

**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

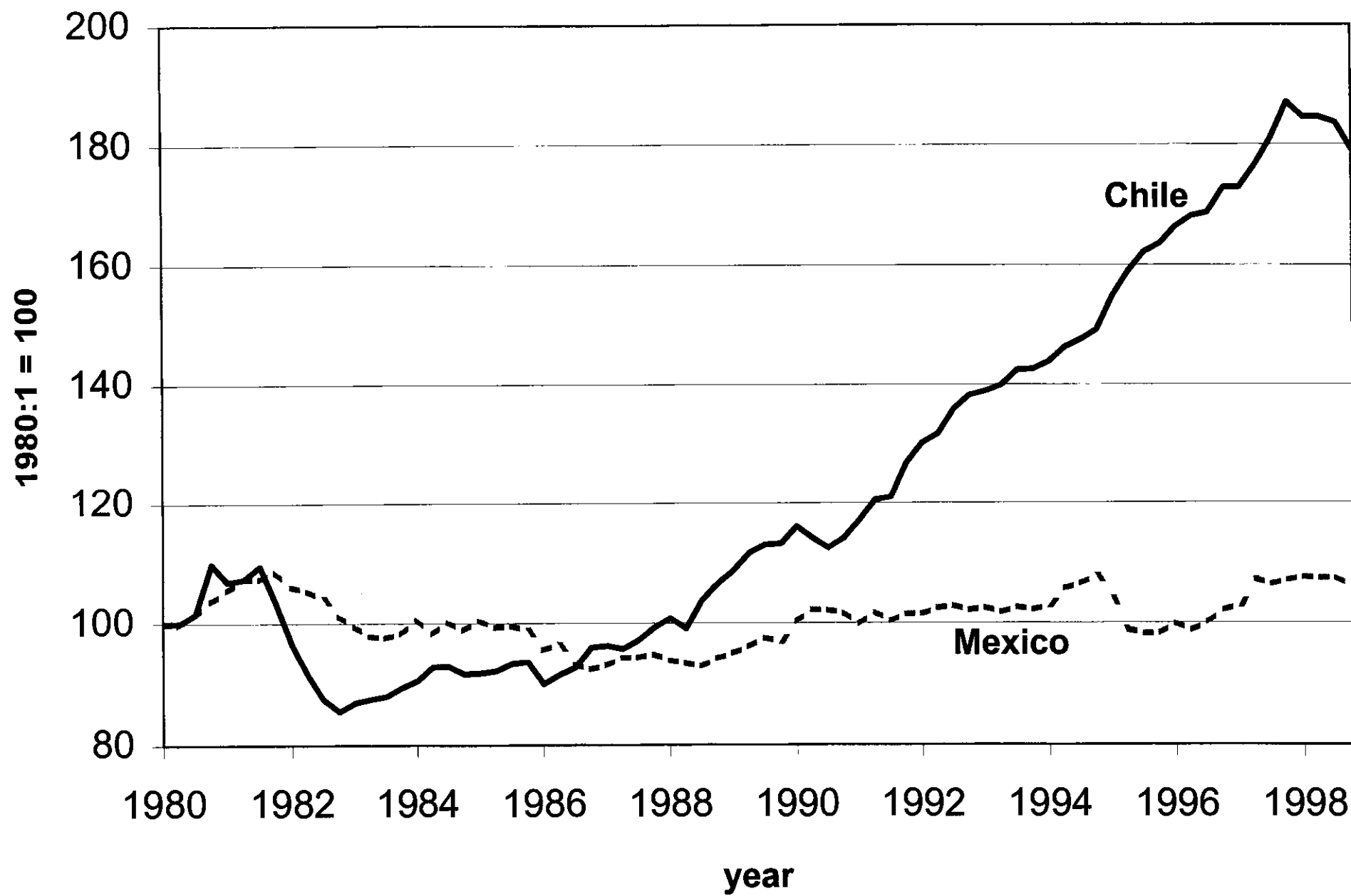
different recoveries

- Chile faster than Mexico

why different pattern?

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## GDP per capita



## **Similar crises**

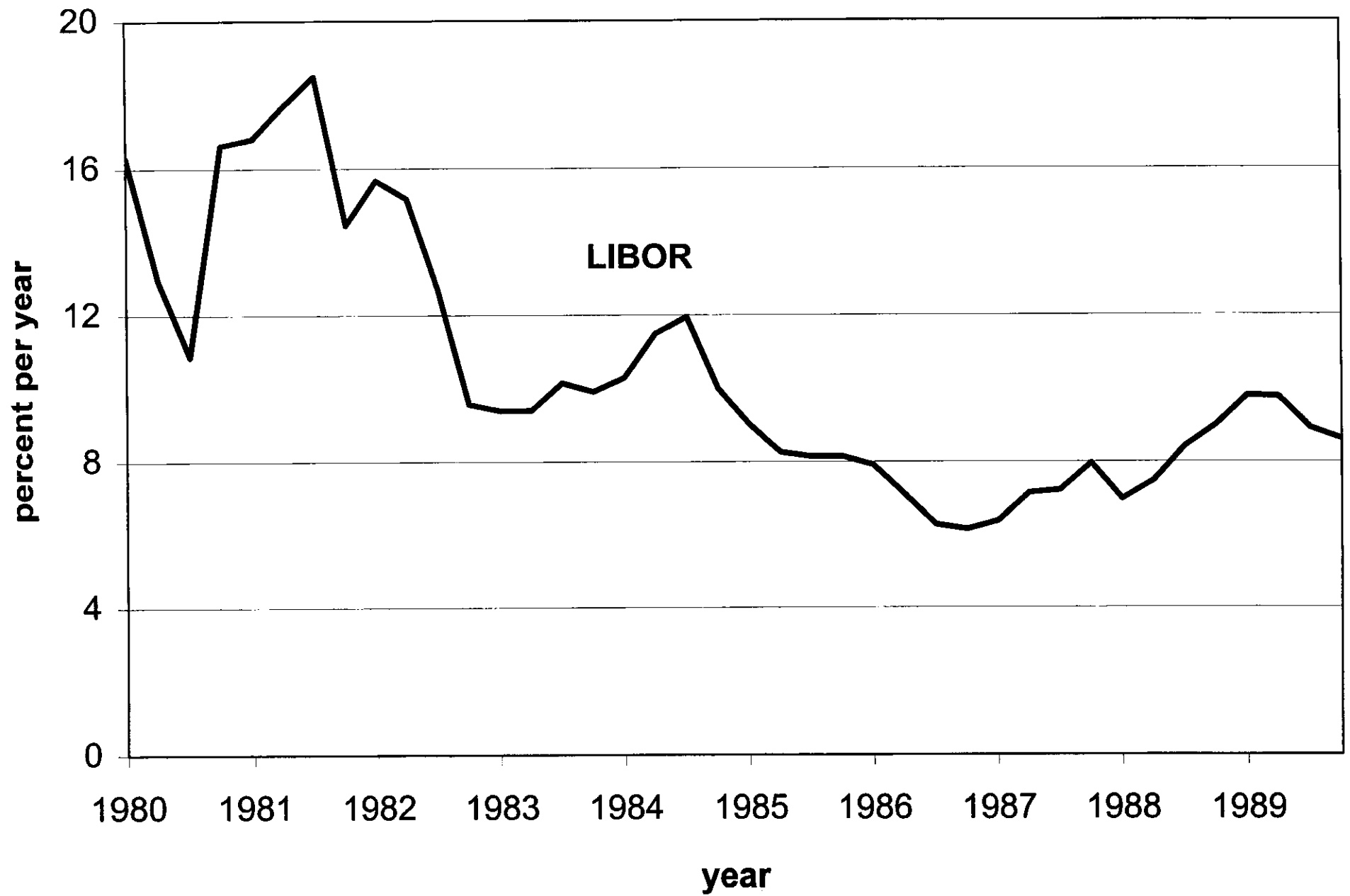
initial conditions

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

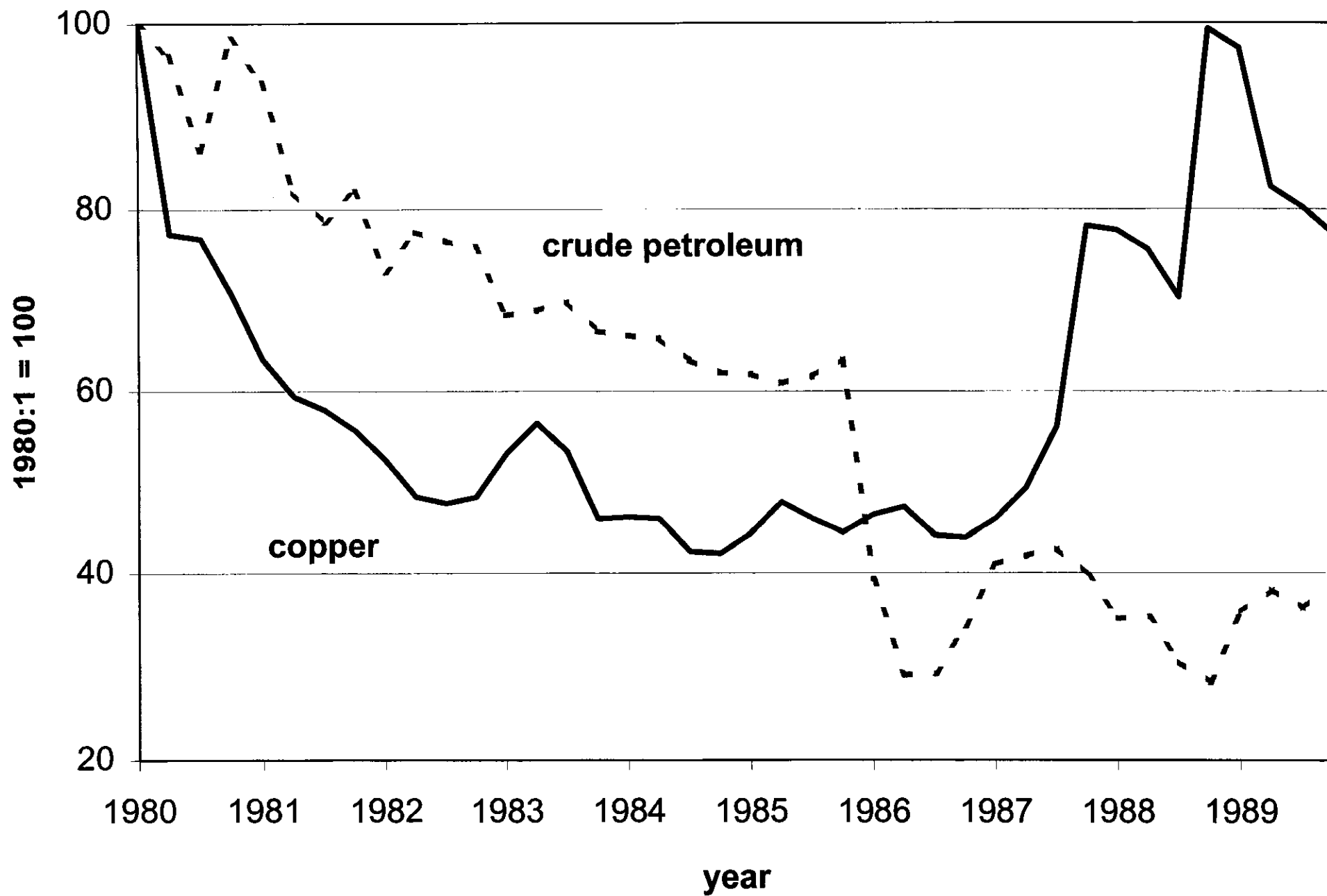
shocks

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

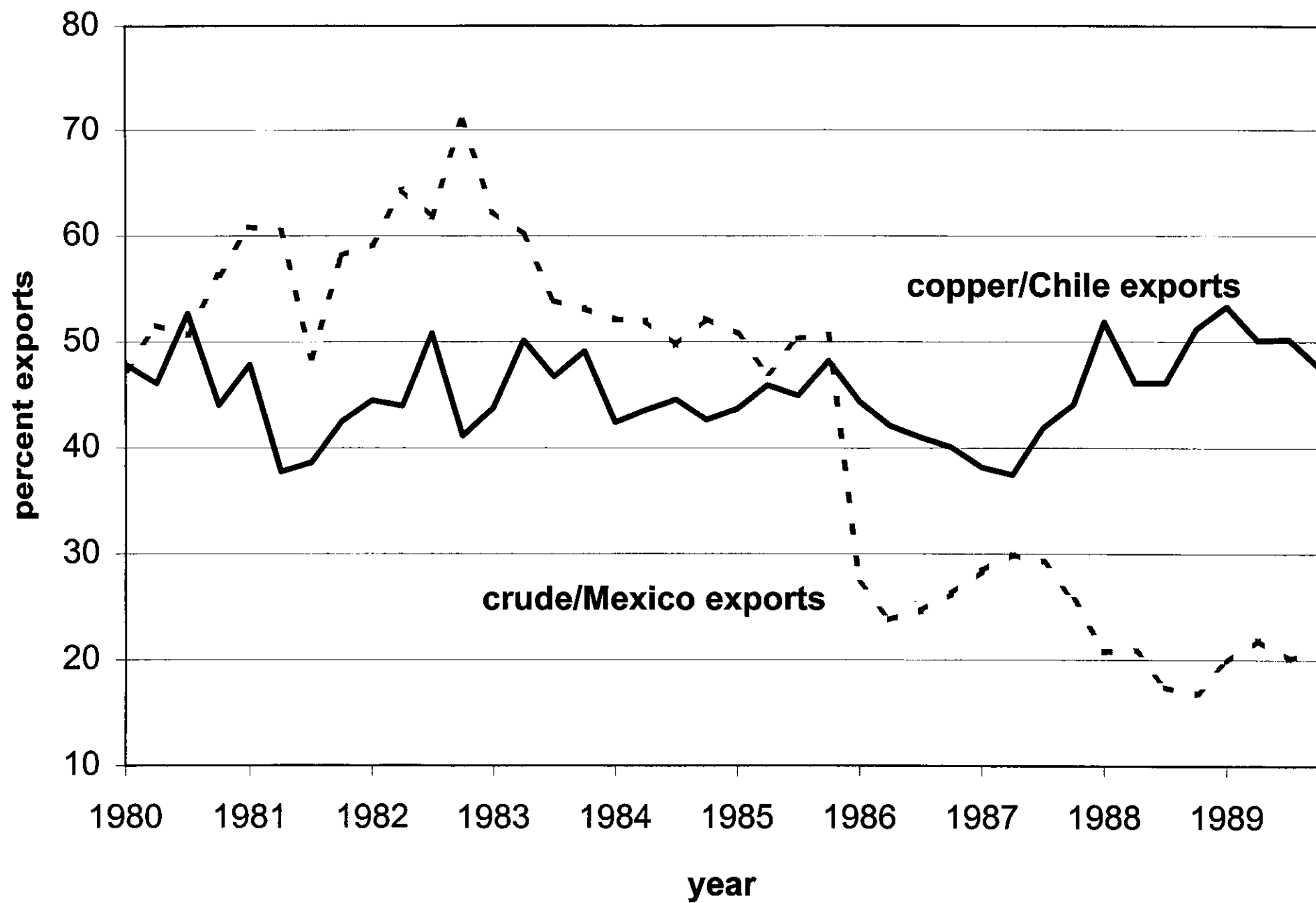
# World interest rate



## 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

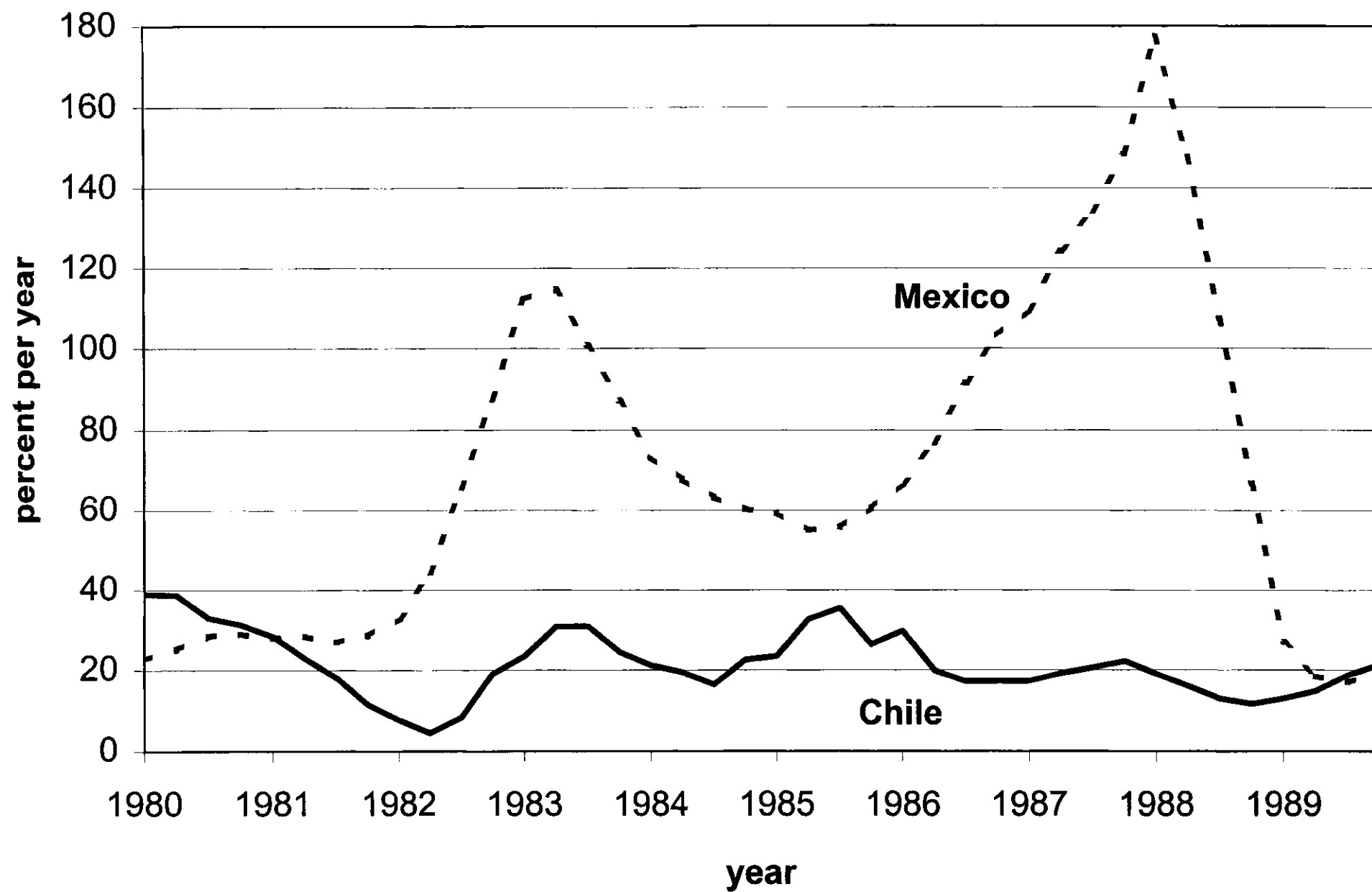
monetary expansions

⇒ rapid recoveries

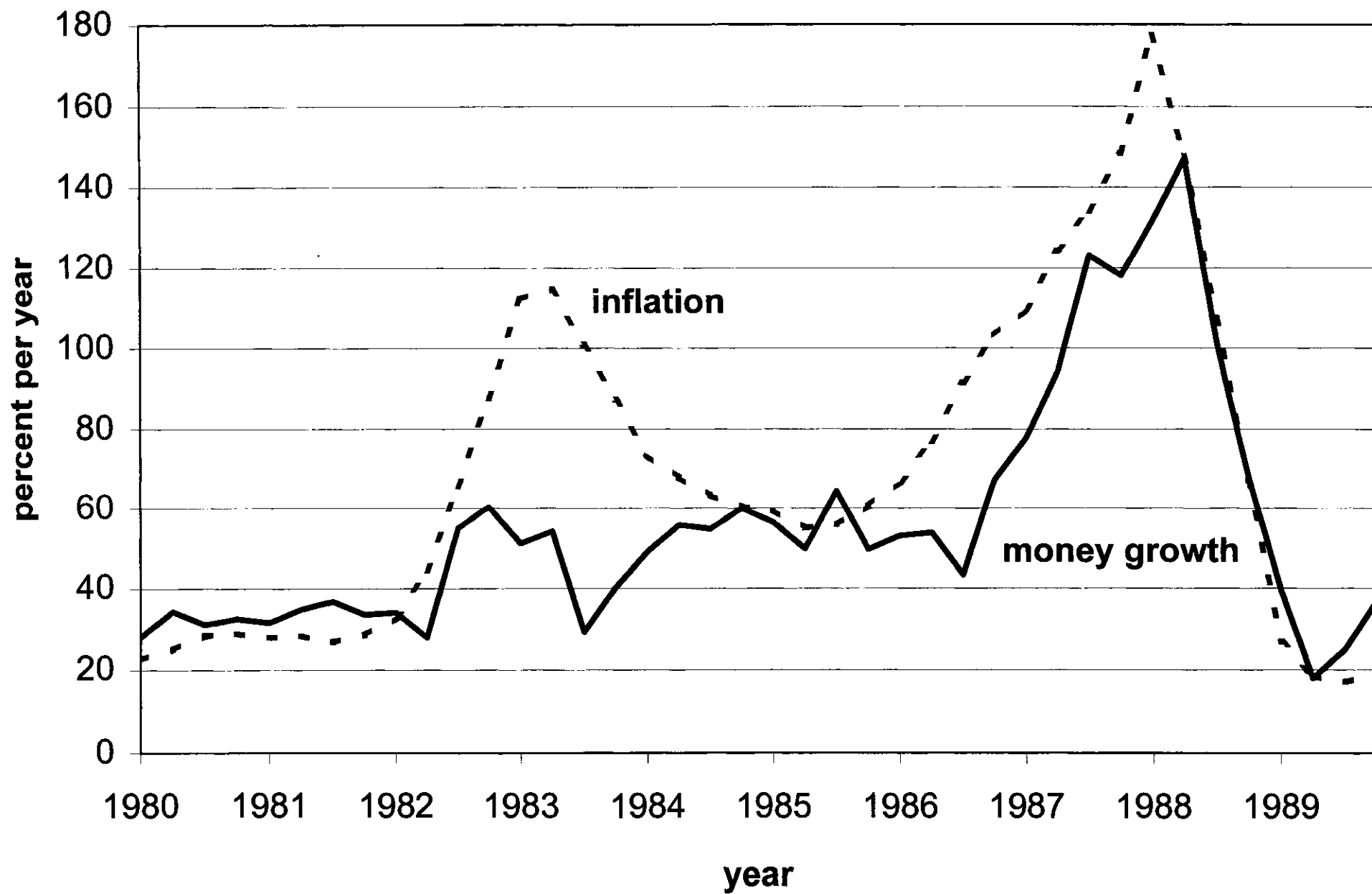
short of inducing hyperinflation, the  
more rapidly a country in a depression  
reinflates, the better

what happened in Mexico and Chile?

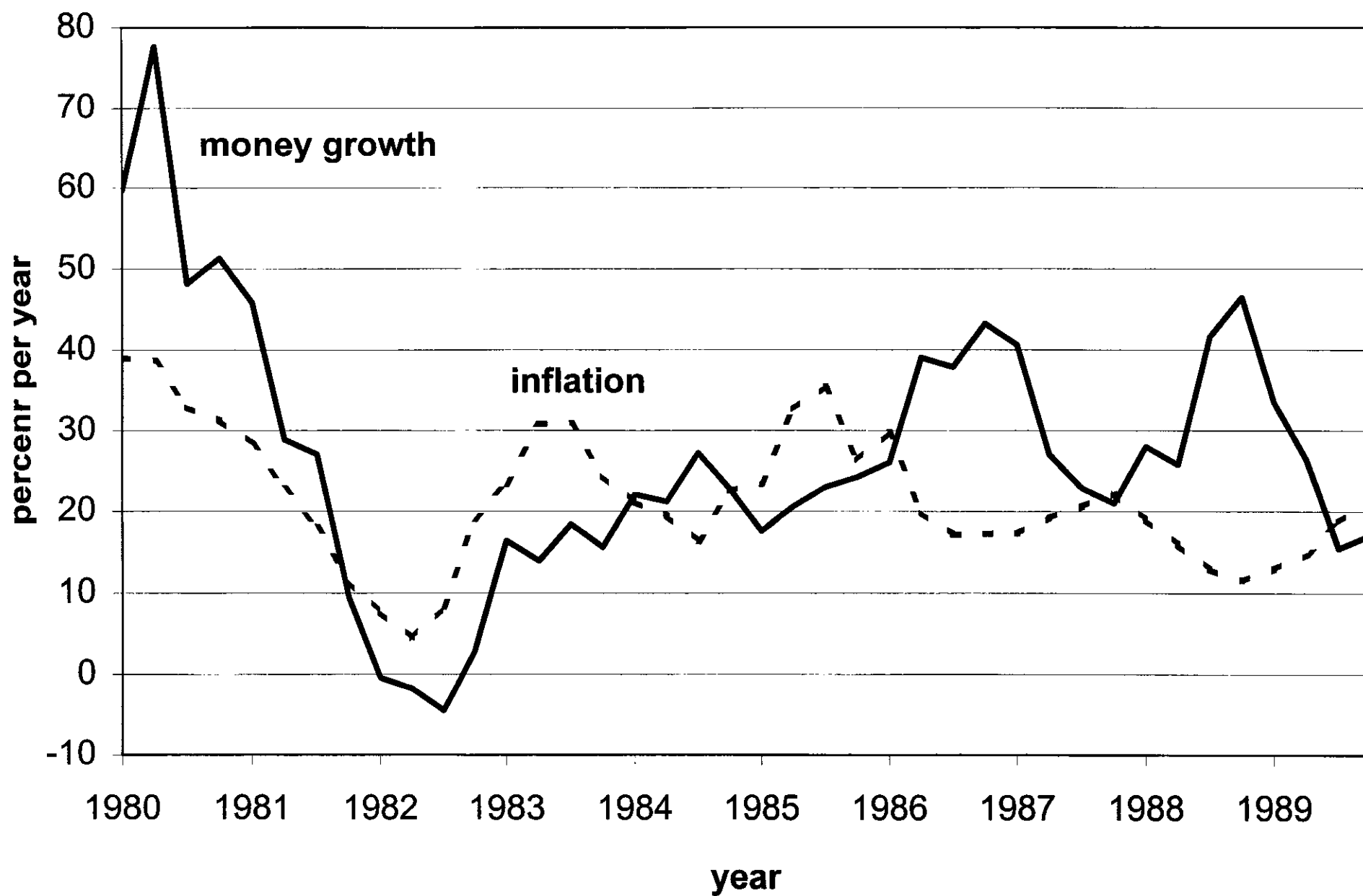
# Consumer price inflation



## 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

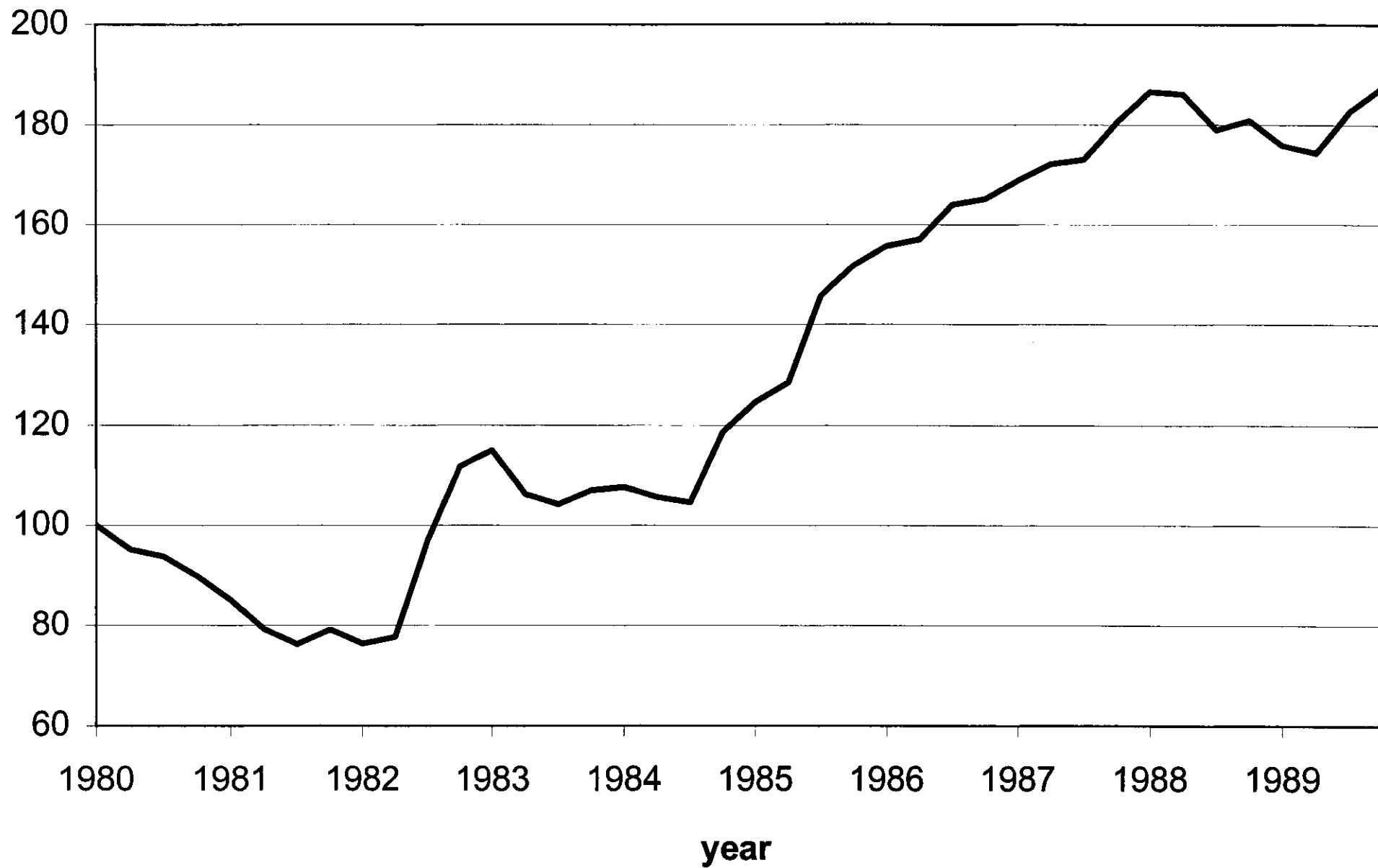
## **Corbo-Fischer story for Chile**

- sustained real depreciation
- decline in real wages

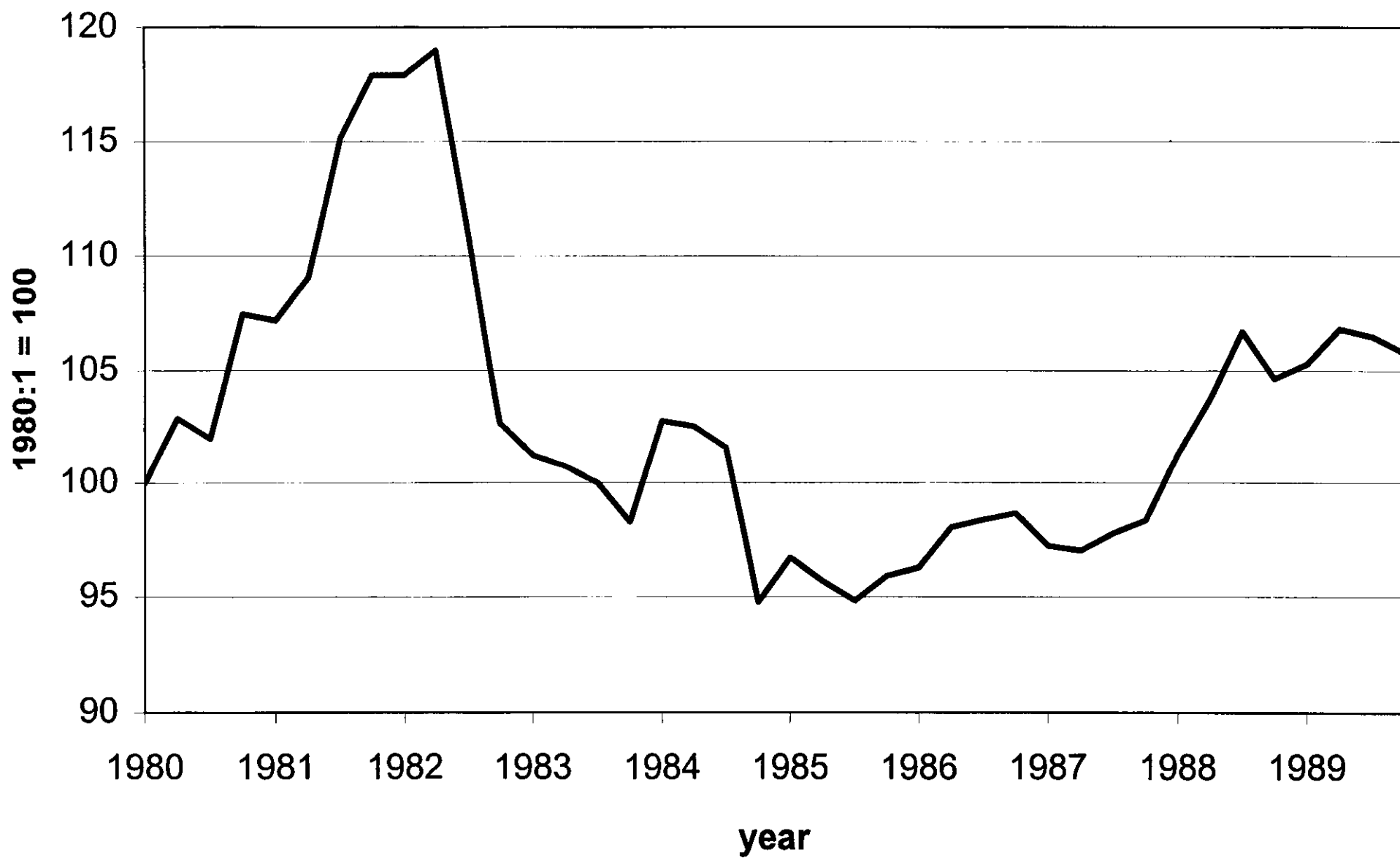
⇒ export-led growth in Chile

# Real exchange rate - Chile

(increase is depreciation)

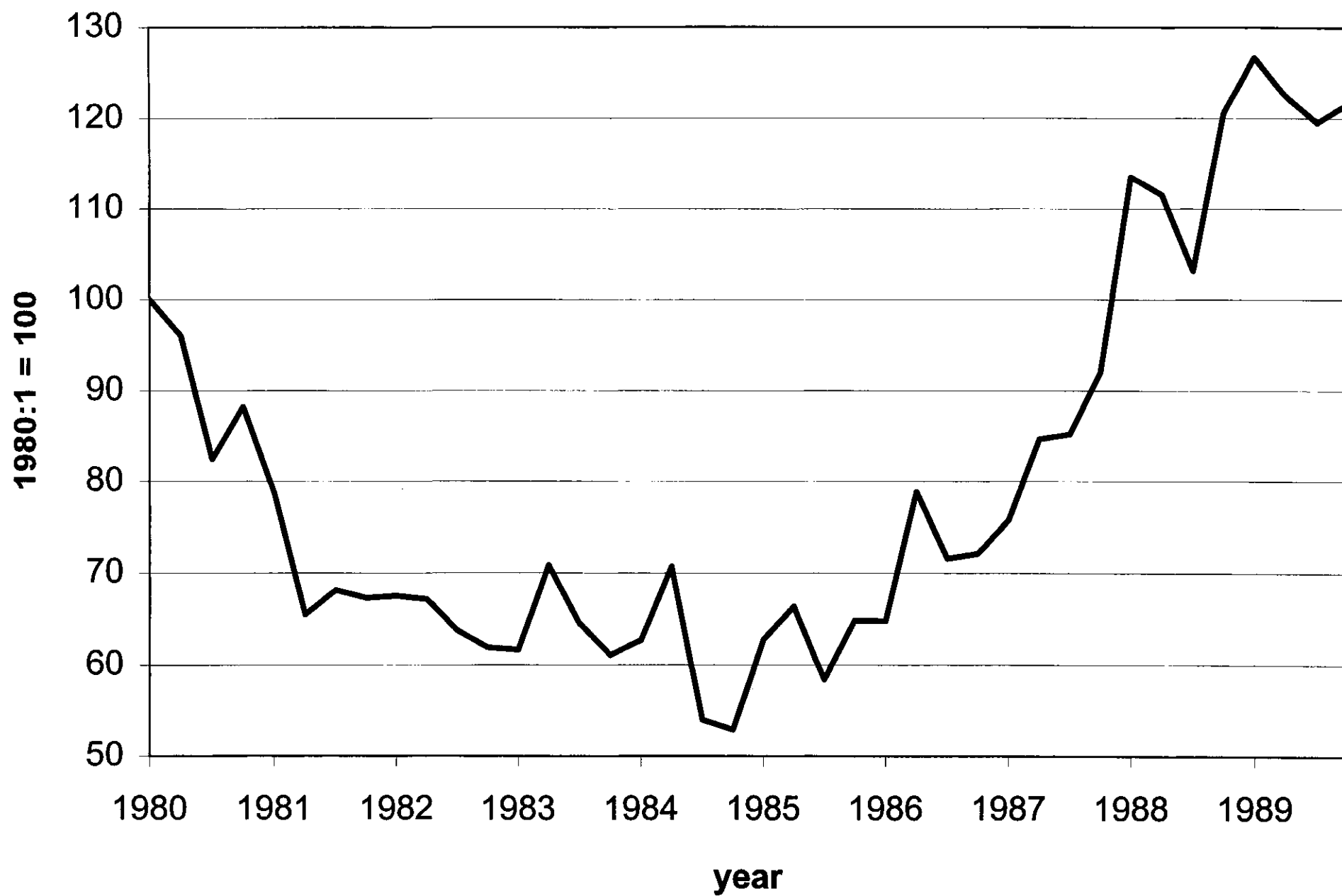


## Real wages - Chile



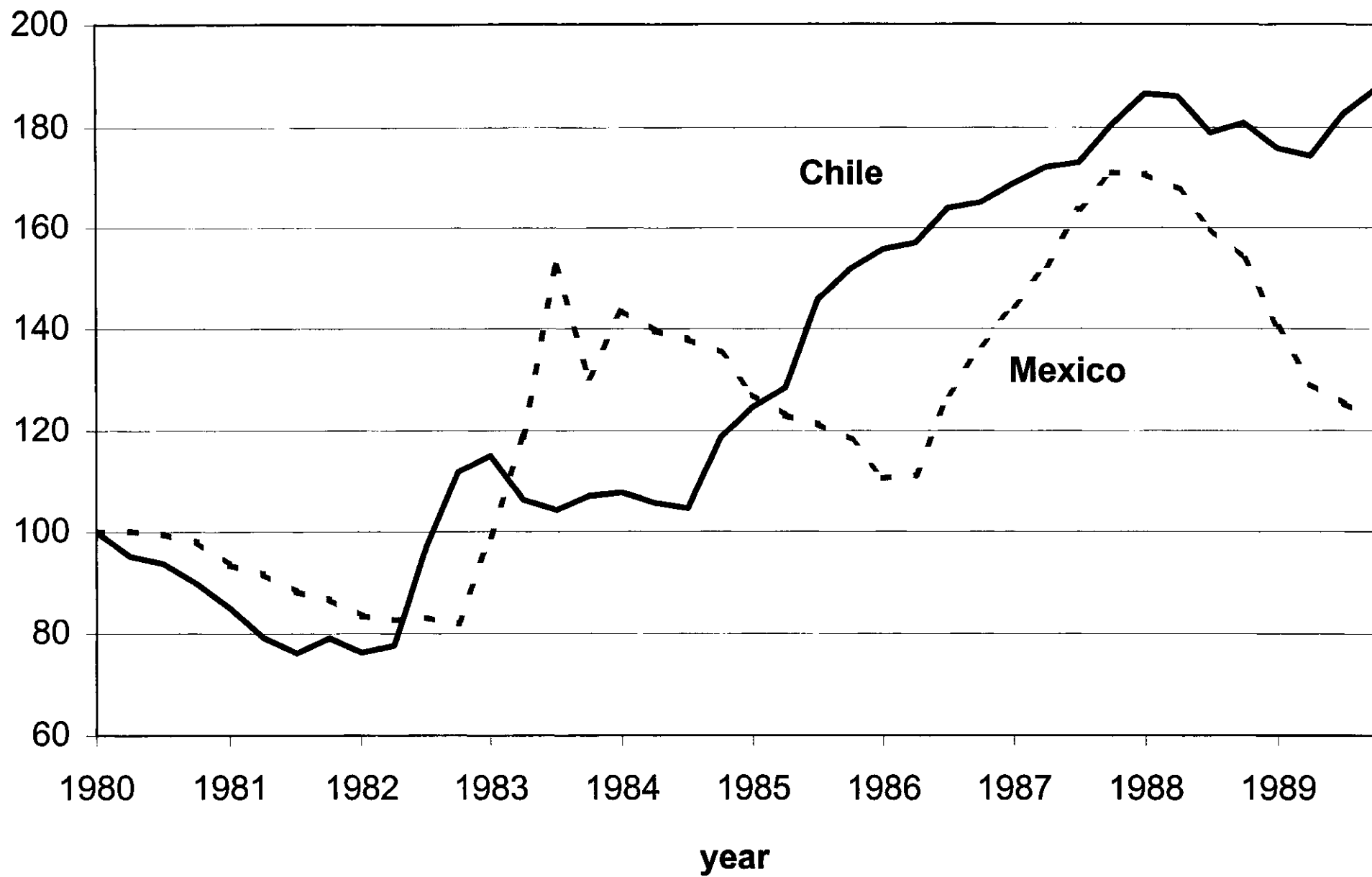


## Real U.S. Dollar Exports - Chile

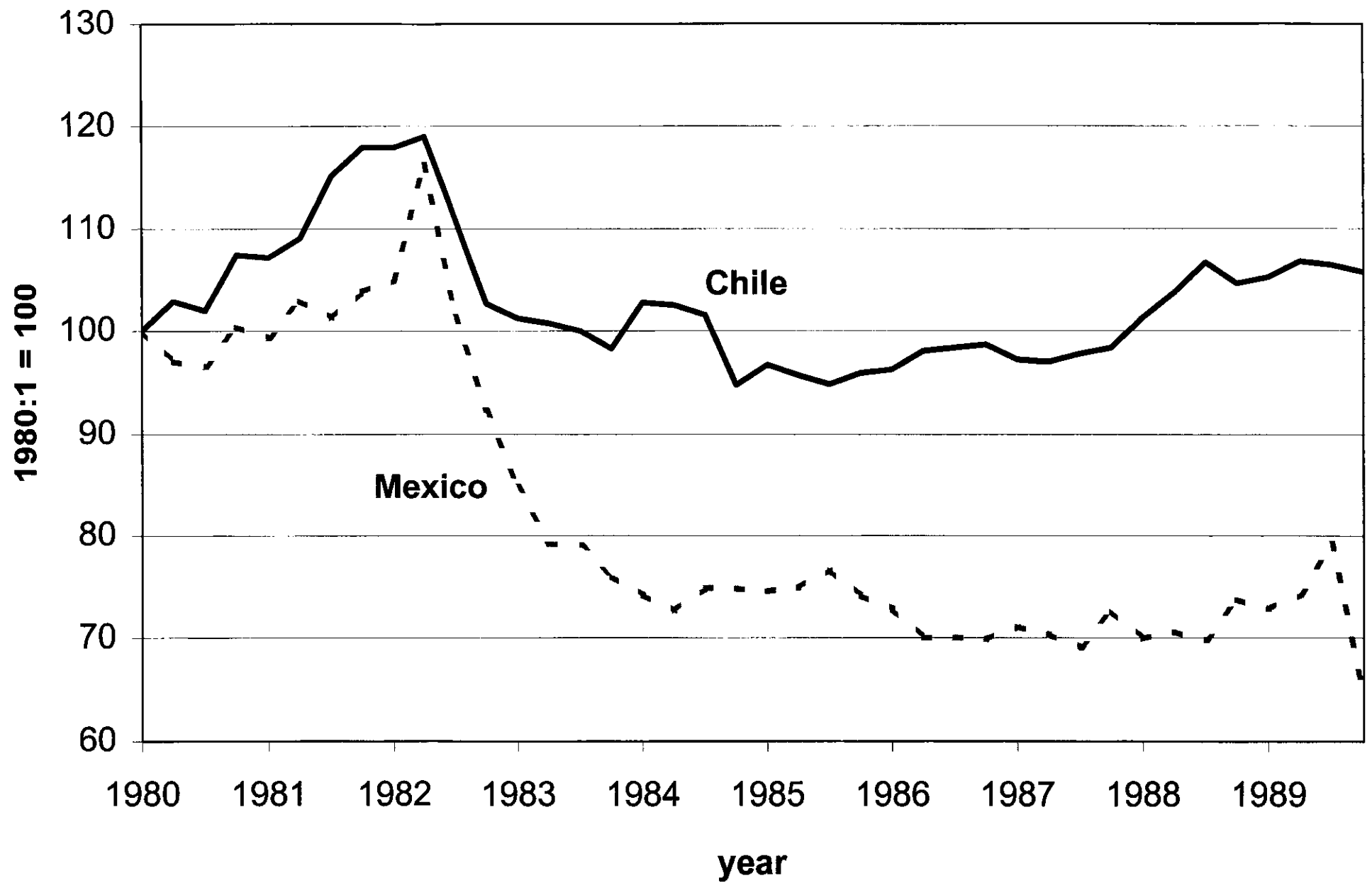


# What about Mexico?

## Real exchange rate

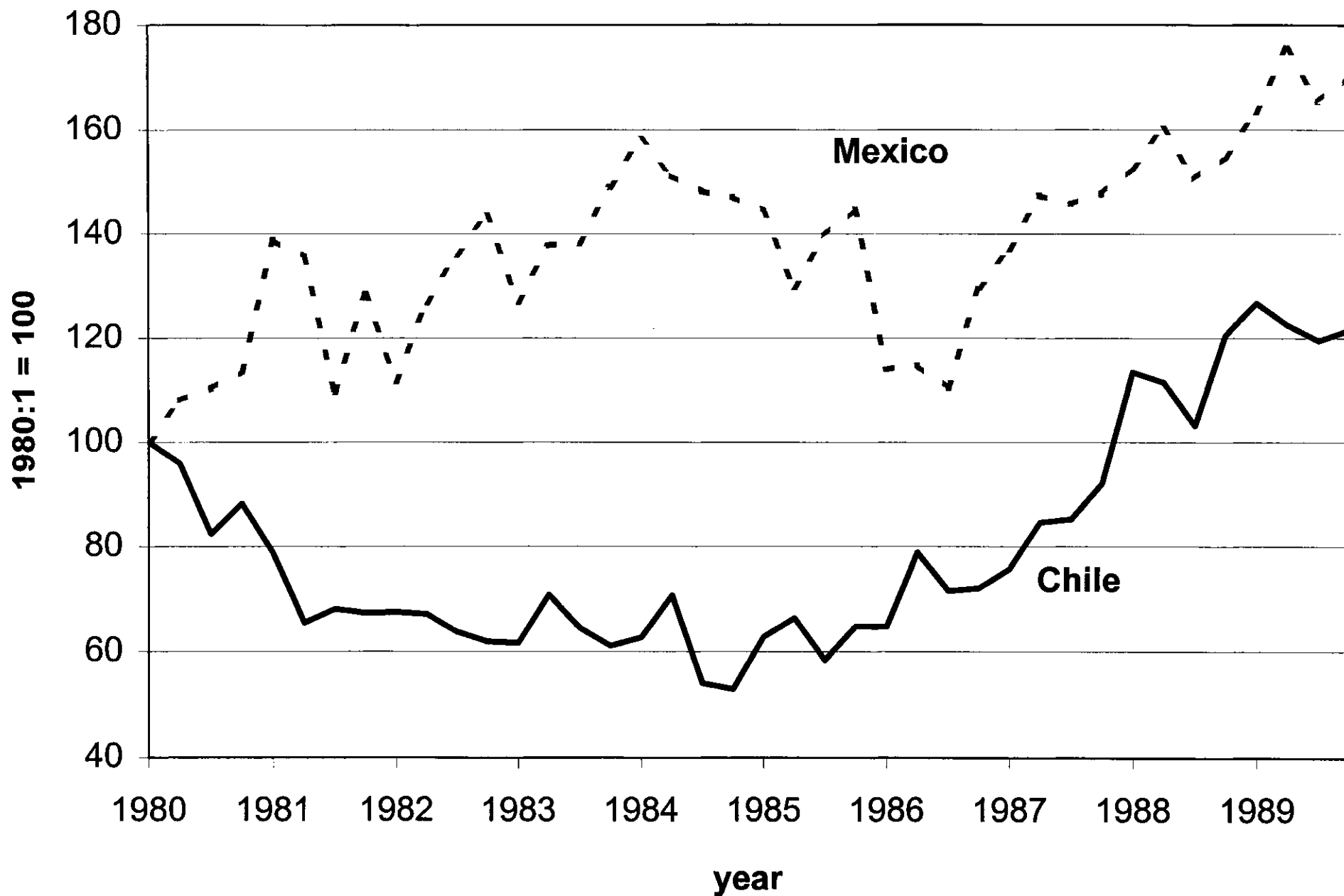


# Real wages



# Real U.S. Dollar Exports

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

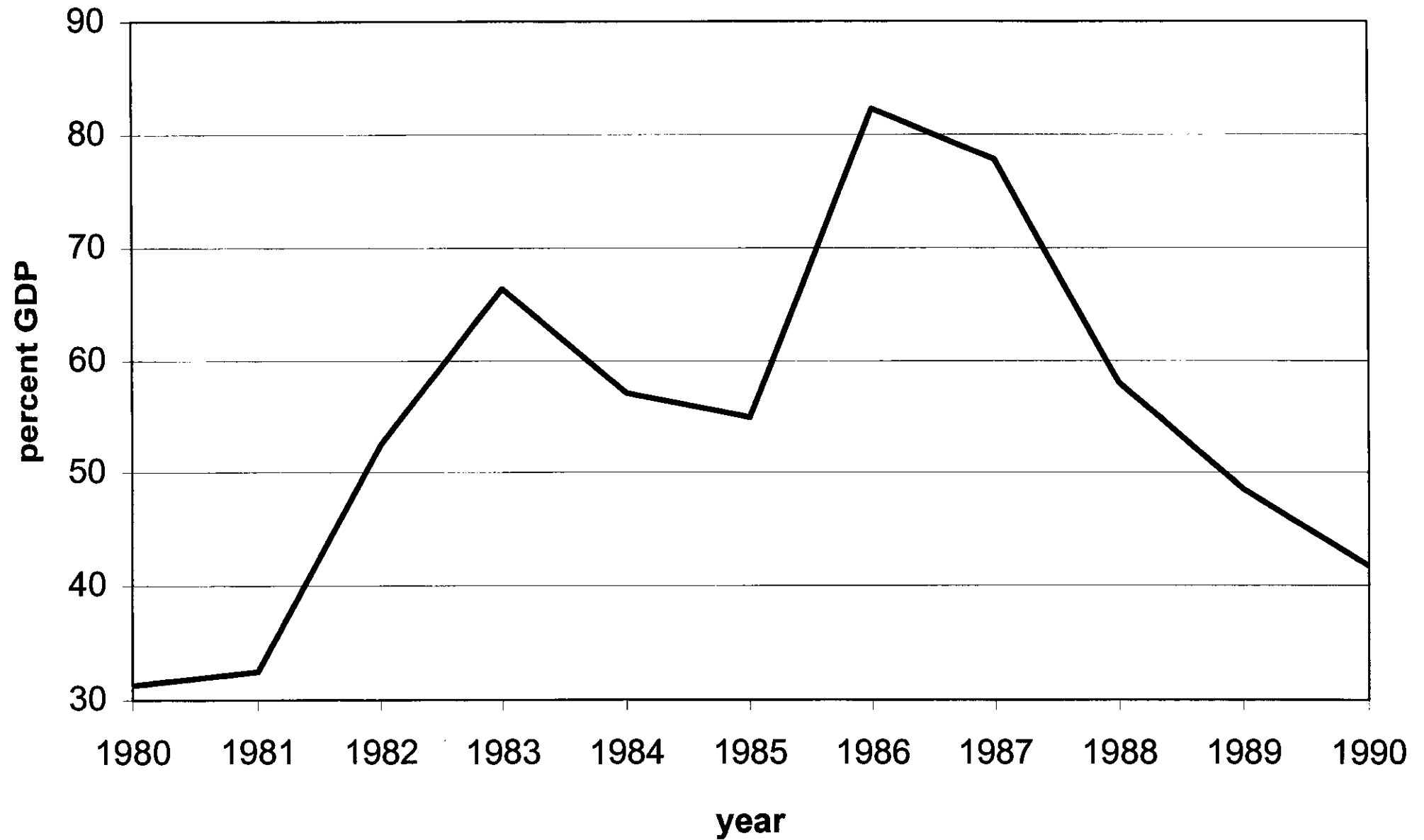


# **Sachs story for Mexico**

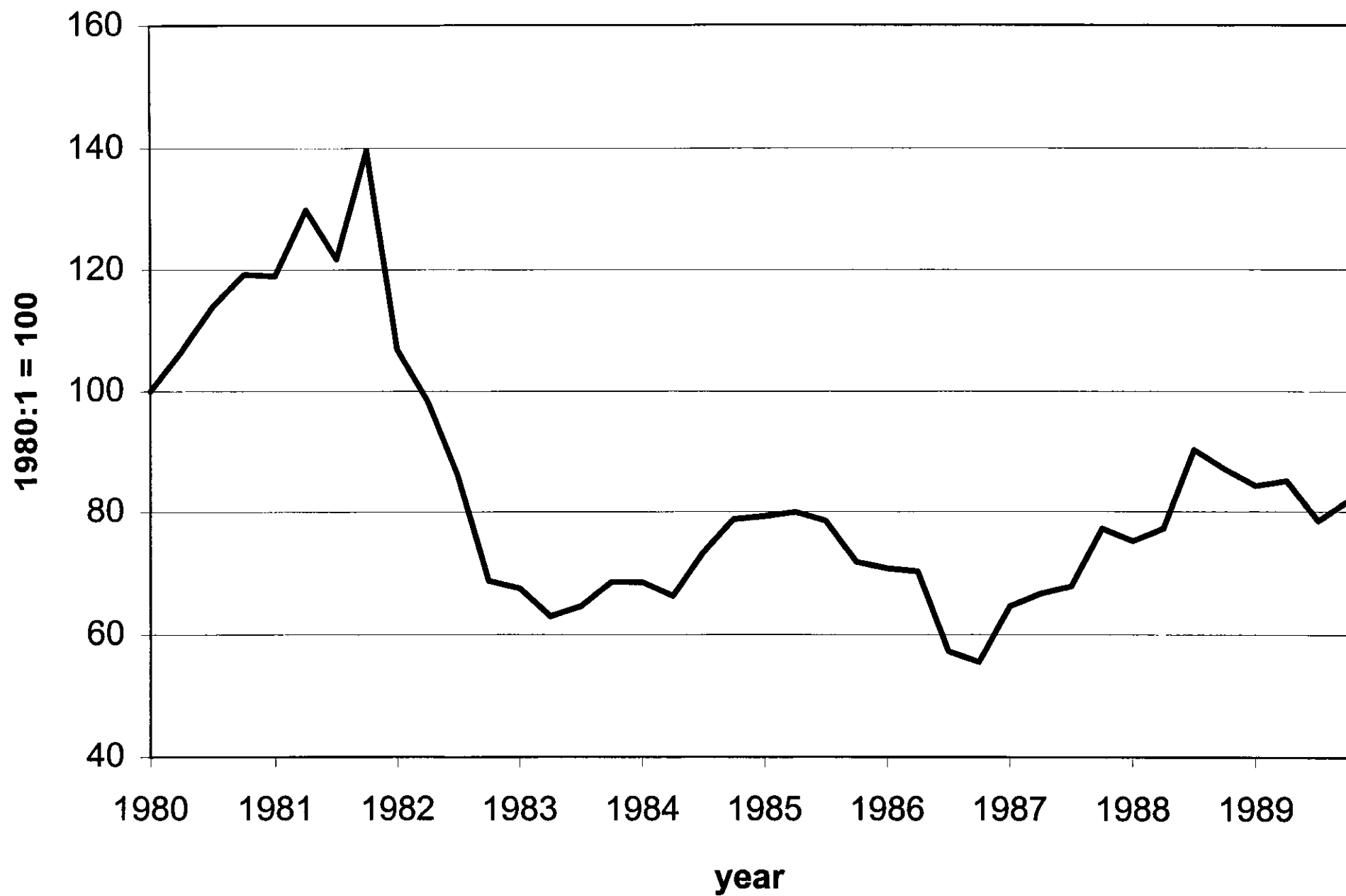
large debt overhang in Mexico

- 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



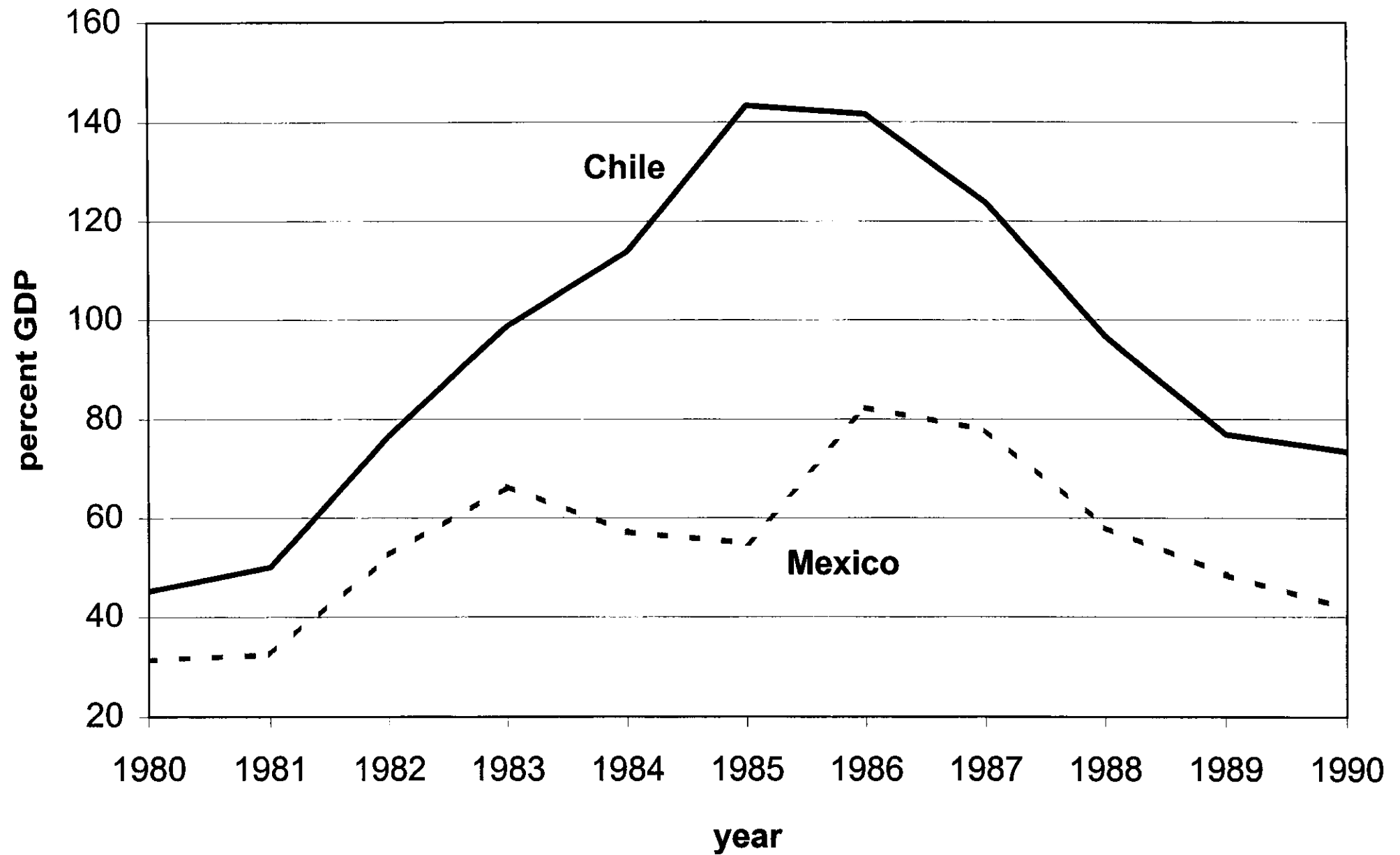
## Real Investment - Mexico





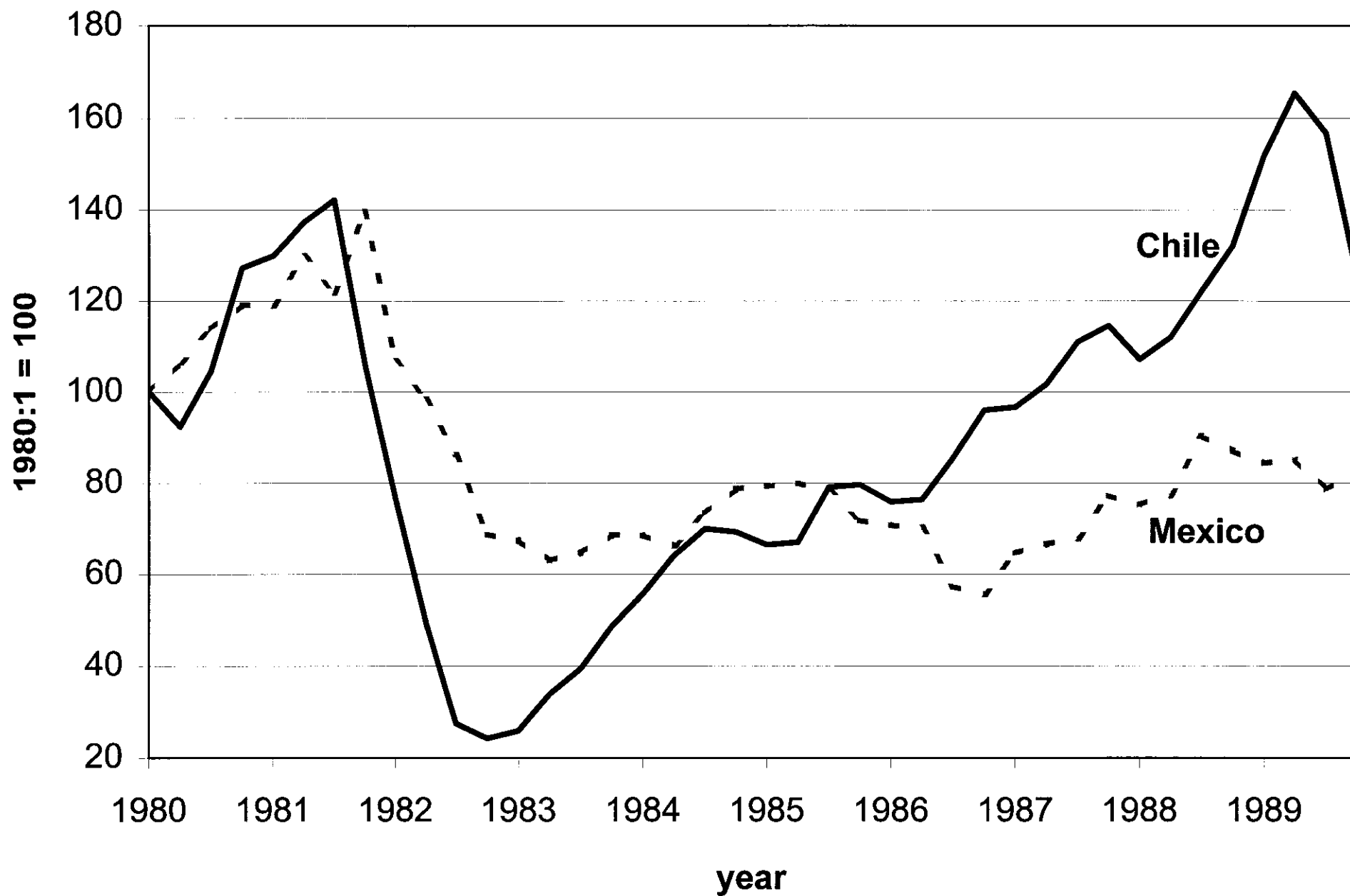
# What about Chile?

## 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**

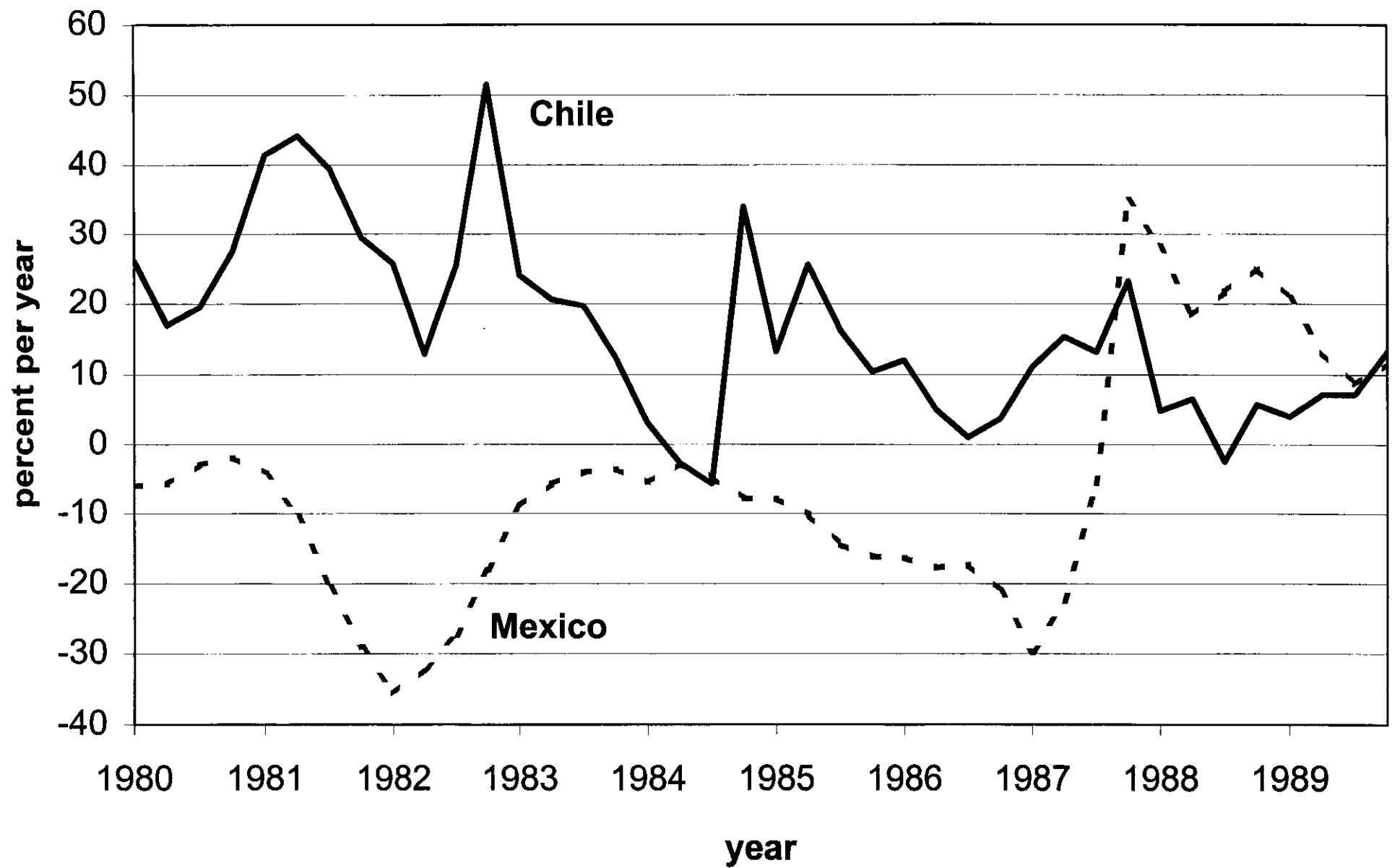
Chile: 1982 and after

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

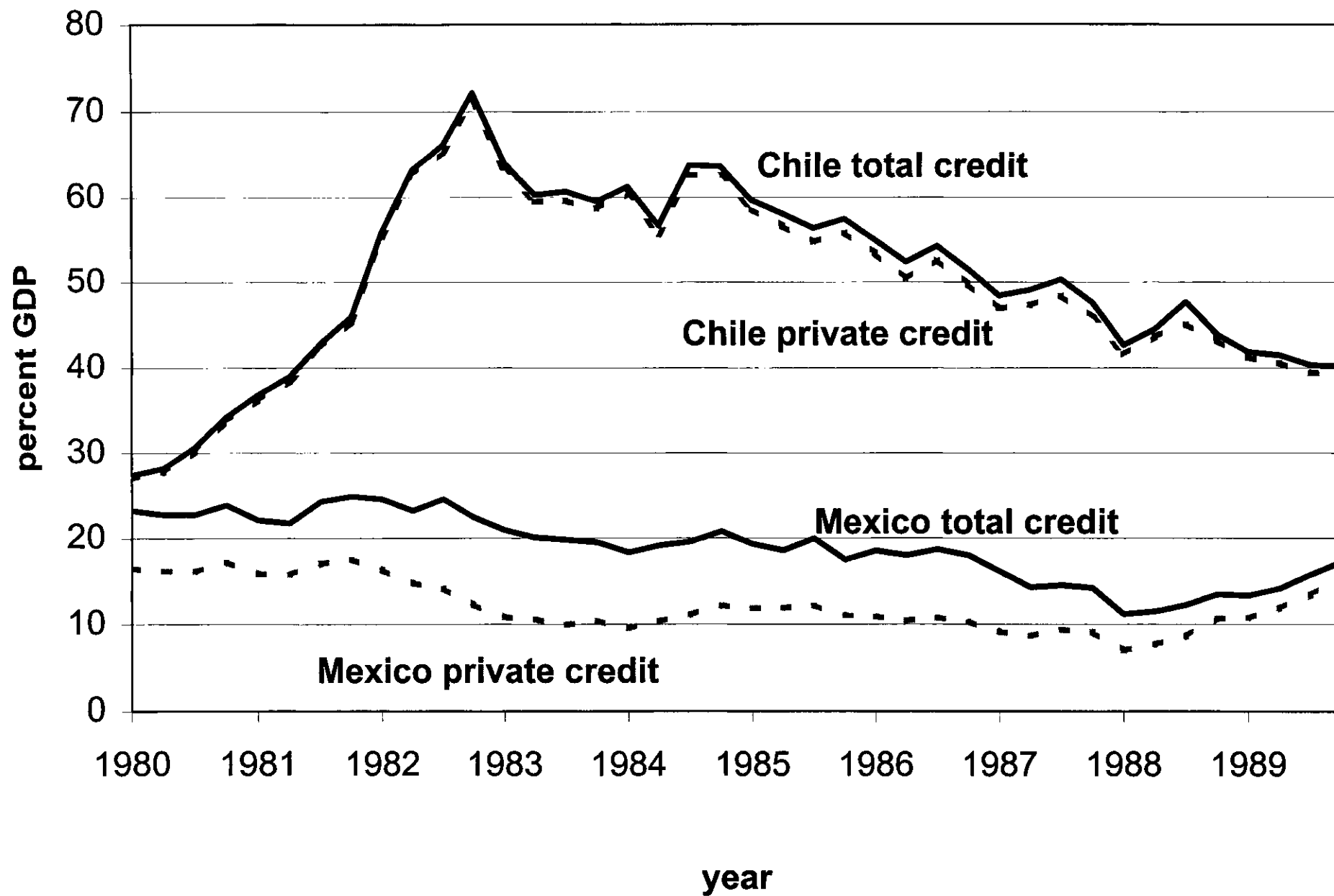
Mexico: 1982 and after

- 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

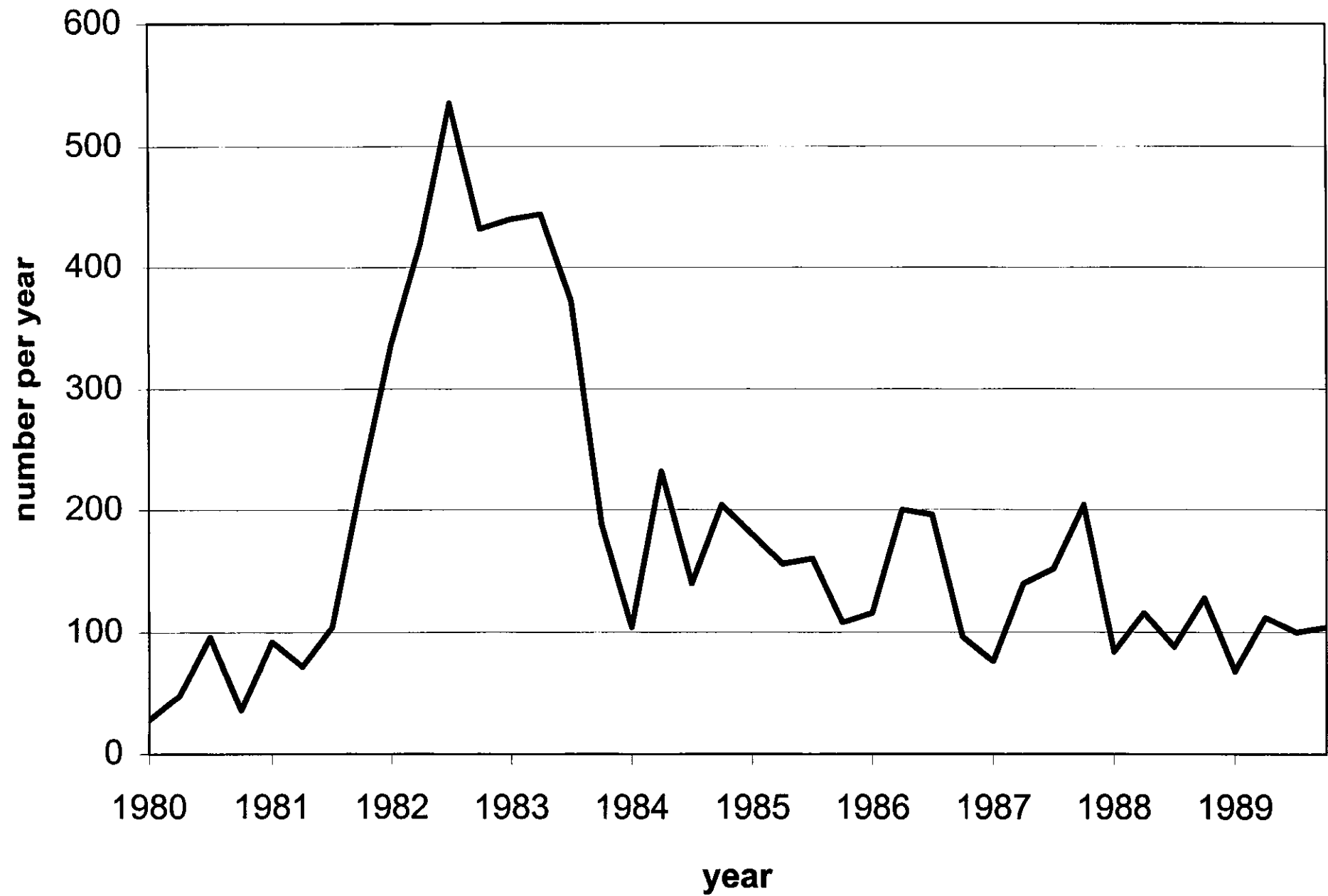
## Chile

- 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**

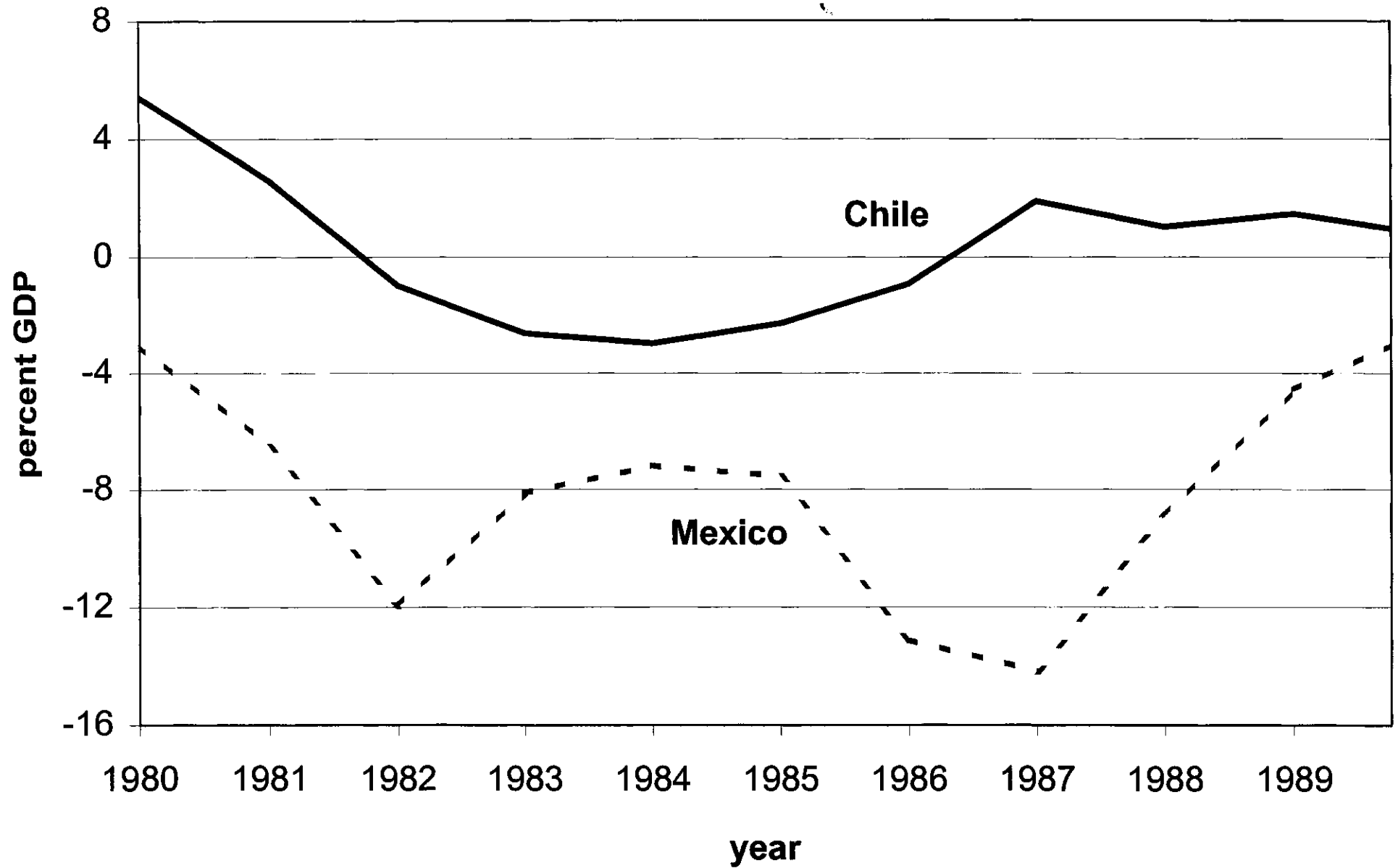
## **Chile**

- 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