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The Value of Political Connections in a Multiparty Parliamentary Democracy: Evidence from the 2015 Elections in Israel

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Abstract

This study uses the 2015 legislature elections in Israel in order to estimate how the market evaluates political connections. Using the political connectedness of boards of directors and senior executives in all the public firms in Israel to identify political connections, the study estimates the impact of the electoral outcomes on the cumulative abnormal returns of firms listed in the Tel Aviv Stock Exchange (TASE) in the days following the elections. Results indicate that political connections had little impact on cumulative abnormal returns in the estimation period. However, some sectors reacted in a robust and statistically significant manner. In particular, gas and oil firms' stock prices showed a notably higher and positive abnormal return. While the effect of the electoral outcomes on specific sectors indicates that the Israeli stock market does evaluate political outcomes through asset prices, the market's lack of responsiveness to political connections after the 2015 elections could indicate that political connections do not carry financial value in the Israeli stock market. This unique result is attributed to the institutional and political system in the country.

Keywords: Event studies; parliamentary elections; political parties; political connections; asset pricing.

JEL codes: D72, G12, G14, G32, M12, O53

1 Introduction

Studies have shown that elections have economic consequences, and that the democratic process influences financial markets (Belo, Gala and Li 2013, Klein 2003, Santa-Clara and Valkanov 2003, Snowberg, Wolfers and Zitzewitz 2007a, Snowberg, Wolfers and Zitzewitz 2007b). The principal factor in explaining why the economy as a whole, and capital markets in particular, react to electoral outcomes is politicians' and political parties' ability to influence the economy. Impacted by political events, firms can improve their position by affecting political decisions in areas that relate to their business operations.

A mechanism for creating such an effect is the establishment of political connections. Tullock (1980) and Baye et al. (1994) have established a framework for an efficient system of connections between politicians and firms that can decrease the costs incurred by lobbying and open a new supplementary venue for political influence for the firms. An

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