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

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Mexico and Chile in the 1980s

crises in 1982

• Chile more severe than Mexico

different recoveries

• Chile faster than Mexico

why different pattern?
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
Real commodity prices

- Crude petroleum
- Copper

Year:

1980 = 100

Graph showing the real commodity prices for crude petroleum and copper from 1980 to 1989.
Commodity exports


percent exports

year

copper/Chile exports

crude/Mexico 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 reflates, the better

what happened in Mexico and Chile?
Consumer price inflation

Mexico

Chile

percent per year

year

Consumer price inflation and money growth in Mexico
Consumer price inflation and money growth in Chile

Yearly data from 1980 to 1989:
- **Money growth**: Generally decreasing over the years, with a sharp decline in 1981 followed by a steady decline until 1987, then a sharp increase in 1988 and 1989.
- **Inflation**: Generally increasing over the years, with fluctuations throughout the period. Notable increases occur in 1980, 1984, and 1988.
### Annual Growth Rates
#### 1984:1 – 1989:4

<table>
<thead>
<tr>
<th></th>
<th>Chile</th>
<th>Mexico</th>
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<tbody>
<tr>
<td>money</td>
<td>28.0</td>
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<td>CPI</td>
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<td>GDP/capita</td>
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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 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

Chile

Mexico

percent GDP

year

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

Chile

Mexico
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
Fiscal reforms

Chile

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

Mexico

- tax reform in 1985
- fiscal deficits
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