ECON 4311 – Economy of Latin America

Lecture 9B: The Lost Decade

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April 1, 2024

Outline

1. Introduction
2. Origins of the Crises
3. Triggers
4. The Crises
5. Consequences of the Crises

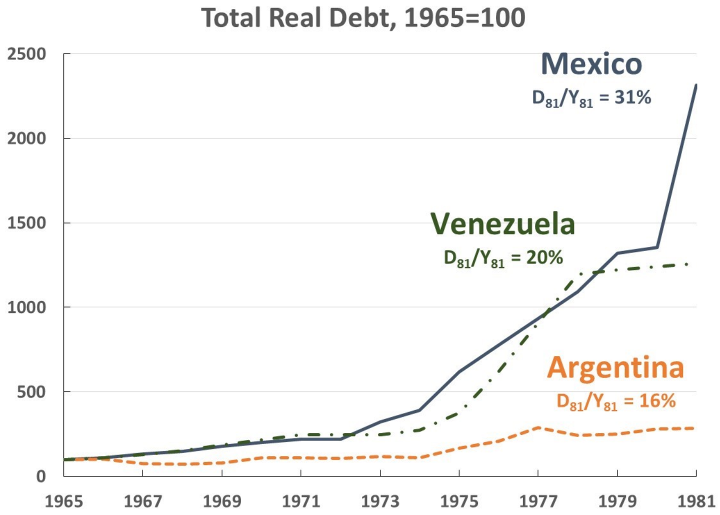
Introduction

- **La "Década Perdida"** (The Lost Decade) is a term used to describe the economic crisis suffered in Latin America during the 1980s.
- Essentially a sovereign debt crisis: in the early 1980s, most LatAm countries realized they could not afford to pay (external) creditors.
- Today:
  - Origins.
  - Triggers.
  - Crises.
  - Consequences.

La Década Perdida: Origins

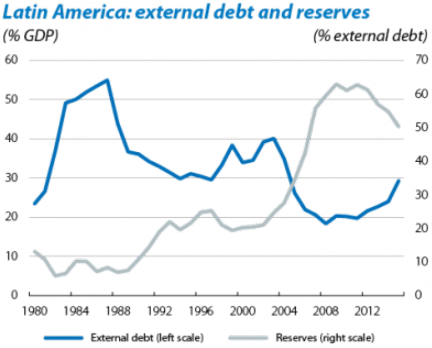
- **Back to Import Substitution Industrialization (ISI)**
  - Set of economic policies aimed at developing domestic industries in order to reduce dependence on imports from other countries.
  - Trade policy, exchange rate policy, targeted lending, SOEs, tax breaks and subsidies to domestic and/or MNCs...
- During 1960s–70s, many LatAm countries borrowed large amounts of money from international creditors to push forward industrialization.
  - Notable examples: Argentina, Brazil, Mexico, Venezuela.
- At the time, these countries exhibited high rates of economic growth, thus creditors were willing to give new, or expand, lending.

La Década Perdida: Origins



La Década Perdida: Origins

- From 1975 to 1983, Latin America more than quadrupled its external debt (from $75,000 to $315,000 millions).
- In 1983, Latin America's external debt amounted to about 50% of the region's GDP.



Source: *CaixaBank Research, based on data from Oxford Economics.*

La Década Perdida: Origins

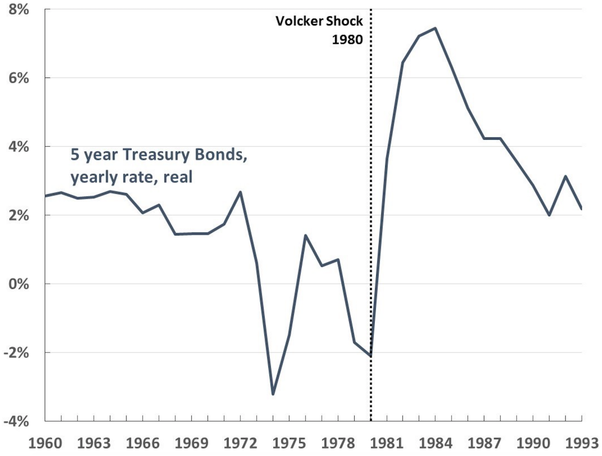
- Initially, most countries obtained loans though international organizations, such as the World Bank.
- After 1973, there were big influx of funds from oil-rich countries which believed that sovereign debt was a safe investment.
  - Sovereign vs. private debt.
  - Why do countries repay their debts?
  - Why do creditors lend to countries?
- Some countries, like Mexico, borrowed against future oil revenues with the debt valued in USD.

The 1980s

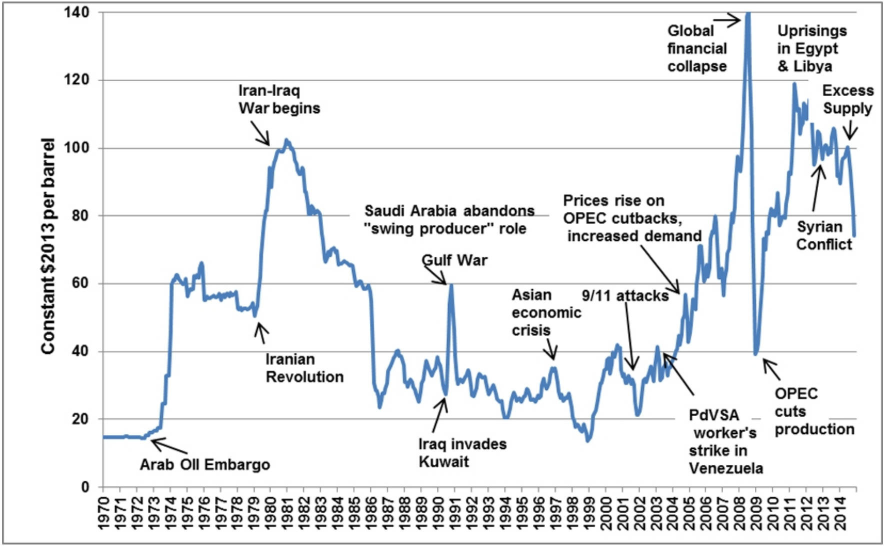
- **Two important things going on in the 1980s**:
  - Volcker shock.
  - Lower prices of primary commodities.
- For most countries in LatAm this meant less available resources, as there were less revenues from exports and more funds had to be allocated to the service of debt.
- **Countries reacted to this**:
  - Devaluating the domestic currency.
  - Creating inflation.
- At some point during the 1980s, it was evident that most countries were unable to repay their debts, which ended in default episodes.

The Volcker Shock

The Volcker shock referes to the increase in real interest rates that occurred during the 1980s with US Fed Chairman Paul Volcker



Oil Prices



Constant $2013 per barrel
140
120
100
80
60
40
20
0
Iran-Iraq War begins
Saudi Arabia abandons "swing producer" role
Gulf War
Prices rise on OPEC cutbacks, increased demand
Global financial collapse
Uprisings in Egypt & Libya
Excess Supply
Syrian Conflict
Asian economic crisis
9/11 attacks
Iranian Revolution
Iraq invades Kuwait
Arab Oil Embargo
PdVSA worker's strike in Venezuela
OPEC cuts production
1970
1971
1972
1973
1974
1975
1976
1977
1978
1979
1980
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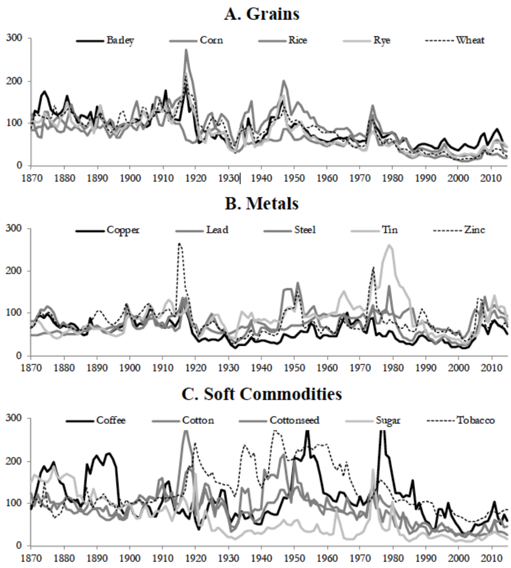
2012
2013
2014

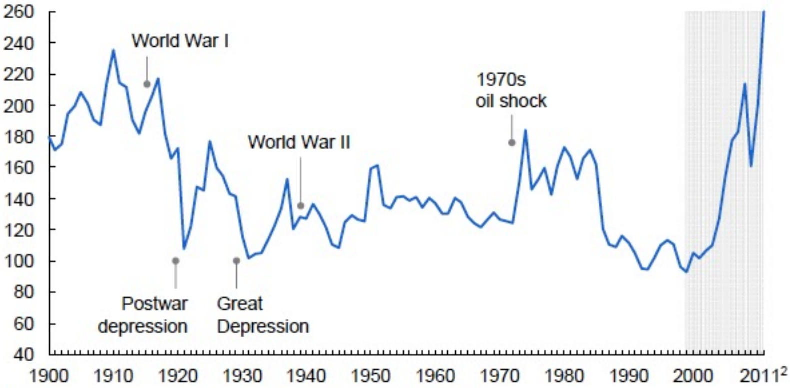
Commodity Price Indexes



MGI Commodity Price Index

Index of 28 prices created by McKinsey, comprising 4 categories: energy, food, agricultural raw materials, and metals.

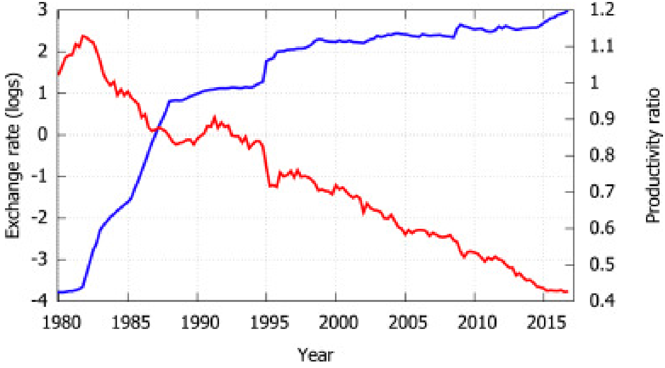
MGI Commodity Price Index (years 1999–2001 = 100)[1]



1 See the methodology appendix for details of the MGI Commodity Price Index.
2 2011 prices are based on average of the first eight months of 2011.

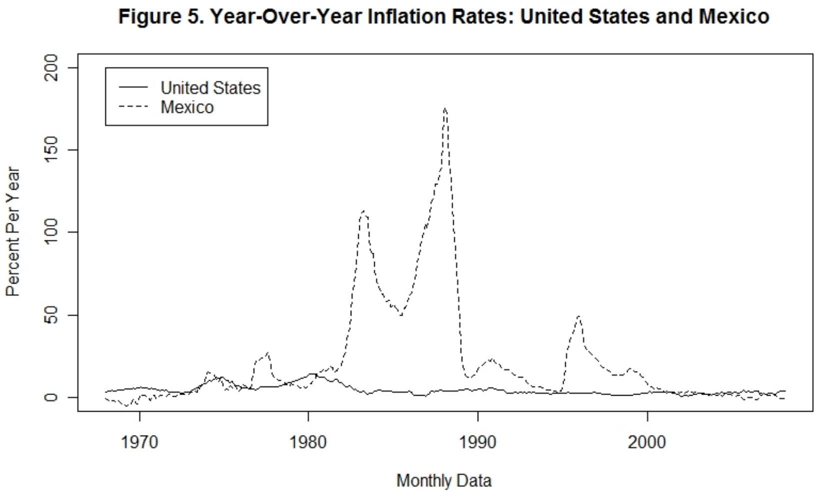
Exchange Rates: MXP/USD

- Depreciation trend of the Mexican peso (MXP) with respect to USD.

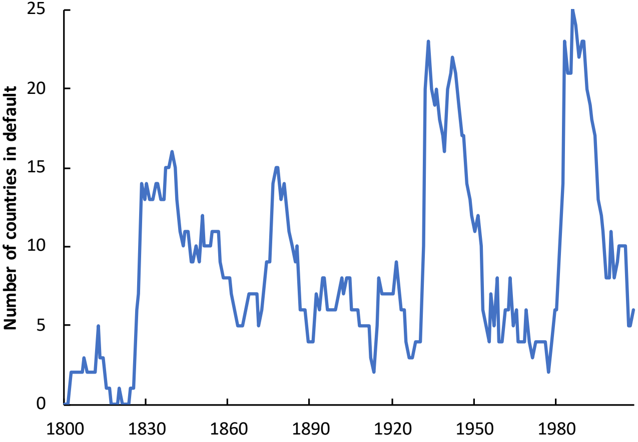


exchange rate MXP/USD productivity MX/US

Inflation in Mexico

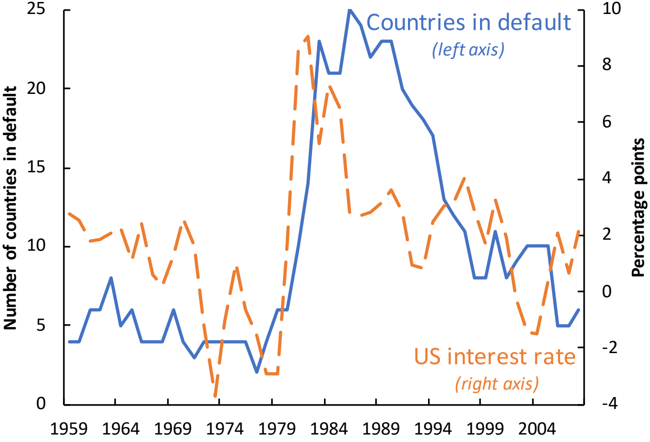


Default

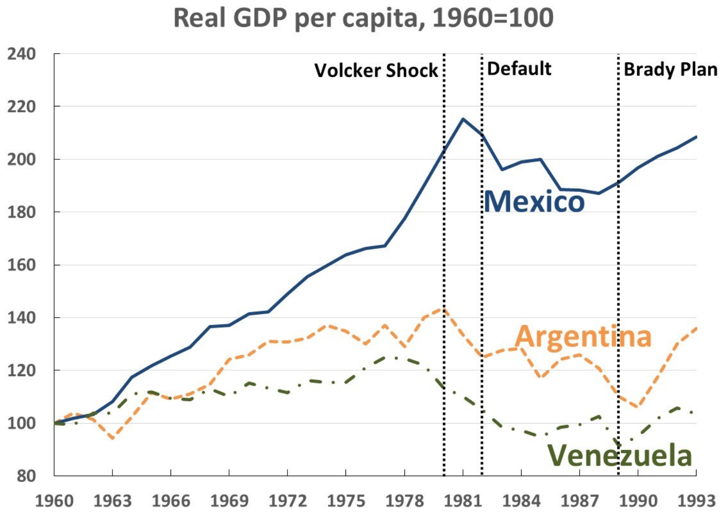


Number of countries in default
25
20
15
10
5
0
1800
1830
1860
1890
1920
1950
1980

Default


Countries in default
(left axis)
US interest rate
(right axis)
Number of countries in default
Percentage points
25
20
15
10
5
0
10
8
6
4
2
0
-2
-4
1959
1964
1969
1974
1979
1984
1989
1994
1999
2004

A Lost Decade



Escaping the Crises

- In the late 1980s, the Bush administration devised the **Brady Plan**.
  - Emphasized debt-forgiveness for highly indebted developing countries.
- This plan emerged as a response to previous failed policies:
  - Initially (1982–85), countries like Mexico were given new loans through commercial banks, the IMF, and other multilateral lending agencies.
    - The hope was that, countries could eventually repay their debts in full.

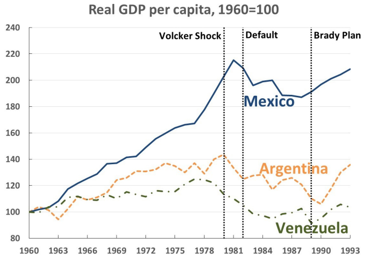
      $\Longrightarrow$ Treated as "liquidity" rather than "solvency" crisis.
    - Eventually it became evident countries were not growing out their debt but rather become more indebted.
  - From 1985 to 1988, the **Baker plan**.
    - Offer new loans conditional on structural reforms (tax reductions, privatization of SOEs, reduction of trade barriers,. . .)
    - By the late 1988, evident again this proposal wasn't working.

Taking Stock

- **La "Década Perdida"** (The Lost Decade) is a term used to describe the economic crisis suffered in Latin America during the 1980s.
  - Essentially a sovereign debt crisis.
- During the 1960–70s, many Latin American countries borrowed large amounts of money from international creditors to push ISI policies.
  - This was possible due to high rates of economic growth.
- **In the 1980s, two crucial things happened:**
  - The Volcker shock.
  - Decrease in prices of primary commodities.
- This meant that it was much harder to service the debt!
  ($\downarrow$ revenues, $\uparrow$ liabilities)

Taking Stock

- **Countries** abandoned ISI policies, devaluated domestic currencies, created inflation, and **ended up defaulting on intl. creditors.**
  - Argentina, Mexico, Venezuela defaulted in 1982.
  - Brazil, Ecuador, Panama, Uruguay in 1983.
- We refer to these episodes as "La Década Perdida" ("Lost Decade") because most Latin American countries missed (at least) a decade of economic growth.



Thank You!