



Institution shocks and economic outcomes: Allende's election, Pinochet's coup and the Santiago stock market

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ABSTRACT

To study the effect of political and institutional changes on the economy, we look at share prices in the Santiago exchange during the tumultuous political events that characterized Chile in the early 1970s. We use a transparent empirical strategy, deploying previously unused daily data and exploiting two largely unexpected shocks which involved substantial variation in policies and institutions, providing a rare natural experiment. Allende's election and subsequent socialist experiment decreased share values, while the military coup and dictatorship that replaced him boosted them, in both cases by magnitudes unprecedented in the literature. The most parsimonious interpretation of these share price changes is that they reflected, respectively, the perceived threat to private ownership of the means of production under a socialist government, and its subsequent reversal.

1. Introduction

The importance of institutions as an influence on wealth, growth, distribution and other economic outcomes is now widely recognized (Acemoglu et al., 2005; Simon, 1991; North, 1991). But fundamental institutional changes are typically protracted and associated with other changes affecting economic outcomes, making the identification of causal effects and the mechanisms underlying them difficult.

The election of Salvador Allende's socialist government in Chile in 1970 and its subsequent reversal by a military coup in 1973 provide a curiously unexploited opportunity to study the effect of institution shocks on economic outcomes.¹ Unidad Popular (UP), the left-wing political coalition that supported Allende, promised, and after elected

took steps to implement profound changes to economic institutions and the structure of property rights, towards the final goal of replacing capitalism with some form of socialism. The military coup that ended Allende's socialist experiment promised a return to pro-business policies, but now under authoritarian rule.²

From a research standpoint, the importance of these events lies not only in the large institutional and policy variation involved, but also in the fact that the outcome of the 1970 election was a surprise. Prior to the election, for example, the leading daily *El Mercurio* had published a number of polls showing Jorge Alessandri (a rightwing independent who had been president from 1958 to 1964) leading Allende by a considerable margin (Table 1). We will use data from vote expectation surveys to show that the perceived probability of a socialist victory was

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¹ The epigraph is from a 12:32 pm telephone conversation in Washington. Source: Library of Congress, Manuscript Division, Kissinger Papers, Box 364.

² Major sources on the history of the Allende government and of the military coup are Stallings (1978), Sigmund (1977), Boorstein (1977), Nef (1983) and Larraín and Meller (1991).

Table 1
Voting intention surveys taken before the 1970 Presidential election.

Survey date	Area	n	Tomic	Alessandri	Allende	Undecided	Allende margin
11–13 April	Gran Santiago	1217	26.3%	38.9%	25.0%	9.8%	–15.4
24–27 April	Gran Santiago	1108	28.3	40.6	27.1	4.0	–14.1
24–27 April	Valparaiso-Vina	621	28.4	42.4	25.4	3.8	–17.7
24–27 April	Concepcion-Talcahuano	648	37.1	30.0	23.5	9.4	–15.0
29 May–9 June	National	3711	26.7	32.4	26.3	14.5	–7.1
19–23 June	Gran Santiago	1333	28.1	37.4	31.3	3.2	–6.3
11–14 July	Gran Santiago	1243	21.2	41.9	31.5	5.5	–11.0
11–14 July	Concepcion-Talcahuano	676	32.8	29.6	33.5	4.0	+0.7
8–16 Aug	National	4104	26.8	40.3	29.5	3.4	–11.2
8–11 Aug	Gran Santiago	1296	26.2	39.0	27.3	7.5	–12.6
21–24 Aug	Gran Santiago	1290	26.8	40.3	29.5	3.4	–11.2

Allende margin = Allende share - max(Alessandri share, Tomic share), with shares recalculated after excluding the undecided. Source: p.35 of the Aug 30, 1970 issue of *El Mercurio*.

Table 2
Average price changes of stocks traded in the Santiago Exchange.

	Sep 1970 presidential election				Sep 1973 military coup			
	first trading day (Sep 8)		until Sep 30		first trading day (Sep 17)		until Sep 30	
	n	change	n	change	n	change	n	change
All	32	–40.8%	128	–41.2%	48	85.4%	93	112.3%
Agriculture and fishing	3	–36.2	13	–44.0	8	58.1	15	55.9
Banking and insurance	5	–38.7	17	–43.3	6	141.2	7	194.8
Commerce and transp.	2	–44.5	10	–40.3	4	48.2	7	44.6
Manufacturing	7	–47.0	22	–42.1	8	100.7	18	87.8
Metallurgy	5	–49.0	12	–43.2	3	113.2	8	124.6
Mining	2	–65.4	11	–45.1	1	27.3	8	69.3
Public Utilities	2	–28.7	6	–44.8	3	42.1	5	107.2
R.E. and Construction	1	–47.1	6	–33.7	3	137.9	5	76.0
Textile	1	–7.7	10	–36.9	4	89.0	7	378.6
Food and beverages	3	–20.9	18	–37.4	7	72.4	11	109.7
Others	1	–33.3	3	–37.4	1	18.6	2	10.6

‘First trading day’ refers to the first trading day after the event. ‘Until Sep 30’ refers to the period between the event and the end of the month; n = number of firms which stocks were traded during the period; change = average price change of stocks that were traded during the period (in percentage points). Source: Authors’ calculation from various issues of *El Mercurio*.

indeed rather low, particularly among potential shareholders (Tables 4 and 5).³ Moreover, while an attempt to remove Allende from power was expected by many, an attempted military coup had already failed earlier in the year, so the success of the coup in September 1973 could not have been entirely anticipated.

We use previously unexploited daily aggregate data and newly digitized firm-level data to document the effect of these two shocks on the value of firms listed in the Santiago stock market. As we will show, the reaction to the Allende victory and to the 1973 military coup was dramatic. Share prices decreased by 22 percent in the first trading day after the September 4 1970 election, and in the rest of the month they kept falling, stabilizing at around half their pre-election values. In the first trading day after the 1973 military coup, share prices increased by 80 percentage points. Our event-study estimates, using both conventional inference and a small sample test based on randomization inference, confirm these effect sizes.

Using voting expectation surveys, we show that the ex-ante probability of an Allende victory was perceived to be very low, especially by wealthier individuals, who were more likely to hold stocks. Taking account of the implied modest pre-election internalization of the probability of an Allende victory, the overall effect of the ‘Allende-shock’,

inclusive of anticipation effects, is somewhat larger than the observed effect (–56% according to our estimates).

Firm-level evidence suggests that the impact of the Allende election and of the subsequent coup are both likely to have been driven by factors common to all publicly held firms, while firm- and sector-level factors appear to have played a minor role, if any. For example, we will see that the shares that lost the most value following Allende’s election were not big gainers following the coup; in fact, the extent of a firm’s share value loss associated with Allende’s election is uncorrelated with the extent of the firm’s share value gains associated with Augusto Pinochet’s coup.

Our results are consistent with the view that the changes in share prices following these two events were not primarily moved by growth prospects or expected wage dynamics, which would have impacted firms and sectors differentially. We build measures of sensitivity to aggregate GDP growth and incidence of labor costs at the narrowest possible industrial sector level, and show that these measures do not help predict stock price changes after the two events of interest. Instead the dominant underlying mechanism appears to have been the challenge to private ownership under a socialist government, and the reversal of this challenge with the subsequent advent of a business-friendly and authoritarian regime.

Our paper contributes to two rich and growing strands of literature. The first attempts to identify the effects of institutional changes on economic outcomes. Important advances have been made in studying the long-term effects of arguably exogenous institutional differences among adjacent geographical units – for example Dell (2010) on coerced labor

³ Besides the quantitative evidence that we will provide here, the fact that the Allende victory was largely unexpected is reported also in Sigmund (1977, pp. 106–110), Marash (1988), Navia (2004), Hersh (1983, p. 273) and NSC (1970). According to Bermeo (2003, p. 160), even “a number of prominent left-wing leaders were shocked by Allende’s victory”.

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