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

Raphael Bergoeing
Patrick J. Kehoe
Timothy J. Kehoe
Raimundo Soto

October 2000
Great Depressions Conference
Federal Reserve Bank of Minneapolis
Mexico and Chile in the 1980s

Crisis 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

1980 - 1989

1980:1 = 100

- Crude petroleum
- Copper
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
Consumer price inflation and money growth in Mexico

![Graph showing consumer price inflation and money growth in Mexico.

The graph plots percent per year on the y-axis against years from 1980 to 1989 on the x-axis. There are two lines: one represents inflation and the other represents money growth. Inflation saw a steady increase from 1980 to 1988, peaking and then declining rapidly thereafter. Money growth also saw a steady increase from 1980 to 1988, peaking and then declining more slowly compared to inflation.]
Consumer price inflation and money growth in Chile
Annual Growth Rates
1984:1 – 1989:4

<table>
<thead>
<tr>
<th></th>
<th>Chile</th>
<th>Mexico</th>
</tr>
</thead>
<tbody>
<tr>
<td>money</td>
<td>28.0</td>
<td>68.3</td>
</tr>
<tr>
<td>CPI</td>
<td>20.3</td>
<td>80.4</td>
</tr>
<tr>
<td>GDP/capita</td>
<td>4.2</td>
<td>-0.2</td>
</tr>
</tbody>
</table>
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 - Chile

Year

1980:1 = 100

Year
What about Mexico?
Real exchange rate

Chile

Mexico
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

percent GDP

year

Real Investment - Mexico
What about Chile?
Real Investment

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

[Graph showing real investment for Chile and Mexico from 1980 to 1989]
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
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

![Graph showing number of bankruptcies in Chile from 1980 to 1989. The graph indicates a significant increase in 1982, followed by a decline and subsequent fluctuations.](image-url)
Fiscal reforms

Chile

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

Mexico

• tax reform in 1985
• fiscal deficits
Government surplus

Chile

Mexico

percent GDP

year

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