“The Monetary and Fiscal History of Chile 1960-2016”, by Rodrigo Caputo and Diego Saravia

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This presentation reflects the author’s views, not necessarily those of the IMF Board or its Management
Outline

• Very nice chapter: comments in three areas

1. Budget Constraint Decomposition

2. Monetary Policy

3. Fiscal Policy
I. Budget Constraint Decomposition

• Useful decomposition to consolidate broad public sector and fill gaps on public enterprises, bank bailouts, valuation changes
  ➢ 3-4%GDP for Nationalizations in 1970-73, but...
  ➢...where are the proceeds from privatizations in 1975-89?

• Break up first period into two (very different): 1960-70, 1971-73
  ➢Done in text but not in Table: isolate hyperinflation of 1971-73
II. Monetary Policy (1)

• Debate in the 70’s-80’s:

• Fiscal deficits cause Money and Inflation:

• \(\Delta Deficit \Rightarrow \Delta Money \Rightarrow \Delta Prices\), or

• \((\frac{\Delta w}{\Delta e}) \Rightarrow \Delta Prices \Rightarrow \Delta Money\)

  --Chile: deficit shock in 71-73
  --Brazil: change in fiscal regime after 1995
Sargent et al. “Conquest of South American Inflations”

- CHILE
Sargent et al. “Conquest of South American Inflations”

• BRAZIL
II. Monetary Policy (2)

• Paper could refer to **two phases** of Inflation Targeting (Morande, 2002):

  • **1990-1998**: Gradual Disinflation with *declining* target
    ➢ Strong *commitment* (building credibility), not much *flexibility*
    ➢ Policy response during Asian crisis

  • **1999-Now**: Pure Inflation Targeting, 2-4 percent band:
    ➢ *Commitment* (established credibility), more *flexibility*
    ➢ Response to Lehman crisis (interest rate cut from 8.25 to 1 percent in a few months)
Figure 2: Inflation in log-scale (1960-2017)
III. Fiscal Issues (1)

- **Fiscal dominance** ended in 1975 (not 1987)
  - Surpluses in all but a few years

- 1974-1990 (*and beyond*): paper understates the importance of Pension Reforms
  - Surpluses “needed” to lower debt, recapitalize central bank (18-20 percent of GDP), and deal with contingent liabilities of Pension Reform
  - On average 3-4 percent of GDP for 30-40 years: more than 100 percent of GDP to finance remnants of PAYG
Fiscal Surpluses: Repay Debt or Pension Transition?

Figure 20: Fiscal Deficit

Source:
III. Fiscal Issues (2)

- Fiscal Rule: good for smoothing copper price windfall (Frankel 2011, Medina and Soto, 2016)

- The rule has a number of other positive features
  - Independent experts committees; fiscal council
  - Transparency

- However, gaps have emerged in last decade (Caselli et al 2017)
  - Repeated revisions to methodology and surplus target
  - No enforcement mechanism (and weak compliance) or escape clause
  - No clear anchor or connection to public debt (sustainability)
Fiscal Rule: Good for Smoothing
Total Public Debt: No Fiscal Anchor?
III. Fiscal Issues (2)

• Commitment from Individuals or Institutions?
  • Garcia et al (2005): reputation and costs of deviating from self-imposed targets are enough incentive to comply
  • Political economy of fiscal rules (Yared, 2018): other mechanisms may be needed

• Defining moments
  --Asian crisis for IT: commitment reinforced, flexibility ensured
  --Lehman crisis for fiscal: commitment and flexibility, weakened
Background Slide: GDP versus Copper Price