Comments

Sebastián Galiani: This paper by Lora and Olivera is very interesting. It investigates whether the Latin American governments that adopted market-oriented reforms during the late 1980s and early 1990s were rewarded with votes by the electorate. Certainly, this is an interesting and much-debated question. It is also a very hard one. There are many sources of complexity.

A virtue of the paper is that the authors keep the analysis at an explorative level. Identifying the impact of the reforms implemented during the 1990s on the voting behavior of the electorate is an intrinsically delicate matter, since there is no good way to assess how the same electorate would have voted had the reforms not been implemented (in precisely the way they were). Another serious difficulty is the lack of a more detailed theory to help disentangle the effects under consideration from the data.

The authors rely on cross-country panel data to attempt to control for factors that could potentially impact the effects they are interested in. Clearly, this is the best strategy for the data sets they use. They analyze both presidential and legislative elections, with separate empirical models.

A first question, which is very important for their analysis, is whether the electorate cares about policies per se, or only in relation to the effects they have on outcomes. This would determine whether the effect of economic reforms on voting behavior is a structural parameter or not. The authors assume that voters do care about policies per se, and that they vote on the basis of policies in the recent past.

Of course, the reforms of the 1990s were not implemented in a vacuum. They could be expected to affect variables such as growth and inflation and were also likely to hit unemployment, although transitorily. All of these variables are likely to influence voters, and thus should be included as controls in the regression models. The authors do so.[1] What is more,

1. They also include other time-varying political control variables. The authors report that the results are robust to the inclusion of year effects, but it is not clear why they do not just report those results instead, since they encompass the ones presented here.

they also rightly compute the total effect (in addition to the direct effect) of the reforms on voting, using ancillary models that estimate the effects of the promarket reforms on these macroeconomic outcomes.

In presidential elections, the authors find that the incumbent's party is rewarded for reducing inflation, but once this is controlled for, the electorate seems to oppose market-oriented reforms.[2] Even when the total effect of these reforms is computed, it appears that reforming parties paid a price for adopting them. Given the relative importance of inflation among the explanatory variables, it would have been useful to check extensively the robustness of this result. Unfortunately, there are episodes of very high inflation that might be driving the results.

In any event, one question naturally arises: why did so many governments adopt promarket reforms? A common argument today is that structural reforms were supposed to deliver more growth than they did. However, even if this were the case, growth is found to have little effect on presidential elections. Thus, if one sticks to the estimated model, one needs to look elsewhere for the answer. Perhaps these reforms were also an essential component of the stabilization programs adopted by the countries that reduced inflation during this period, in a way not captured by the ancillary models reported in the paper? This seems to be the case for Argentina.[3]

Another important issue is how the reforms affect voting, once the main economic outcomes are controlled for. It is true that voting may well reflect the taste of the electorate for these policies. But it could also capture other things. It is likely to depend on the way these policies were implemented. It might perhaps capture distributive effects. For example, voters might not have fixed ideas about trade liberalization in general. Maybe, in deciding how to vote, an individual only considers his own economic situation, which could have been affected by this particular policy reform and is also affected by the macroeconomic performance of his country.

Consider privatization. Firms improved substantially after privatization. And consumers, in general, also benefited.[4] But not everyone gained: displaced workers lost earnings and employment security, even in the long run.[5]

2. They find that the results for legislative elections are different. This is troublesome, because there is no theory to help interpret it. Why should one expect inflation to be more influential in presidential elections, for example, and growth to be more influential in legislative elections?

3. Galiani, Heymann, and Tommasi (2003).

4. See, for example, Galiani and others (2005); Galiani, Gertler, and Schargrodsky (2005).

5. See, for example, Galiani and Sturzenegger (2005).

Although the average benefits outweigh the costs, privatization might have a small positive effect on the welfare of each consumer but a large cost among the small group of displaced workers. The former might not decide how to vote on the basis of the outcome of privatization, but the latter would certainly do so. This is just a speculative counterexample. These issues need to be explored further. A promising research strategy would be to exploit panel data on voting at the smallest electoral district level, where the proportions of potential winners and losers from each reform can be identified using census data.

Ernesto Dal Bó: The 1990s saw several governments in Latin America implement various combinations of the reforms commonly associated with the Washington Consensus. One important question concerns the effects of these reforms. A vast body of work in several different applied literatures has dealt with, for example, the impact of trade liberalization, deregulation, and privatization. As the reform process seems to be losing momentum across the continent, a second important question has emerged: what are the constraints on the reforms' sustainability?

This paper by Lora and Olivera relates to the second, which is a crucial question if one believes that market-friendly reforms are, under some guise, beneficial. In a democratic government, reforms must appeal to the electorate, or a large enough portion of it. This, in turn, is a precondition for politicians to have a stake in implementing such reforms. Lora and Olivera's central claim is that apart from macroeconomic stabilization programs, the effect of the Washington Consensus policies tends to be to drive votes away: privatization, tax reform, trade and financial liberalization generally cost votes.[1] If this is true and more reforms are desirable, the challenge appears substantial: why expect political entrepreneurs to provide policies that lose votes? This question is crucial because we would like both to see policies that can bring Latin America prosperity and to preserve democracy.

The authors study variations in the vote shares of the party associated with the incumbent president or the dominant party in the legislature.

1. Williamson (1990b) includes ten priorities in his synthesis on "what Washington means by policy reform": fiscal discipline; tax reform; the liberalization of interest rates, foreign investment, and trade; a competitive exchange rate; privatization; deregulation; the redirection of public expenditure toward social areas such as health, education, and infrastructure; and the protection of property rights. In practice, some reforms were emphasized over others. As I argue below, there are reasons to believe this bias may have had important consequences.

The explanatory factors are economic outcomes (such as inflation and growth), political controls (such as political polarization or party fragmentation), and policies in place (such as privatizations, trade opening, macroeconomic stabilization, or a composite index of structural reforms). Coefficients on inflation tend to be negative and sometimes significant; those on growth tend to be quite unstable, but appear positive and significant in specifications related to the party dominating the legislature; and those on policies associated with the Washington Consensus tend to be negative. For example, the indexes of both structural reforms and trade liberalization appear to lose votes to presidents (see table 11), while privatizations tend to cost dominant legislative parties votes (see table 14). The authors interpret these results as evidence that macroeconomic stabilization programs that reduce inflation pay off quite handsomely in terms of votes and growth tends to pay off as well, while policies associated with the Washington Consensus are, in themselves, vote losers. The fact that these policy variables have negative coefficients in the presence of economic outcome variables is interpreted as evidence that the public has an intrinsic negative attitude toward such policies. In other words, voters disapprove of market-friendly reforms per se, regardless of their impact on economic performance. This is the second important claim in the paper. Calculations are provided to show that although reforms may yield votes by virtue of their beneficial effects on economic performance, they lose votes overall because Latin Americans dislike market-friendly reforms per se.

Two Observations

The problems of estimating the impact of a policy (and hence how it will affect voters' opinions) are well known. Here, I argue that the potential benefits of policy reform might be underestimated, in terms of both their economic and their electoral impacts. For instance, consider a few countries set on various growth trajectories. Assume now that, foreseeing collision, policy reform is implemented more aggressively when countries get to very bad stages of their growth trajectories—that is, reforms are endogenous. It may be possible for the reforms to improve growth outcomes relative to what the countries would have experienced without the reforms, while estimates indicate that reforms are associated with less, rather than more, growth. The key problem is that we lack the counterfactual trajectory for each country, corresponding to less or no reform. When estimates of the reforms' impact on economic outcomes are used in combination with estimates of the outcomes' impact on votes, the electoral payoff from the reforms will tend to be underestimated.

A second possible problem could arise when reformist governments are elected right after an acute crisis. Suppose, now, that the old administration, which is seen to be responsible for the crisis, is heavily punished at the polls. This is likely to get the reformer-to-be government elected with a very large share of votes. Once reforms have been put in place and the crisis resolved, vote shares may well regress to the mean corresponding to normal times. Successful reformers might then be reelected because voters approve of their work, but their reelection vote shares may be lower than when they were first elected. In this case, estimates will show reforms as destroying votes even when they really do not; in the absence of the reforms, the incumbent reformers would have been hit even harder at the polls. True, inflation reduction appears to continue to earn votes, according to the authors' results. Thus if the bias I mention is affecting both the reform and the outcome coefficients, it is not enough to alter the sign of the inflation coefficient. However, it is still possible that the electoral impacts of both reforms and inflation are biased downward.

The Specification

The basic specification driving the analysis in this paper is reported in column 1 of table 5 and in table 11. This specification includes both economic outcomes and policy indexes as explanatory variables of variation in vote shares. One problem with this specification is that it could be unfair to the policies. After all, if the policies are improving economic outcomes and these outcomes are included as regressors, the coefficient on the policy variable will never capture some of the policy's electoral rewards. These will be attributed to the improved economic outcomes. Also, to the extent that the policies affect the economic outcomes, the regressors are not independent.

A better approach might be to estimate the impact of policies on all relevant outcomes, and then estimate the impact of those outcomes on votes. A crucial question, of course, is how to identify all the relevant outcomes that the policies might affect. Moreover, this strategy does not attempt to determine whether voters disapprove of reforms for reasons other than their economic consequences. The authors are highly concerned about this second issue, and the inclusion of policy variables next to economic outcome variables is meant to capture any intrinsic value that the public may place on policies.

To get around the problem of evaluating the electoral impact of policies in a specification that includes outcomes, the authors attempt to separate the effect of policies due to the intrinsic value voters may perceive from the effect due to their impact on economic outcomes. In order to do this, the authors regress both growth and inflation on the index of structural reforms, which yields significant estimates of how much reforms reduced inflation and fostered growth (reported in table 6); call this effect A. Given that improvements in inflation and growth are estimated to yield votes (column 1 of table 5)—call this effect B—the authors compute the electoral gains from reform through improved performance by multiplying effects A and B. Then they add the resulting (positive) estimate to the negative coefficient on policies themselves in the basic regression from column 1 of table 5. They conclude that the net effect that Washington Consensus policies have on votes is negative: the direct "intrinsic value" effect is larger than the "outcome improvement" effect.

On Interpretation

The authors emphasize that the negative coefficient on the structural reforms index represents an intrinsic distaste on the part of voters for market-oriented policies. One could argue against this interpretation. The reason relates to the question of defining the complete set of relevant outcomes. To be concrete, suppose that reforms reduce inflation and improve growth but also severely damage the environment, causing air quality to drop to unhealthy levels. Now, suppose one runs the authors' regression with the change in the share of votes as the dependent variable and inflation, growth, and a reform policy index as independent ones, without including an air quality variable. If people punish the government for the decline in air quality, using the authors' interpretation for this regression one would conclude that the public dislikes market-friendly reforms. In this case, that conclusion is wrong. People may not care in the least about policy labels but care strongly about air quality, which has been affected by the policies.

Therefore, I believe that the conclusion that Latin American people dislike market-friendly reforms *per se* is premature. A much larger set of controls for various relevant outcomes should be explored in the future. I discuss below some possible reasons why voters may be unhappy with reforms irrespective of their ideological profile. One potential candidate is the deterioration in the social atmosphere that some countries have experienced. As reforms went deeper in Argentina, for example, there were alarming increases in crimes against property.[2] A relatively safe society just a few decades ago, its "social air" has now become a lot less easy to breathe; even middle-class people now discuss defensive tactics against "express kidnapping."

Why Are Latin Americans Unhappy with Reforms?

For the reasons explained above, I view the evidence that reforms cost votes as indicative rather than definitive. In particular, I am skeptical that reforms may cost votes because of their labels. Even if they do, I would still argue that what is now being interpreted as ideological motivation may be capturing other concerns. However, when these findings are considered next to the available survey evidence indicating that Latin Americans are dissatisfied with some structural reforms—especially privatization—a rather negative picture emerges.[3] This is puzzling. The reforms are backed by reasonable theory, and moreover, several of them have had good effects. Most economists would have expected the electorate to endorse the reform process strongly and visibly. Why do we find ourselves analyzing evidence that seems to point the other way?

As the profession expected, a number of reforms have had measurable benefits. I will not attempt a systematic overview of the impact of structural reforms here. An arbitrary selection of the literature suggests that even privatizations, which are strongly opposed in opinion polls, have had a number of benefits. Some such studies have appeared in this journal. David McKenzie and Dilip Mookherjee, for example, review evidence on the effects of privatizations from studies applying to four Latin American countries: Argentina, Bolivia, Mexico, and Nicaragua.[4] The emerging picture shows improvements in labor efficiency and access to services, without generalized negative effects on the income distribution or poverty. There is evidence that privatizations have increased firm efficiency.[5] Sebastian Galiani, Paul Gertler and Ernesto Schargrodsky show that in Argentina the privatization of water led to improvements in service and

2. Between 1991 and 1998, the years during which most reforms were introduced and per capita GDP increased by about 40 percent, crimes against property rose by around 71 percent.

3. See the polls conducted by Latinobarómetro. See also Lora, Panizza and Quispe-Agnoli (2004) on reform fatigue.

4. McKenzie and Mookherjee (2003).

5. See, for instance, Boubakri and Cosset (1998) for a study of developing countries that includes some Latin American cases.

thus to reductions in child mortality.[6] The privatization of power generation in Argentina led to a large increase in generating capacity, which in turn contributed to lower energy prices. The privatization of energy distribution, in particular, when coupled with regulation through price caps, had beneficial effects on productivity.[7]

Given the need for electoral support in order for the reform agenda to progress, it seems important to ask why, if reforms have a number of benefits, one does not see stronger support for them. There are several possible reasons.

One answer is given by Lora and Olivera: voters are strongly ideological. There is little reformers can do about this. If ideology is a fixed taste that goes against economic convenience, then maximizing social happiness may require abstaining from further reforms.

It is possible that reforms constitute an investment, and as such entail costs during the first few years, whereas benefits will tend to accrue later on. If voters are not aware of this temporal pattern, they may be quick to punish reformers when experiencing the costs. Voters may not realize that judged in terms of net present value contribution, the reformers deserve to be rewarded.

Moreover, reforms may create very diffuse benefits and highly concentrated costs, and voters may react more strongly in the face of large variations in payoffs. For example, privatizations tend to increase consumer surplus but generate layoffs. Suppose that one such reform creates a small benefit for 80 percent of the population, so that this fraction of the population is now likely to reelect the reformer with a 60 percent chance when he faces a challenger (assume no abstentions nor a third candidate). This gives the reformer a 48 percent vote share from the "winners." But the remaining 20 percent of the population is badly hurt by the reform, so only 5 percent of this group will reelect the reformer. Thus the overall vote share for the reformer is only 49 percent of the vote, which is insufficient to obtain reelection even though a large majority gained from the reform.

Economists can get biased estimates when they lack the appropriate counterfactual, and so can voters. Therefore, voters may not associate reforms with improved economic outcomes, even when they have been beneficial. This outcome is even more likely if voters compare their governments' performance to that of neighboring nations, and it is the countries on the worst trajectories that implement more reforms.

6. Galiani, Gertler, and Schargrodsky (2005).
7. Estache and Rossi (2005).

It may be the case that reforms are made possible by one of two things (or both): a large fiscal crisis or a substantial amount of corruption.[8] Either of these two factors could facilitate reform by softening the resistance of vested interests. Traditional economics emphasizes the role of compensating transfers to facilitate Pareto-improving moves. These transfers can be hard to implement openly. Corruption could then facilitate reform, because it allows reformers to pass compensating transfers to "losers" or players with veto power over the reform process. But if crisis and corruption facilitate reform, voters may associate reforms with these two traits, which in themselves have a number of negative consequences that may cost votes. In this case, it is not reform that costs votes. The electoral consequences of the facilitating factors are confused with those of reforms.[9]

Voters may also be motivated by spite and considerations of fairness. Even when reforms create a substantial consumer surplus, individuals may be negative about them as a result of the fortunes that some key players have made in the process.

Another interpretation is that voters are cruel pragmatists. They elect leaders who they think will be pragmatic enough to effect the transfers that would make reform happen. Examples of successful reformers who were later accused of corruption are Fujimori in Peru and Menem in Argentina. Once these leaders have delivered the reforms, why would rational voters keep them around? The social benefits from their (alleged) corruption have been realized, and there would be only costs to be reaped further down the line.

Voters' assessments of reform may be affected by the economic cycle. The debate on the negative opinions of reform is relatively new. As such, it may be marked by the fact that since about 1998 a few Latin American countries have encountered new macroeconomic problems and less abundant foreign capital. It would be interesting to see if opinions remain negative during a future wave of capital inflows and macroeconomic recovery.

It is possible that voters may associate reforms (rightly or spuriously) with a number of outcomes that economists have not paid enough attention to when discussing policy reform. Here, I discuss only one such possibility: reforms may be correlated with a deterioration in the "social atmosphere."

8. On fiscal crisis as a catalyst, see, for instance, Drazen and Grilli (1993).

9. In their conclusion, Lora and Olivera note in passing that they did not find any connection between perceptions of corruption and electoral results. It would be worthwhile to explore this connection further, under alternative specifications.

By this I mean that while reforms were being implemented, perceptions of security, social cohesion, and trust in others may have suffered.

The Social Constraint to Policy Analysis

I begin with a simple conjecture: policy reform indexes may be positively correlated with data on crimes against property and kidnapping with extortion. (This may not be the fault of the reforms; the issue also requires investigation.) These phenomena, like air quality in my earlier example, are essentially missing in the specification used by Lora and Olivera. If my conjecture is true, it may imply that voters do not care about reforms from an ideological standpoint, but associate them with decreased security and enjoyment of public spaces and social life.

Note that unemployment figures, inequality, or simple poverty measures may not capture all the relevant variation when it comes to explaining how social issues affect electoral results. Indicators of marginality, the importance of the shadow economy, the average spell of unemployment, and the concentration of longer spells at certain skill levels may be more telling. In this connection, a pertinent question is to what extent reforms change not the levels, but the profiles of employment.[10] For instance, if reform pushes some workers to a different sector, it may impose on them a large loss of industry-specific human capital. Some of these workers may decide to drop out of the labor force and not even look for a job. Measured unemployment will remain the same, while marginality increases.

Although the original body of Washington Consensus recommendations did include elements such as public expenditures in social areas and the protection of property rights, these do not seem to have been the main focus of the reform process. There are various possible reasons for this. The most energetic reforms may have been those fueled by business interests. Also, it may have been easier to pursue reforms that entailed reducing the scope of public intervention than those that would make intervention more sophisticated. Further, in the absence of clear theoretical predictions of how reforms may impact welfare when property rights are not perfectly enforceable, the protection of property may not have been seen as a vital component of the reform agenda.

10. Galiani and Hopenhayn (2003) show that after a decade of reforms in Argentina, taking into account reincidence, the risk of unemployment rose significantly and was distributed unequally in the labor force.

A reassessment of the implementation constraints to policy reform could be productive. Political economics has done a lot to clarify how political constraints may shape the process of endogenous policy formation. An analogous analysis of how social constraints may limit the set of desirable and implementable policies is still lacking.

My study with Pedro Dal Bó takes a step in this direction, arguing that social conflict may impose a social constraint on policy analysis.[11] The reason is that in a world where property rights cannot be perfectly protected, certain policies could unleash a "social backlash" of forced redistribution. We examine a simple, small open economy model in the presence of one critical distortion: individuals may engage in appropriation activities; for example, they may become members of a guerrilla organization that extorts payments from nonmembers, or simply become criminals. The size of this "appropriation sector" is governed by a balance between the opportunity costs and the returns to appropriation activities.

The key assumption in the model is that appropriation activities are more labor intensive than the overall economy. (The model uses the labels "capital" and "labor," but these could be interpreted to mean, respectively, skilled labor and unskilled labor; we would then say that appropriation is relatively intensive in unskilled labor.) Shocks or policies that hurt labor-intensive activities (or that favor capital-intensive ones) drive wages down relative to the mass or disputable wealth in the economy. This lowers the main opportunity cost of appropriation activities relative to their returns, so appropriation expands. An example is trade liberalization that increases the perceived price of capital-intensive goods relative to labor-intensive goods.[12] Similar effects could follow from deregulation and foreign investment that increase productivity in capital-intensive industries more than in labor-intensive ones. These forces clearly have the potential to generate efficiency gains and make society wealthier. However, by hurting the relative value of labor in a world where appropriation is relatively labor inten-

11. Dal Bó and Dal Bó (2004).

12. Under the skilled versus unskilled labor interpretation, this increases the wage gap across skills, increasing inequality, and it drives appropriation activities up. Thus the model can account for simultaneous increases in GDP per capita, inequality, skill premiums, and crime, as experienced by Argentina in the 1990s. One prediction of the model is that not all forms of inequality will affect crime, so simple measures of inequality may not always be neatly associated with crime. Appropriation activities are only affected by forms of inequality that affect the structure of remuneration across factors (or skill levels). Otherwise, the balance between the costs and returns to appropriation may remain unaltered.

sive, such forces may unleash an appropriation backlash that leaves all agents in the economy worse off.

We tend to consider a number of reforms convenient because we expect their efficiency gains will make societies more prosperous. However, when the protection of property rights is imperfect, we are in a second-best world. The welfare implications of reforms may then depend on new considerations, and the set of reforms that are desirable and sustainable will change. It may pay to reassess the Washington Consensus from this perspective.

Conclusion

Lora and Olivera have produced an interesting, thought-provoking piece. The problem they tackle belongs to a set of complicated issues on which it is hard to derive definitive conclusions. More work is needed. Their evidence suggests that market-friendly reforms may not have produced handsome electoral payoffs beyond those secured in the macroeconomic stabilization phase. This is consistent with survey evidence on public attitudes toward reforms and with the sentiment one perceives in casual interactions on the continent.

One challenge that lies ahead is to reconcile the evidence of important benefits from some reforms—notably privatizations—with the fact that many Latin Americans seem to reject the idea that they have benefited from the reforms. I have here proposed a few potential approaches, including (1) examining how opinions on reforms are affected by factors ranging from the economic cycle to the perceived fairness of their implementation, (2) analyzing how corruption—a much vilified trait—may have been instrumental in pushing reforms forward, and (3) investigating the role of a social constraint on the implementation of reforms. In particular, a reassessment of the reform process in terms of its impact on social peace and criminal activities would be profitable. This should entail more reflection on what constitutes desirable and sustainable policy in a world where the protection of life and property can only be imperfect.

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