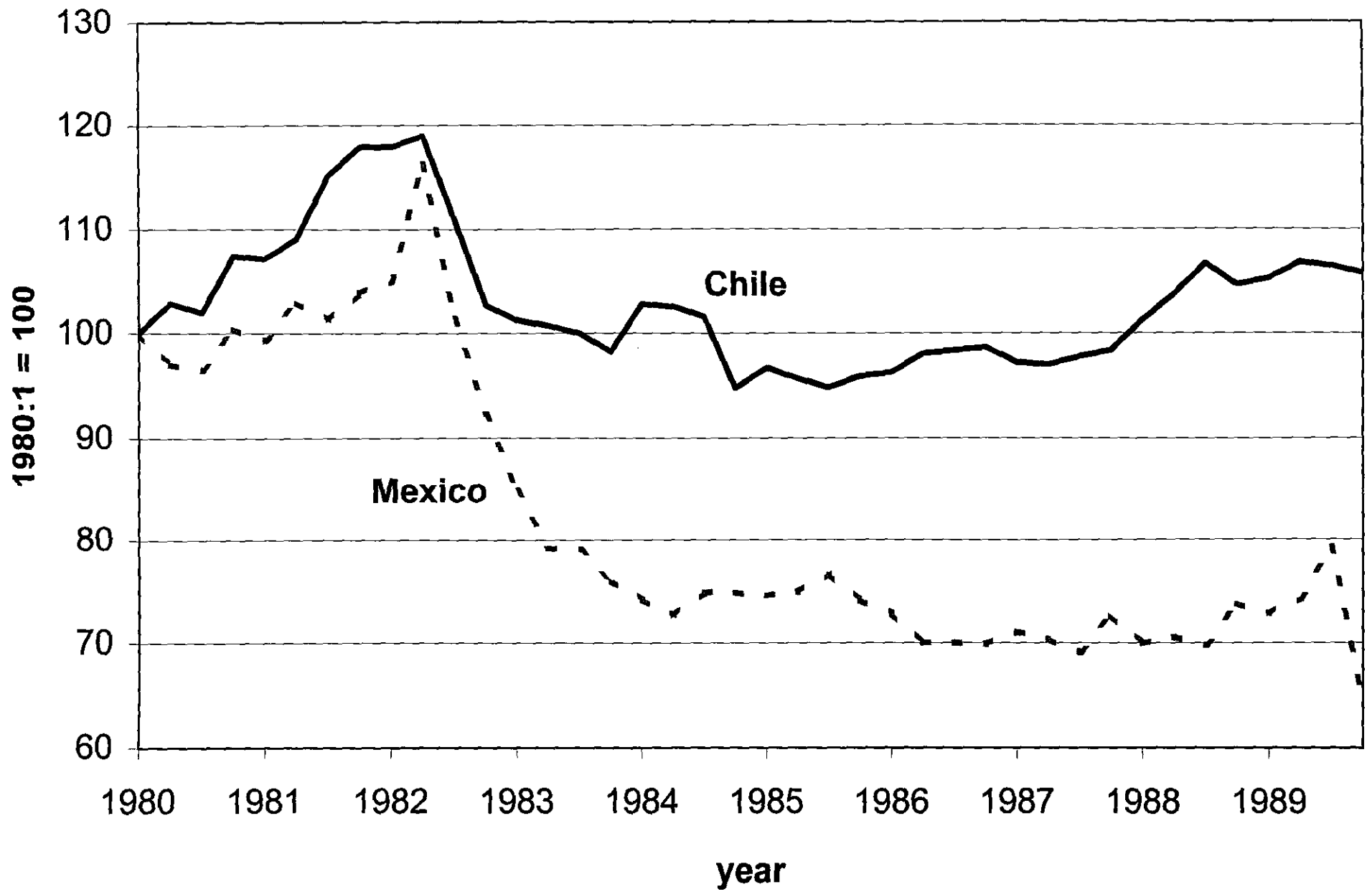
Real U.S. Dollar Exports - Chile



Real exchange rate

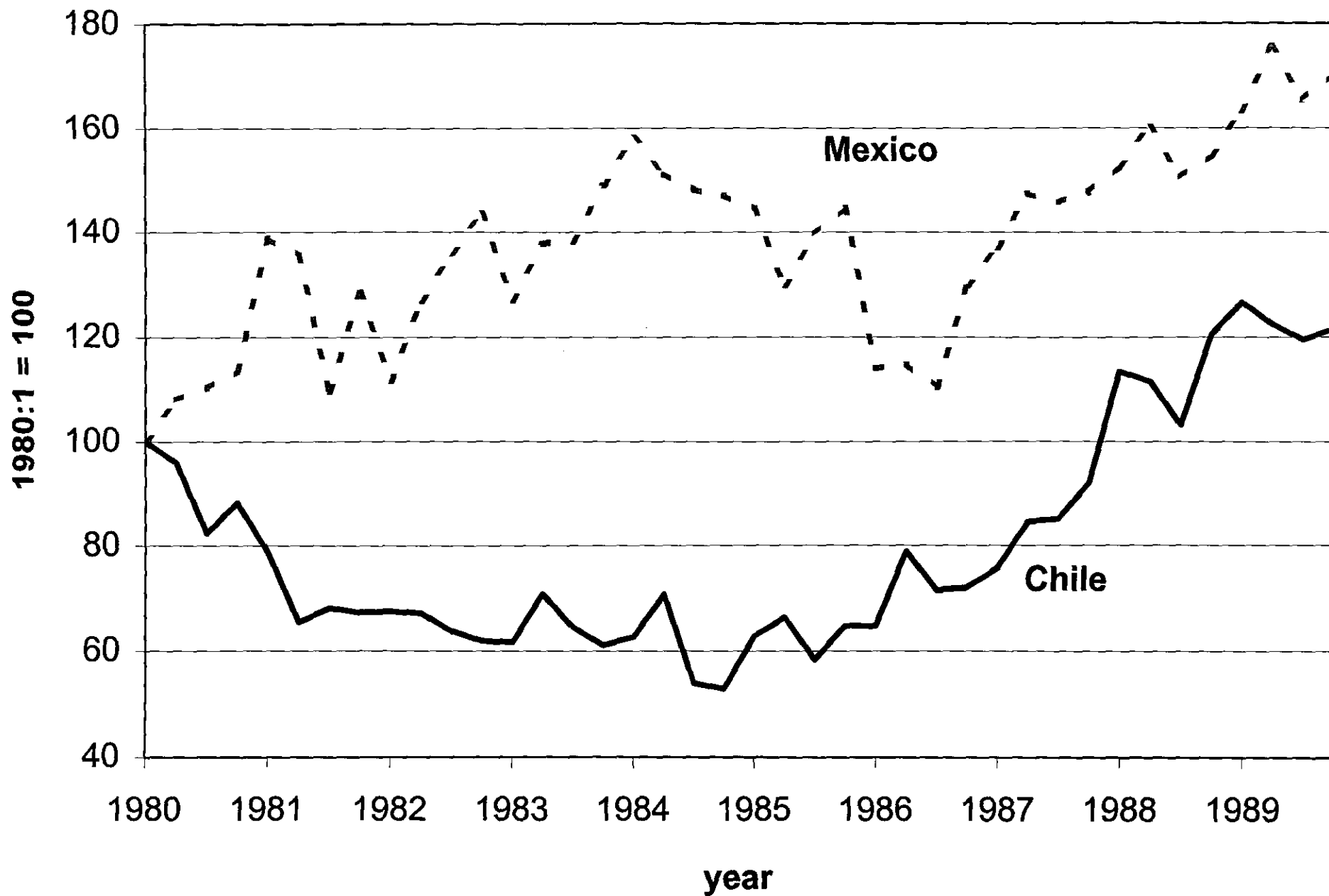


Real wages



Real U.S. Dollar Exports

1980:1 Chile exports/GDP=0.24 Mexico exports/GDP=0.08

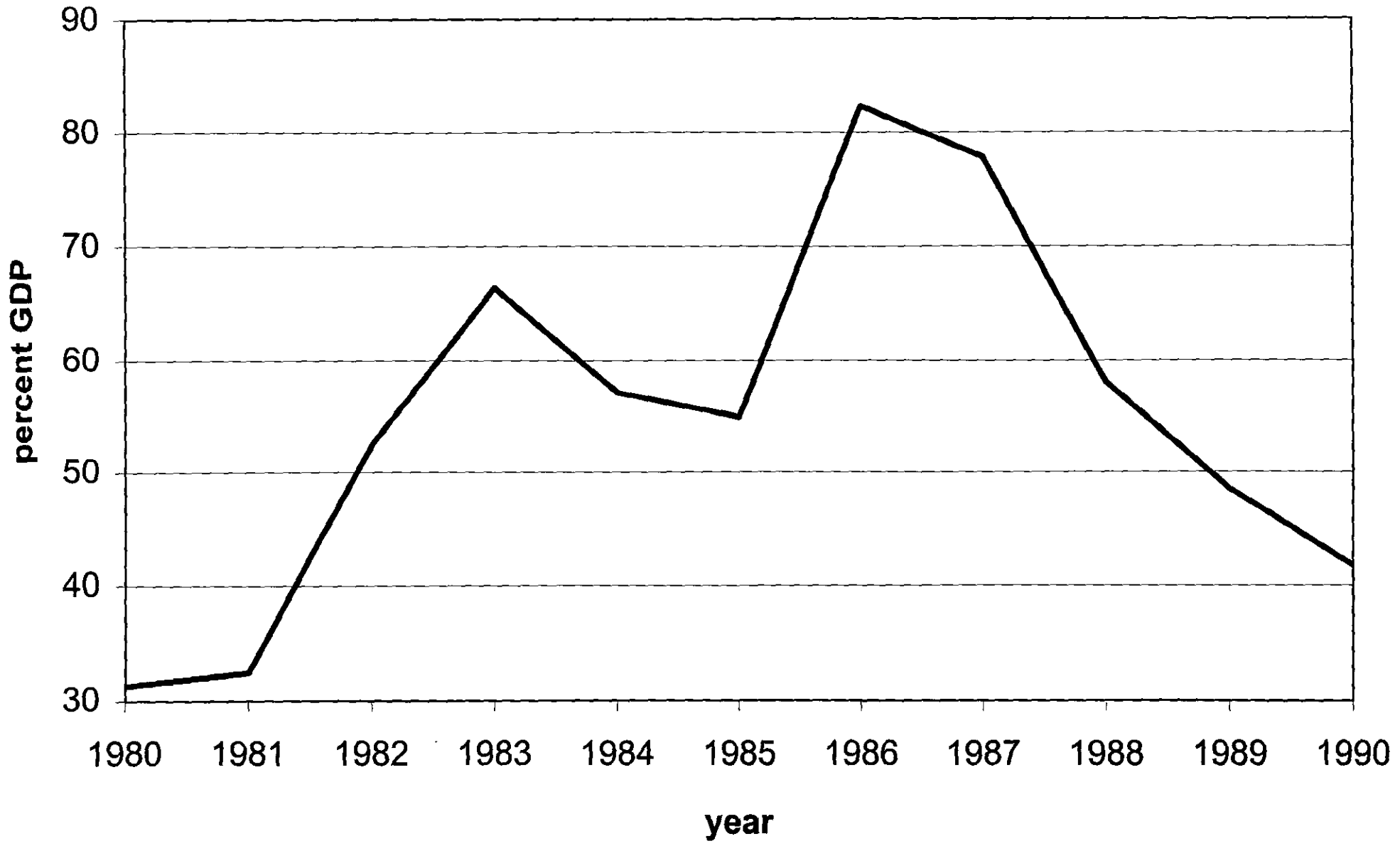


Sachs story for Mexico

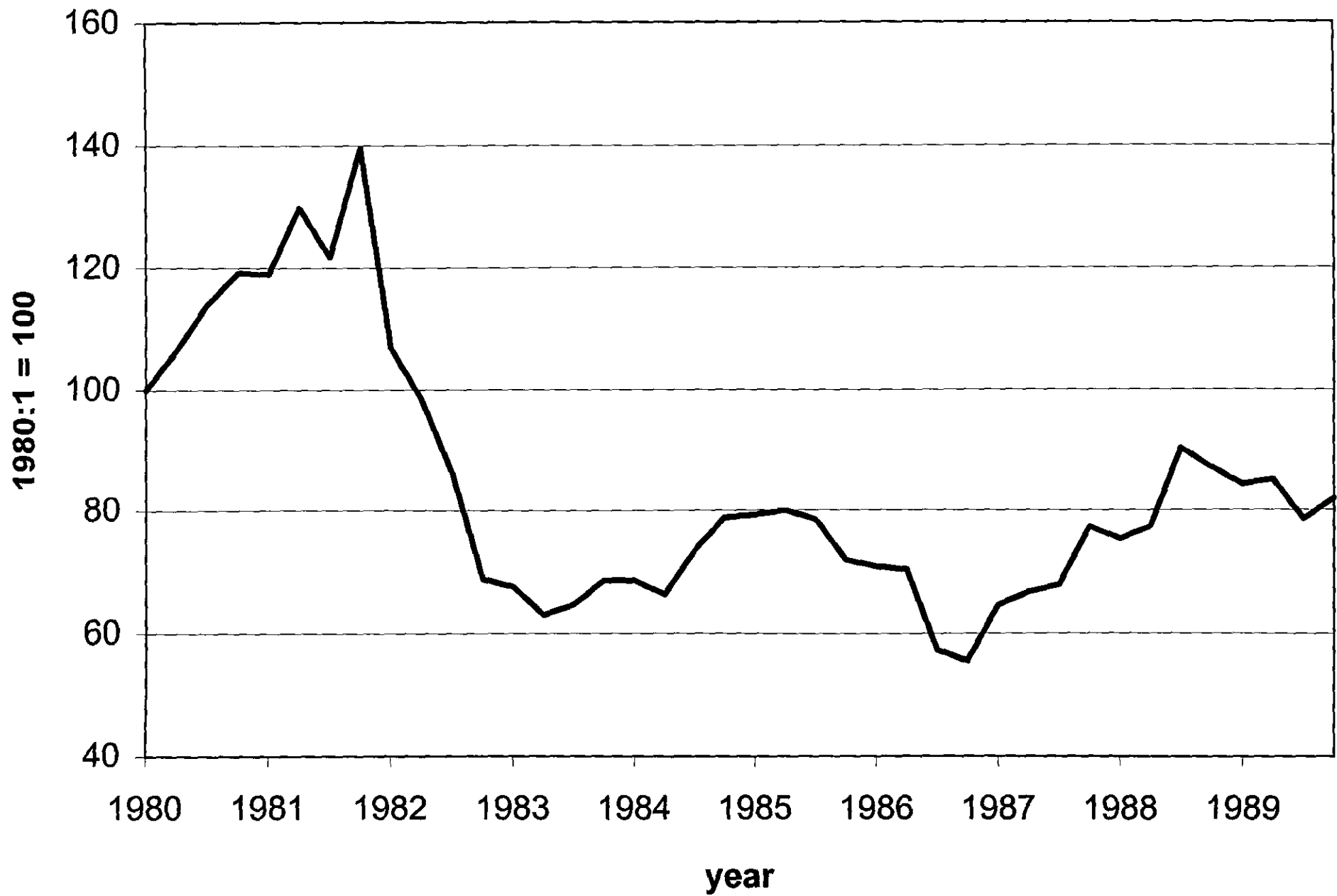
large debt overhang in Mexico

- fear returns on new investment mostly used to pay old loans
- distorts private incentives towards consuming rather than investing funds
- socially profitable investments not undertaken

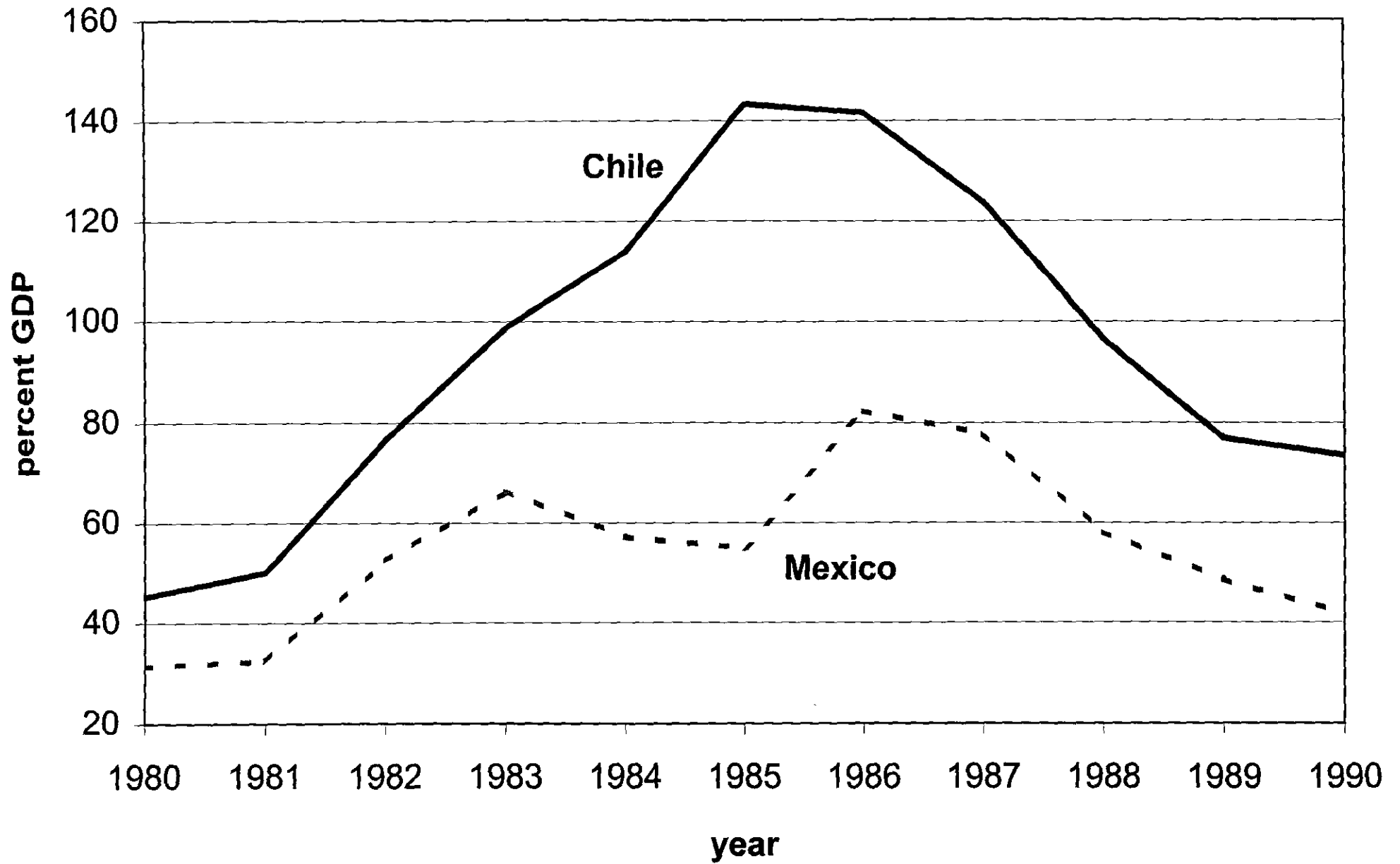
Foreign debt - Mexico



Real Investment - Mexico

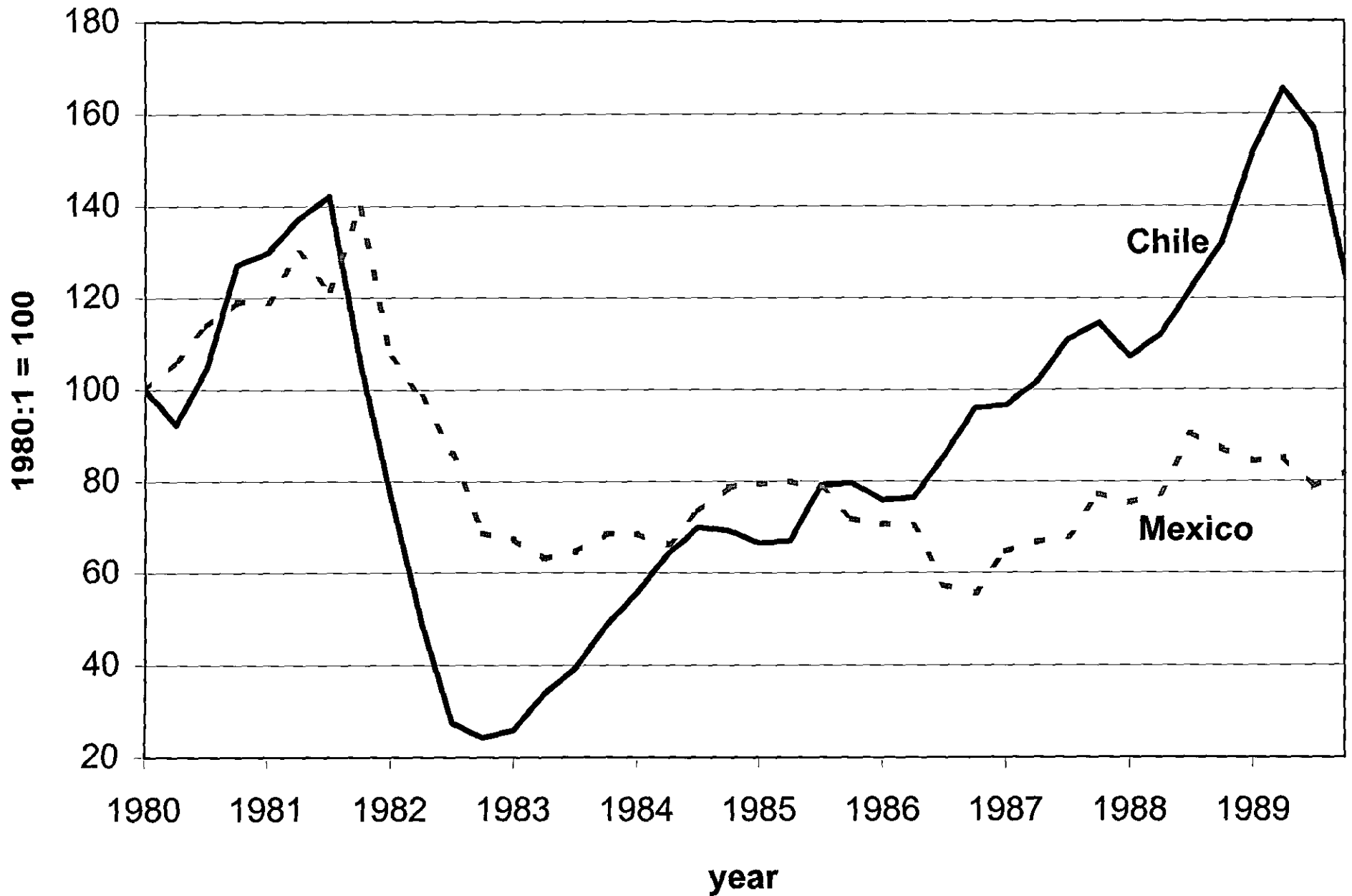


Foreign debt



Real Investment

1980:1 Chile investment/GDP=0.23 Mexico investment/GDP=0.25



Structural reforms

- Chile had reformed in 1970s
- Mexico had not

- areas of reform
 - banking
 - trade
 - privatization
 - fiscal reforms
 - social security reform

Banking in Chile

- hasty liberalization in 1975
 - poorly supervised *financieras*
 - explosion of *grupos*
 - bailouts

Banco Osorno 1976

CRAV grupo 1978

- better after crisis

Banking after crisis

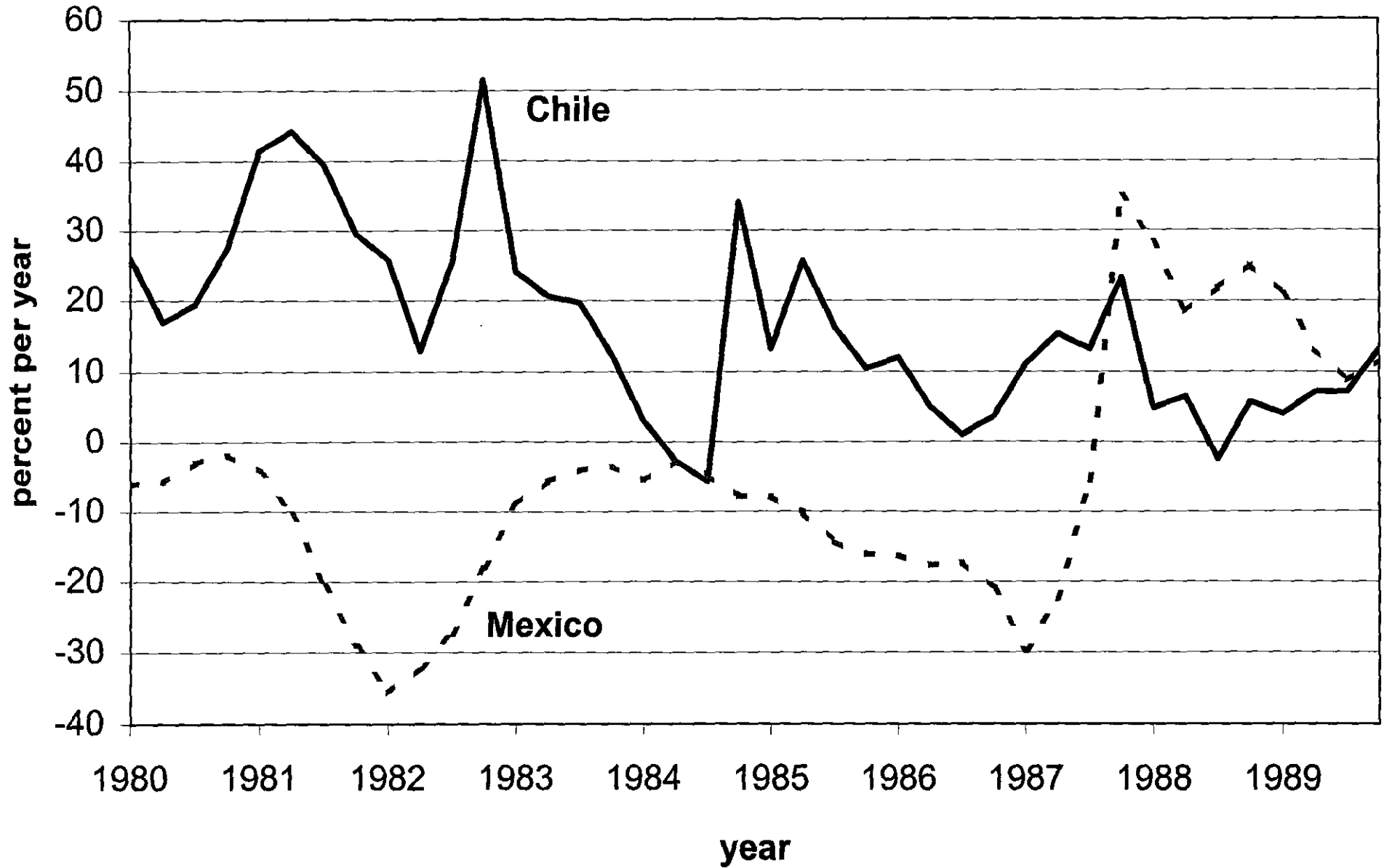
Chile: 1982 and after

- took over failed banks, then reprivatized
- market-determined interest rates
- tight regulation and supervision

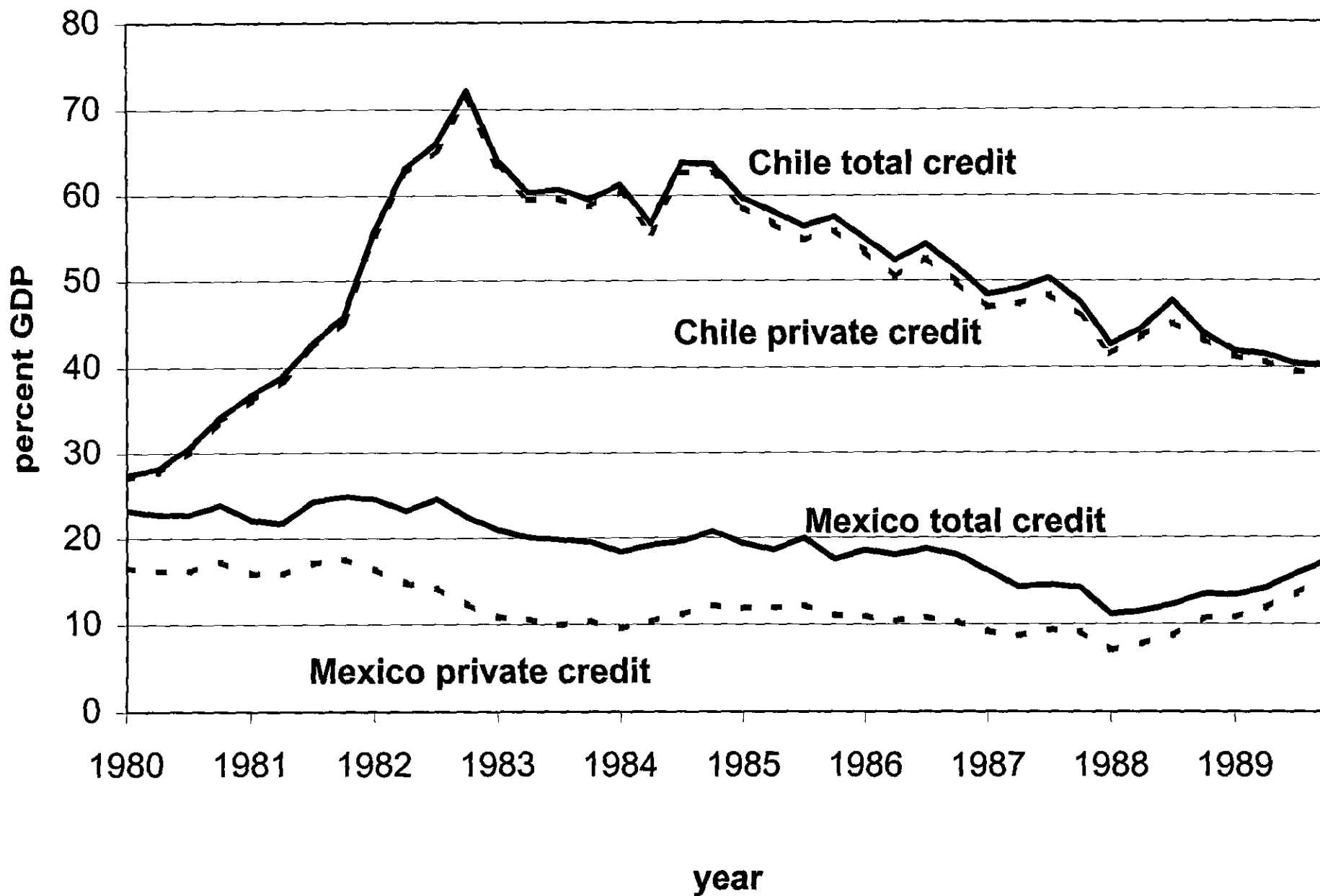
Mexico: 1982 and after

- nationalized all banks
- government set low deposit rates
- 75% of loans either to gov't or directed by gov't

Ex-post real interest rate



Credit to private sector and to public enterprises



Trade

Chile: by 1979

- all quantitative restrictions eliminated
- uniform tariff of 10%
- temporary tariff hike during crisis

Mexico: in 1985

- 100% of domestic production protected by import licenses
- nontariff barriers and dual exchange rates

Privatization

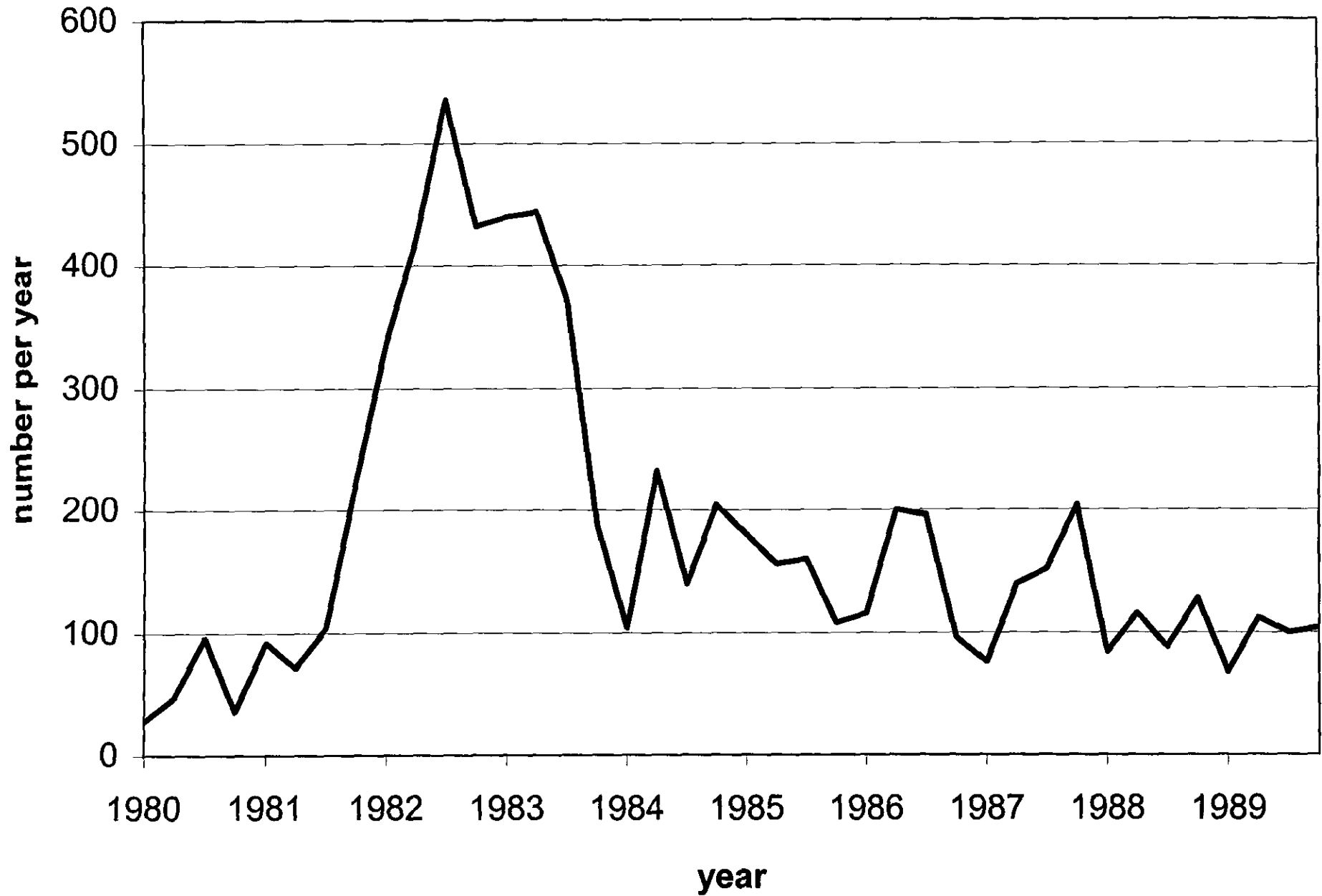
Chile

- major privatizations 1974–1979

Mexico

- major nationalization 1982
 - expropriated bank's holdings of private companies
 - government controlled 60-80% GNP
- major privatizations
 - started 1984 and intensified 1989
 - banks gradually privatized after 1990

Bankruptcies - Chile



Fiscal reforms

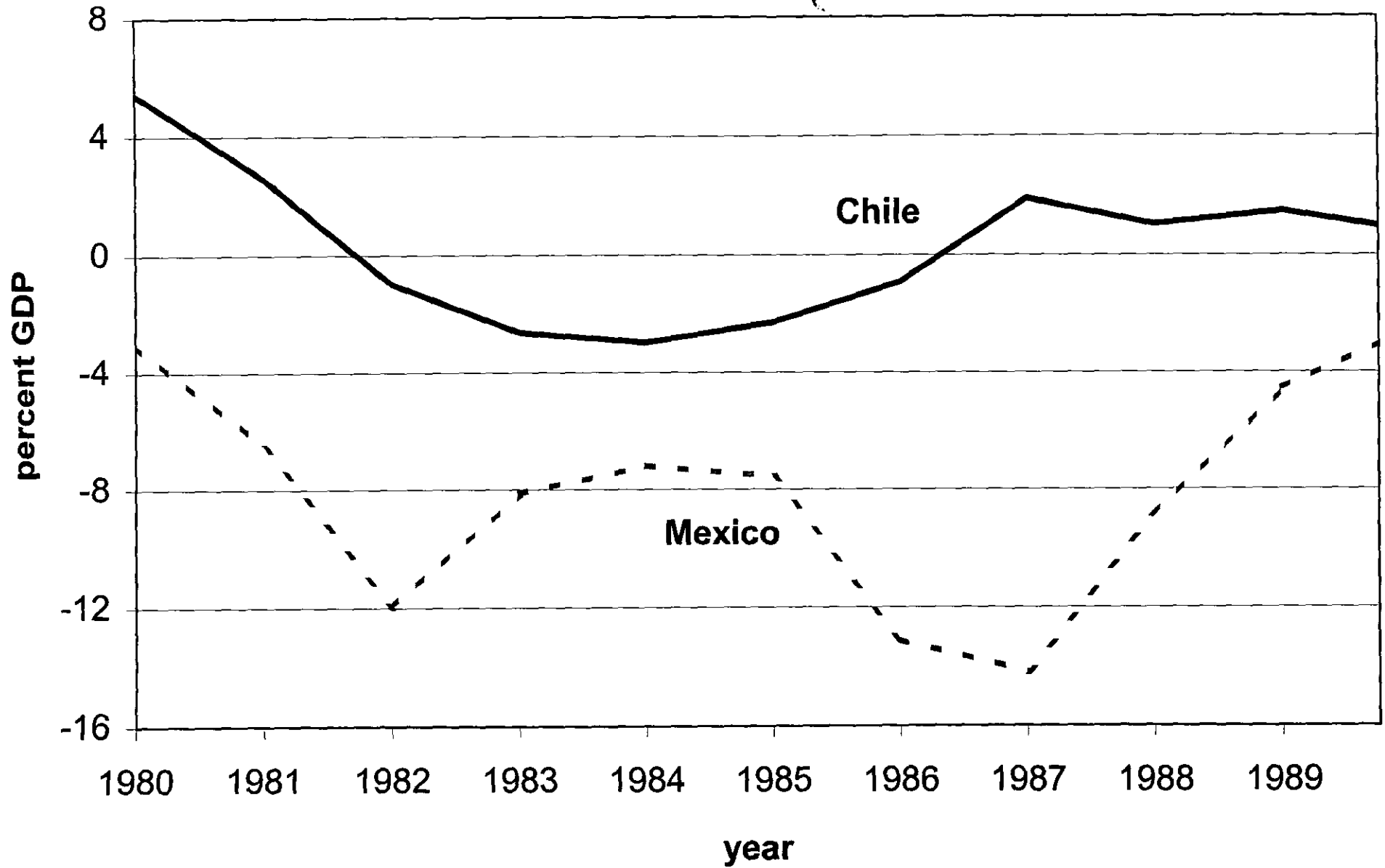
Chile

- major tax reform 1975
- social security reform 1980
- fiscal surpluses

Mexico

- tax reform in 1985
- fiscal deficits

Government surplus



Bottom line

Different recoveries due to

- Chile reaping benefits of reforms
- Mexico paying costs for distortions

Not due to

- money
- real exchange rates
- debt overhang