Elections, Policy Preferences and International Financial Market Constraints

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Presentation at the IPES Conference,
November 12, 2010

Research Question

To what extent have governments' actual (as opposed to their nominal) policies converged with increasing financial openness?

Financial Openness

- Cost of reallocating capital decreases
  $\Rightarrow$ Financial reaction to elections should become stronger
- Cost of market-unfriendly policy increases
  $\Rightarrow$ Governments' de facto policies should converge

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Strong Convergence

H1a: As financial integration increases, stock market responses to elections **decrease**.

H1b: The negative (positive) response of stock markets to the election of a left-wing (right-wing) party **becomes smaller** as financial integration increases.

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Weak Convergence

H2a: As financial integration increases, stock market responses to elections **do not change**.

H2b: The negative (positive) response of stock markets to the election of a left-wing (right-wing) party **remains constant** as financial integration increases.

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No Convergence

H3a: As financial integration increases, stock market responses to elections **increase**.

H3b: The negative (positive) response of stock markets to the election of a left-wing (right-wing) party **becomes larger** as financial integration increases.

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Dependent Variable

- Cumulative Abnormal Return ($\widehat{\text{CAR}}$)
- Difference between
  - *Expected* Return without election
  - *Actual* Return after the election

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- Ideology
- Financial Openness
- Contraints Variables:
  - Minority Government
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  - Central Bank Independence
  - Political Constraints Index

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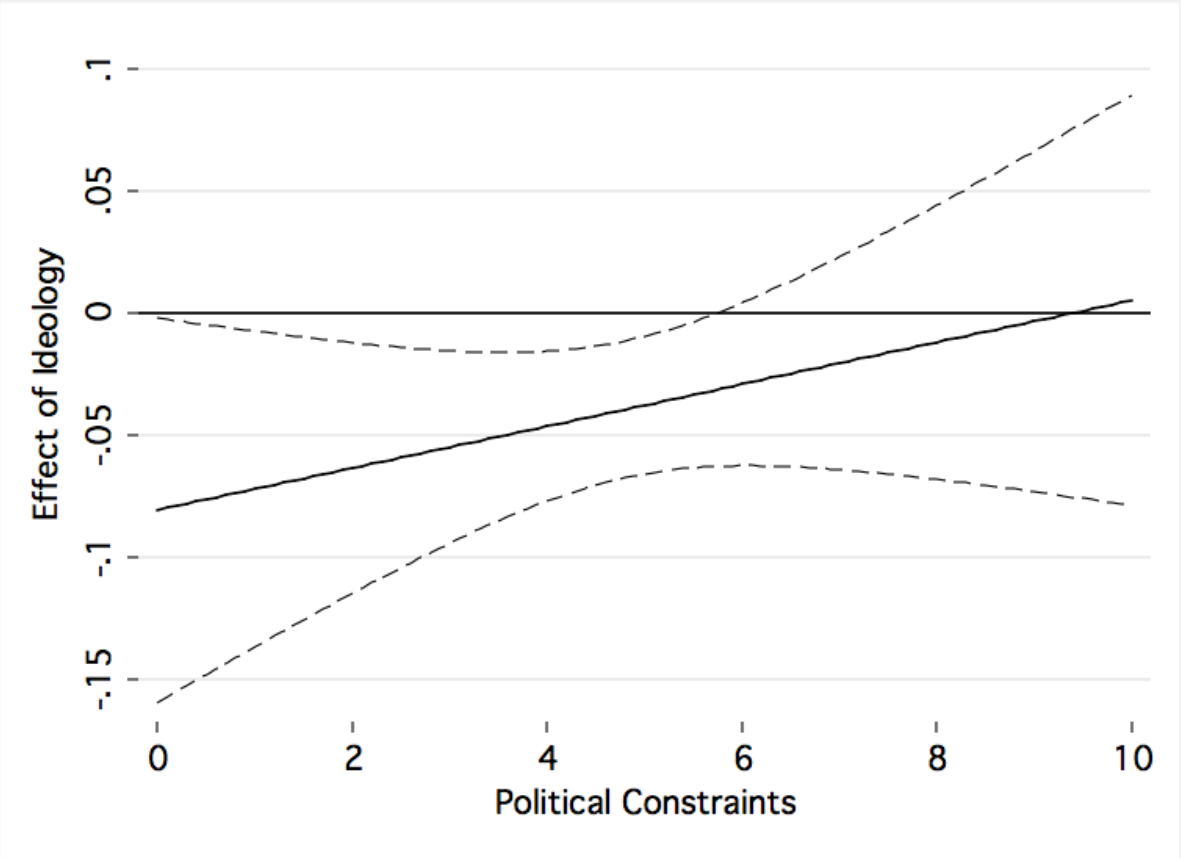
Size of Stock Reactions

	Openness	Flows	Minority	Multi	CBI	Index
Openness	-0.147					
	(0.141)					
Log(Flows)		-0.282				
		(0.241)				
Minority			-0.289			
			(0.444)			
Multi				0.343		
				(0.431)		
CBI					-0.131	
					(1.216)	
Index						-0.328
						(0.109)
Constant	4.196	3.878	3.169	2.847	3.152	4.911
	(1.212)	(0.752)	(0.284)	(0.316)	(0.531)	(0.761)
N	205	176	205	205	205	205

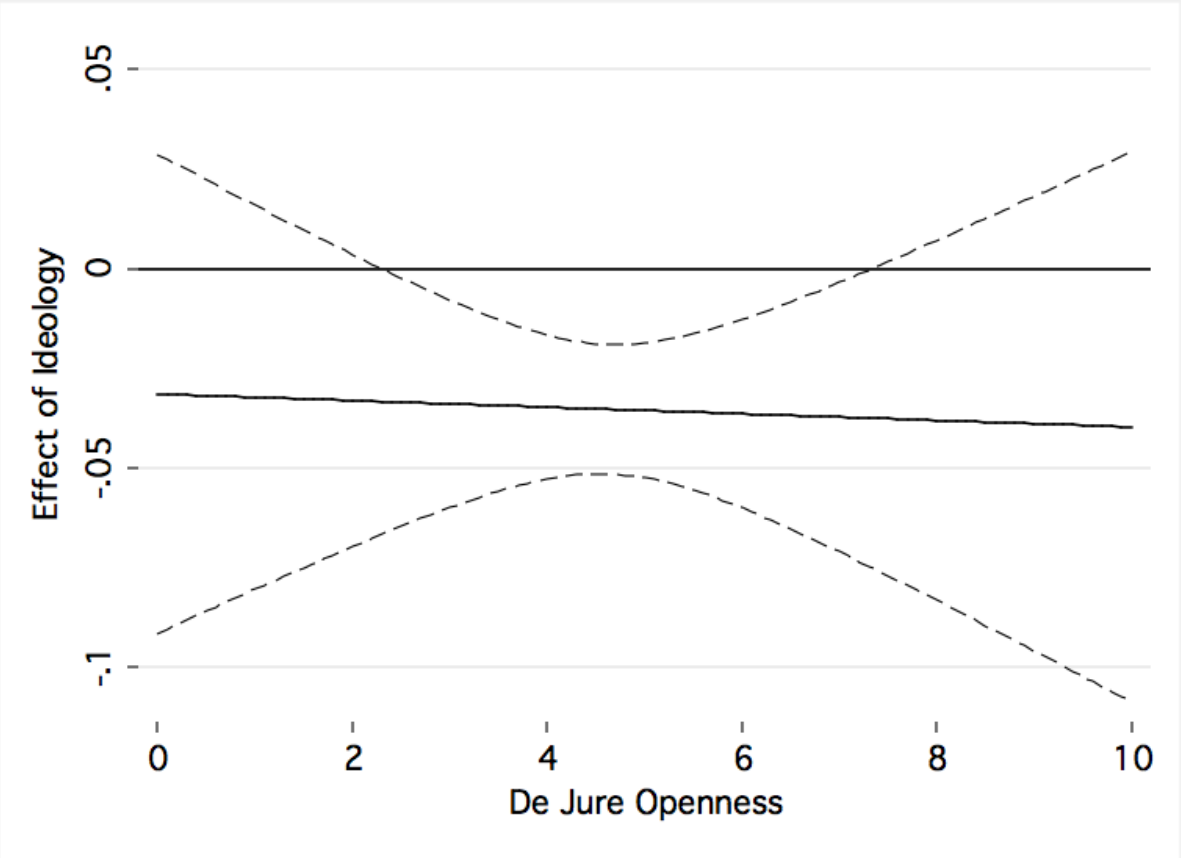
Direction of Stock Reactions

	Simple	Constraints	De Jure	Flows
Ideology	-0.037	-0.080	-0.031	-0.056
	(0.016)	(0.040)	(0.031)	(0.027)
Constraints		-0.595		
		(0.360)		
Ideology*Constraints		0.009		
		(0.008)		
De Jure Openness			-0.204	
			(0.323)	
Ideology*De Jure Openness			-0.001	
			(0.006)	
Log(Flows)				-0.690
				(0.694)
Ideology*Log(Flows)				0.003
				(0.013)
Constant	1.920	5.022	3.485	4.033
	(0.861)	(1.880)	(1.654)	(1.613)
N	205	205	205	176

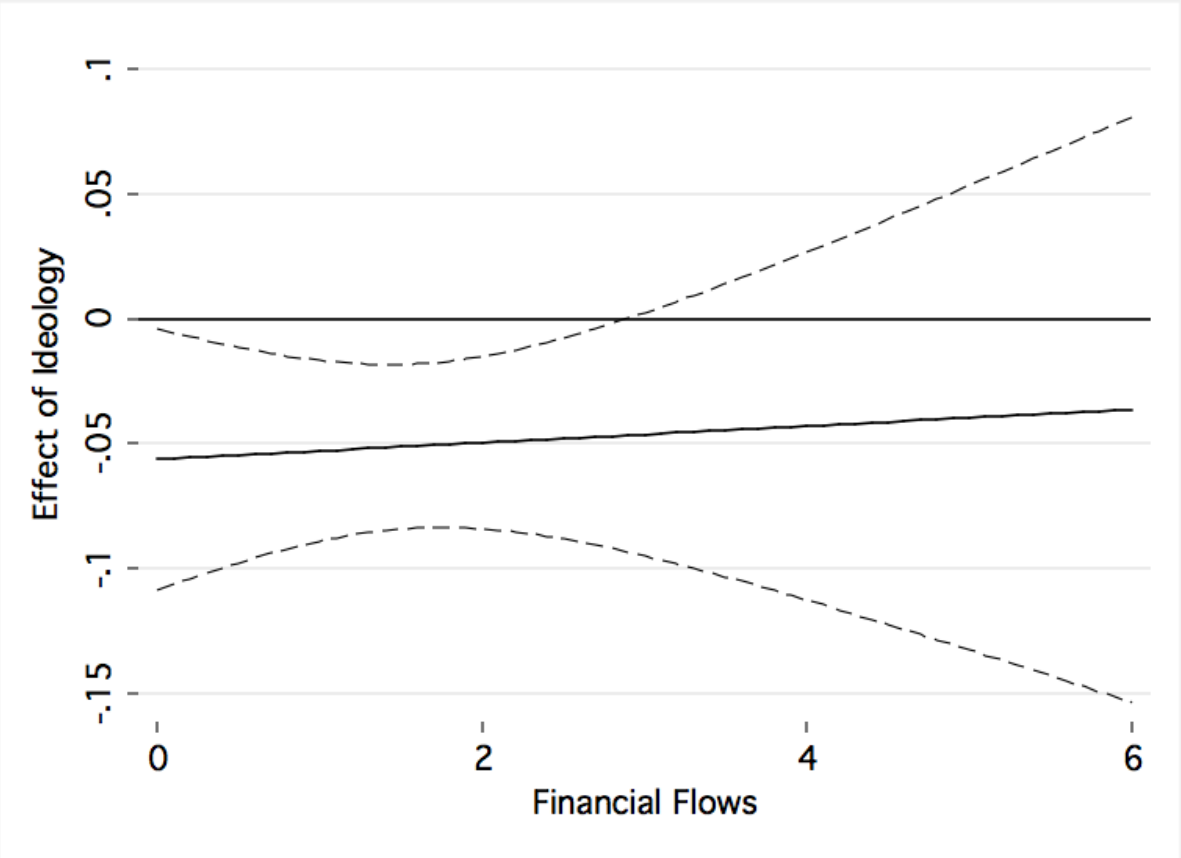
Effect of Political Constraints



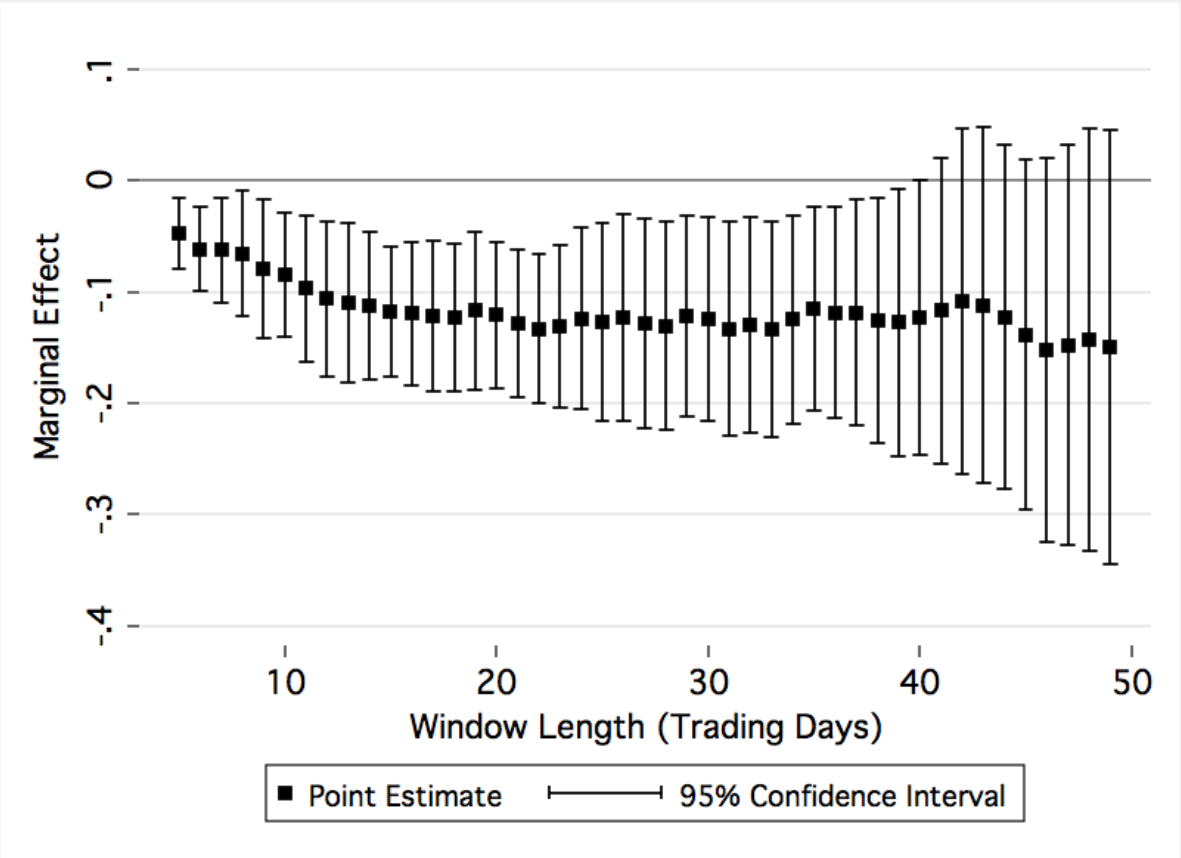
Effect of Financial Openness



Effect of Financial Flows



Different Event Windows



Main versus Placebo Analysis

	Simple	Constraints	De Jure	Flows
Main	-0.037	-0.048	-0.035	-0.053
Placebo	0.001 [-0.015; 0.017]	0.001 [-0.024; 0.026]	0.001 [-0.015; 0.018]	0.001 [-0.017; 0.020]

Implications

- Weak convergence of actual policies
- Politics is less important for financial *returns*
- Politics is still important for financial *decisions*
- Good news for democratic political competition?

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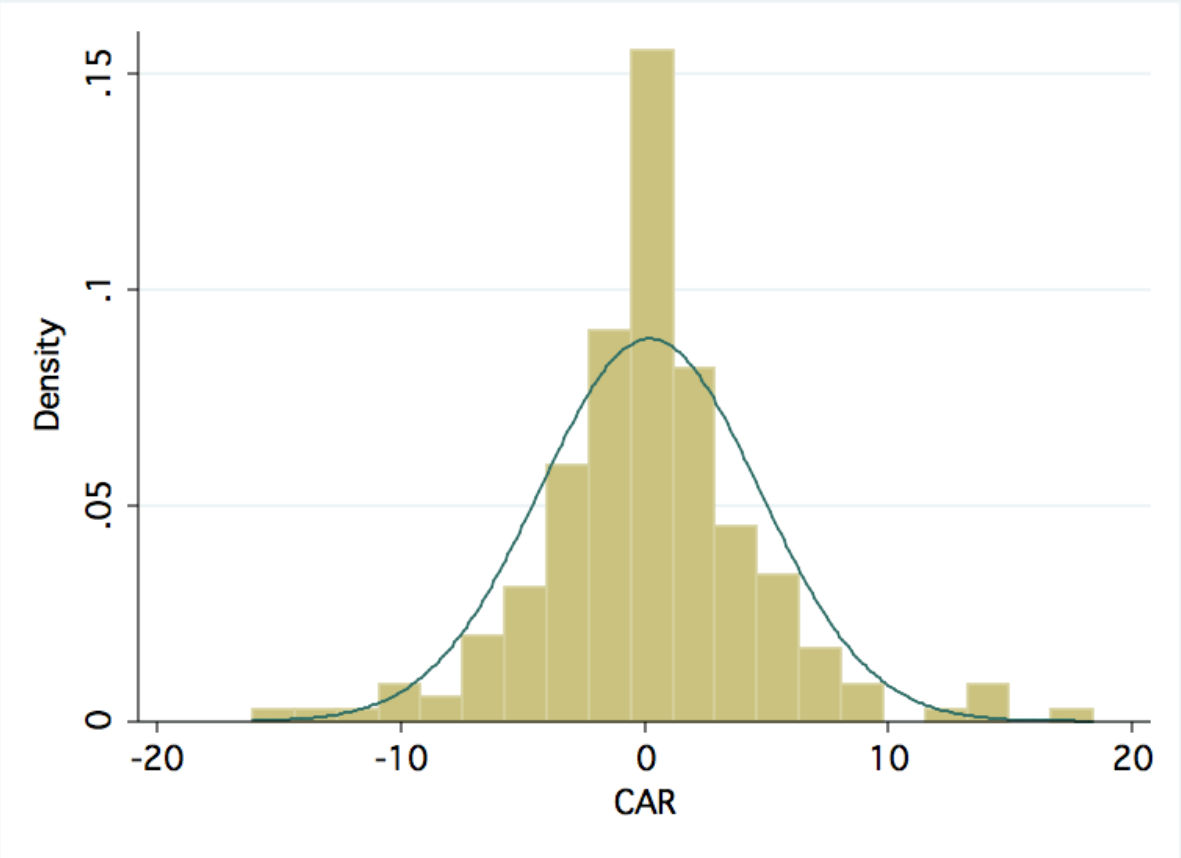
Distribution of CARs



Size of Stock Reactions

$$|\widehat{\text{CAR}}_i| = \alpha_0 + \alpha_1 \text{Openness}_i + \sum_{j=1}^{k} \alpha_{j+1} \text{Constraint}_{i,j} + \epsilon_i$$

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Direction of Stock Reactions

$$\widehat{\text{CAR}}_i = \beta_0 + \beta_1 \text{Ideology}_i + \beta_2 \text{Openness}_i + \beta_3 \text{Ideology}_i * \text{Openness}_i + \sum_{j=1}^{k} (\beta_{j+3} \text{Constraint}_{i,j} + \beta_{j+k+3} \text{Ideology}_i * \text{Constraint}_{i,j}) + v_i$$

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