Savings–investment dynamics in Mexico

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Abstract

This study examines the savings–investment relationship and the adjustment of the current account for Mexico over the period 1960–2002. Though savings and investment are cointegrated, the error correction model exhibits structural instability with the onset of the LDC debt crisis in the early 1980s. The inclusion of interactive dummy variables reveals that the current period-pass through of savings to investment is negative and statistically significant in the post-1982 period. This result parallels the results reported by Dooley, M., Frankel, J., & Mathieson, D. J. (1987). International capital mobility: What do saving-investment correlations tell us? *IMF Staff Papers*, *34*, 503–530 and Jansen, W. J., & Schulze, G. G. (1996). Theory-based measurements of the saving-investment correlation with an application to Norway. *Economic Inquiry*, *34*(1), 116–132.
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1. Introduction

It is widely understood that international capital mobility is vital to global resource allocation, allowing for investment beyond what is available from domestic savings. Feldstein

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and Horioka (1980) examine capital mobility in the context of savings and investment correlations. According to Feldstein and Horioka, a high savings–investment correlation is indicative of capital immobility while lower correlations indicate capital mobility.[1] However, a number of researchers question their findings and interpretation and the fact that a high correlations between savings and investment exists is not incompatible with capital mobility.[2]

While there are reservations in the literature with respect to the interpretation of savings–investment correlations as a measure of capital mobility, inter-temporal general equilibrium models suggest that the relationship reflects the inter-temporal budget constraint and current account solvency. This short paper uses the error correction modeling approach proposed by Jansen and Schulze (1996), Jansen (1996), Coakley, Hasan, and Smith (1999), and Coakley et al. (1996, 1998) to examine the savings–investment relationship in the case of Mexico, a country which has experienced a great deal of economic turmoil ranging from the LDC debt crisis of the early 1980s to the currency crisis in 1994. Specifically, the following questions will be answered: (1) To what extent are shocks to savings in the current period pass through to investment? (2) Are saving and investment cointegrated and what is the magnitude of the adjustment? (3) What impact did the LDC debt crisis of the early 1980s and the 1994 currency crisis have on the current period pass through and the adjustment of the current account to long-run equilibrium?

Section 2 provides a brief overview of the Mexican experience. Section 3 discusses the data, methodology, and results. Concluding remarks are presented in Section 4.

2. Brief overview of the Mexican experience

During the 1970s there was a great deal of lending by the international banking community to LDCs in response to attractive investment opportunities. Many of the funds available for such lending originated from petroleum-exporting countries. Vos (1988) argues that in such an environment both investment and savings may rise, as domestic absorption is less than the net inflow of capital, which appears to have happened in Mexico up to the onset of the 1980s. While petroleum-exporting countries like Mexico enjoyed the increased petroleum revenues of the 1970s, the non-petroleum exporting LDCs experienced dramatic declines in income and savings as many of these countries attempted to maintain previous

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[1] See Tesar (1991) and Coakley, Kulasi, and Smith (1998) for excellent surveys of the literature and issues surrounding the Feldstein–Horioka result.

[2] Obstfeld (1986) attributes the high correlation to labor force growth and the procyclical nature of savings and investment. Coakley, Kulasi, and Smith (1996, 1998), among others, argue that the high savings-investment correlation is simply a reflection of a binding inter-temporal budget constraint and current account targeting by government authorities. Harberger (1980), Baxter and Crucini (1993) and Ho (2003) provide evidence to suggest that the savings–investment correlation depends on country size. Murphy (1984) and Wong (1990) emphasize the impact of the non-traded goods sector in explaining the high savings-investment correlation. Sachsida and Caetano (2000) provide theoretical justifications that the savings-coefficient in the Feldstein–Horioka savings–investment regressions measures the degree of substitutability between domestic and external savings, and not capital mobility.