

# The Fiscal and Monetary History of Chile, 1970-1981

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# General comments

- I don't understand what the purpose of the paper is:
  - Economic history of Chile since 1960?
  - Study the underlying fiscal/monetary causes of inflation/public debt accumulation?
  - Attempt to recount the evolution of fiscal/monetary policy?
  - It seems it wants to attribute base money creation and/or public indebtedness to fiscal policy
- The approach (based on an accounting identity) is more successful with the events during the Allende period, where fiscal policy was evidently one of the major components of inflation
- For the first period of the military government (1974-81), the accounting identity that is at the core of the paper (public sector intertemporal budget constraint) tells only part of the story and obscures more than it illuminates
- External factors don't enter the picture and, most glaringly, private indebtedness, at a time when the public budget was increasingly in surplus

# Let me restate the budget constraint of the government

$$(B_t - B_{t-1}) + (b_t P_t - b_{t-1} P_{t-1}) + (b_t^* E_t - b_{t-1}^* E_{t-1}) + (M_t - M_{t-1}) = B_{t-1} R_{t-1} + b_{t-1} P_{t-1} r_{t-1} + b_{t-1}^* E_{t-1} r_{t-1}^* + D_t + T_t$$

Budget deficit + extraordinary transfers + interest payments on last year's debt (in whatever denomination) must be financed with new debt issuance (in whatever denomination) or with increases in high-power money supply. All in nominal terms. The paper then divides by nominal GDP and gets the ratios needed to calculate the contributions to financing needs and how they were met (table 6).

I don't see here some of the very important stylized facts of Chilean inflation-cum-crises in the 1974-81 period, which are caused by external shocks and private sector borrowing.

# This schema is useful for understanding inflation during the Allende period (1970-73)

- No borrowing capacity, leading to monetary financing of deficits
- 1970-71: large fiscal expansion with relatively mild inflation acceleration, in spite of considerable seigniorage, because of large excess capacity
- 1972-73: even larger fiscal expansion, with even larger base money creation, with accelerating inflation beyond the point where seigniorage yields more real revenues
  - No excess capacity
  - Falling output because of de facto nationalizations and collapse of private sector

# So far so good, but the problem is with the explanation of the 1974-81 period

- Lifting of price controls in **1974-75** led to higher inflation and pressures to expand liquidity, which if not validated would have ended in a depression
- Government is successfully cutting its deficit, not increasing it, so that inflation is not fiscal
- Contributing to inflation is the recession induced by terms-of-trade shocks and huge falls in output
- Therefore, outright inflation is a combination of lifting of repressed inflation and falling output
- I don't see the enormous fluctuations in output in the framework to explain variations in inflation, nor the specifics of the traumatic efforts at normalizing prices

# Things get even more complicated with the period **1976-81**

- Exchange-rate-led stabilization with depreciation lagging past inflation and eventually fixed exchange rate in 1979
- At the same time, opening of capital account and availability of external financing (recycling of petrodollars), with a fiscal surplus, not deficit
- Inflation gradually decelerating
- Huge currency appreciation and current account deficit accommodating capital inflow to PRIVATE sector, not borrowing by public sector
- But the model (which is an accounting identity of the public sector's budget constraint) hasn't brought in the private sector and its role
- With a fixed exchange rate (or a lagging crawling peg), capital inflow produces liquidity expansion that has nothing to do with fiscal policy
- Nothing is said in this schema of international conditions that enabled the authorities to follow these policies: flood of liquidity owing to the recycling of petrodollars, ending with the Mexican crisis of 1982 and retrenchment of international financial flows to all emerging economies