Politics and Finance – How National Parliaments Affect Firms' Cost of Capital[☆]

Abstract

This study provides first empirical evidence on the link between economic policy concepts in parliaments and capital markets' risk perception. We identify inherent parliamentary disagreement about economic policy as a common determinant of firms' cost of capital across developed democratic nations.

We use firm-level panel regressions to examine the long-term relationship between parliamentary disagreement and firms' cost of capital. For identification, we exploit exogenous variation arising from surprising elections in a staggered difference-in-differences setting.

A higher level of disagreement in national parliaments leads to an increase in the cost of capital for firms. Making use of firm-level heterogeneity in the sample, we provide additional insights into the underlying mechanisms. The study shows that firms with a higher share of international revenues are less affected by parliamentary disagreement.

The results are robust to a variety of alternative specifications and are in line with theoretical predictions in the literature. This paper provides empirical evidence on economic policy uncertainty originating from the central political institution – the national parliament.

Keywords: Parliaments, political uncertainty, economic policy, cost of capital, equity risk premia.

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1. Introduction

A nation's economic policy defines the environment for firms to operate in and for investors to allocate their capital. Within democratic nations, national parliaments determine the future course of economic policy. Over the course of their legislative period, members of the parliament exert continuous influence on a nation's future economic policy by allocating budgets and by voting on bills and resolutions. In this process of policymaking, each parties' fundamental and distinct political positions guide parliamentarians in their day-to-day decisions. Financial market participants form rational expectations about both the direction and the impact of future policies by observing political dynamics, such as national elections, government formations and political positions of parties. These expectations manifest themselves in asset prices via changes in discount rates.

Despite a growing body of theory, empirical evidence on what market participants should expect from political dynamics concerning economic policy remains limited.

Pastor and Veronesi (2013) and Baker et al. (2016) are among the more recent scholars suggesting that uncertainty concerning economic policies represents a critical channel between politics and finance. However, the underlying components of economic policy uncertainty and the extent to which local politics or international dynamics drive developments, are little understood.

We address this question by observing economic policy concepts in national parliaments over time, as parliaments are the political institution at the very core of policymaking within a democracy.

Motivated by previous literature on economic policy uncertainty, we propose parliamentary disagreement, measured as the dispersion of economic policy positions among parties within a parliament, as a key driver of capital markets' political risk perception. We hypothesize that the higher the level of disagreement among parties within a national parliament, the more difficult it is for capital market participants to form expectations about future policies. We argue it is due to this increased level of uncertainty that we observe higher levels of cost of equity capital in times of higher parliamentary disagreement.

To measure parliamentary disagreement, we observe the representation of political parties in national parliaments for 130 legislative periods across 19 developed countries between 1987 and 2014. Based on data provided by the Manifesto Project (Volkens et al., 2017), we are able to measure each party's position towards fundamental economic policy dimensions based on their political programs. This analytical setting allows us to derive two measures for each elected parliament: (i) the aggregated representation of economic policy positions, and (ii) the level of dispersion of economic policy positions among parties. These measures represent the basis for our empirical analyses.

The study makes use of two different empirical settings: i) long-term yearly firm-level panel regressions and ii) short-term monthly staggered difference-in-differences regressions. The first setting utilizes of the full sample and captures the long-term relations between our key variables of interest. This setting is most suitable for policymakers who are concerned about long-term effects. To test the plausibility of the results, we further analyze how a firm's internationality influences the relation. Firms with larger exposure to national

politics through a higher share of domestic revenues are affected relatively more by local economic policies.

The second setting exploits exogenous variation in our key variable of interest – parliamentary disagreement – introduced by elections with surprising outcomes. For a subsample of 80 elections across 16 countries, we manually collect polling data on party level generated by country-specific polling institutes. We measure unexpected parliamentary disagreement as the difference between actual and expected (polled) outcomes. Applying a staggered difference-in-differences approach, the study shows that parliamentary disagreement that is higher than anticipated by the public leads to an increase in firms' costs of capital in the months after the election.

To mitigate potential concerns with regards to the robustness and potential reverse causality of the results, we run a large variety of alternative specifications.

This paper contributes to the existing literature on the relationship between political institutions, economic policy uncertainty, and financial markets. It complements the understanding of the economic governance of nations and its association with investors' risk perception and provides evidence for firm-level heterogeneity of the effects.

The remainder of this study is organized as follows: Section 2 provides an overview of the previous literature and our theoretical and empirical contributions. The collection and construction of our dataset are described in Section 3, while Section 4 provides further details on our methodology. Descriptive statistics, empirical results and robustness tests are discussed in Section 5 to Section 7. Section 8 concludes.

2. Literature and Contribution

The overarching theoretical question this paper relates to is whether and under what circumstances we should observe differences in economic expectations (or in actual economic outcomes) between different legislative periods or economic systems. This topic is addressed by literature from the fields of financial economics and political economy with more recent contributions in the areas of asset pricing and corporate finance. In the following, we will roughly outline theories and empirical studies that have contributed to our understanding of the current state of literature. In line with our research questions, we subsume previous research loosely under two strands: (i) research on uncertainty with respect to economic policy and its relationship with corporate finance and financial markets; (ii) research on the antecedents and consequences of economic policy directions in the context of corporate finance and financial markets.

2.1. Economic Policy Impact and Financial Markets

Efforts to formalize the relationship between the public and private sector date back to at least Leontief (1941) with his work on "The Structure of American Economy, 1919-1929". Economic policy represented a fundamental element in his general equilibrium model of the US economy. Further early contributions within this theoretical setting include Myrdal (1957) and Hayek (1976) who supported the hypothesis of economic policy as a fundamental driver of economic development.

The evolution of public choice theory, under which parties and electorate are considered rational, utility-maximizing agents, provided the theoretical basis for endogenous political outcomes, where prevalent political directions are determined by economic conditions (Kenneth J. Arrow, 1952; Black, 1958). Since the 1970s, this theoretical foundation has been complemented by debates between two competing theories within the political economics literature focusing on the interplay between parties' political positions and the state of the economy, or business cycles.

The political business cycle theory by Nordhaus (1975) suggests that - at their core - parties are agnostic of any fundamental party positions and primarily act opportunistically to reach their overall goal, that is to secure re-election. According to this theory, governments induce business cycles by using expansionary monetary and fiscal policies ahead of elections to boost economic indicators such as unemployment in the short run only to reverse or neutralize such measures after their re-election. On the other side, proponents of the Partisan Theory (Hibbs, 1977) and later Rational Partisan Theory (Alesina, 1987; Alesina and Sachs, 1988), argue in favor of economic effects dependent on the type of government - and their distinct set of economic policies - in charge. These scholars often attribute preferences to parties: while right-wing parties mainly focus on low inflation, left-wing parties are more concerned about unemployment. Both theories have been tested empirically, discussed and refined in various studies using economic data[1] and also stock market returns.[2]

All in all, today there is a consensus on the existence of differences in economic policies among parties and that these differences have economic consequences. However, after reviewing previous literature we observe several shortcomings:

Firstly, Potrafke (2016) reviewed 100 OECD panel studies that analyze party ideologies and their impact on a variety of economic variables and (rightfully) concludes that causal inferences in most of the studies are invalid due to the endogeneity of the variables that capture government ideology. In our study, we apply in addition to a similar panel regression design a staggered difference-in-differences regression design where we exploit exogenous variation in the key explanatory variable. Furthermore, we perform additional analyes to mitigate endogeneity concerns.[3]

Secondly, the majority of research has been devoted to establishing a link between political ideologies and actual economic outcomes, even though many of these response variables, e.g. unemployment or economic growth, are backward-looking and slow-moving. Hence, it is at best very difficult to correctly specify a model to capture such links. We overcome this concern by using forward-looking proxies of investor expectations as our dependent variable: Our main variable is the implied cost of equity capital, a measure that is well documented within the finance literature (Gebhardt et al., 2001; Hail and Leuz, 2006; Pastor et al., 2008; Li et al., 2013). For robustness tests, we use the end-of-year dividend yield.

[1] See e.g. Alesina (1997) and Potrafke (2016) for a survey of this literature.
[2] See e.g. Santa-Clara and Valkanov (2003) for an analysis on Democratic versus Republican cycles.
[3] See Section 4 for further details.

Thirdly, it is important to note that partisan theories and therefore the majority of research is closely tied to party identities rather than actual policy positions and mainly rely on classifications of parties on a left-right or socialist-conservative scale. This approach might not only be overly simplistic in adequately capturing variation in economic policy but also causes methodological problems if parties' ideologies change over time. Our approach focuses solely on the relative representation of political positions within parliaments. Thereby we consider political positions independent of party identities.

Fourthly, previous empirical studies are primarily country-level studies omitting firm-level heterogeneity within economies. We are able to run firm-level analyses as we estimate our main dependent variables on the firm level.

2.2. Political Uncertainty and Financial Markets

Researchers within the area of Economics and Finance have started rather recently to investigate uncertainty originating from politics in the context of financial markets. Within the theoretical strand of literature, most recently, Pastor and Veronesi (2012) and Pastor and Veronesi (2013) have made significant advancements in establishing a formal link between political uncertainty and both asset prices and risk premia. They propose two uncertainty related transmission channels between political decisions and risk premia: (i) policy uncertainty, i.e. the uncertainty around what type of policy is going to be adopted by the government, and (ii) policy impact uncertainty, i.e. the uncertainty about how a certain policy affects firms' future earnings. Further theoretical contributions have been made by Croce et al. (2012a) and Croce et al. (2012b) who develop structural models to link tax uncertainty and fiscal uncertainty to risk premia. Empirical studies include for example Erb et al. (1996) and Brogaard and Detzel (2015), who find a positive link between measures of political risk and equity risk premia. Pantzalis et al. (2000), Li and Born (2006), and Boutchkova et al. (2012) investigate political uncertainty around elections and testify elevated levels of volatility and risk premia. Julio and Yook (2012) and Baker et al. (2016) empirically investigate the effects of political uncertainty on firms' investment behavior and find that firms delay investments to times with lower political uncertainty.

We contribute to this area of literature by proposing parliamentary disagreement, measured as the dispersion of economic policy positions within a countries' parliament, to represent one component of policy uncertainty. We argue that when there is less agreement among parties about future economic policy, outcomes of the political arbitration and negotiation processes are more uncertain and more difficult to forecast for both insiders and outside observers. Furthermore, we provide evidence that firms with a stronger focus on the domestic market have a higher exposure to the uncertainty that is induced by the parliamentary disagreement within national parliaments.

3. Data

Our unbalanced yearly panel dataset combines firm-level data with corresponding country-level data. The following section describes our data collection and sampling pro-

cess. For a detailed overview of all variables retrieved, the reader is referred to Table A. 20 in the Appendix.

Our sample is restricted mainly by two dimensions. First, the sample is limited to democratic countries covered within the Manifesto Project dataset of Volkens et al. (2017), from where we derive our variables of interest. The dataset covers around 50 countries globally. Second, we limit our sample to countries and time periods for which we have sufficient firm-level information to calculate our main dependent variable, the implied cost of capital. Here, the key restriction is the availability of firm-level future earning forecasts.

3.1. Firm-level Data

The firm-level dataset covers information on stock prices, financial statements and earnings forecasts on an annual basis. We retrieve historical financial data from Datastream/Worldscope and earnings forecast data from the Institutional Brokers' Estimate System (I/B/E/S), both services provided by Thomson Reuters. All financial variables used in the regression analyses are winsorized at the 1%-level.

3.1.1. Implied Cost of Capital (ICC)

The main dependent variable used in this study is the cost of equity capital proxied via the Implied Cost of Capital (ICC). ICC reflect the discount rate that equates - at any given day - the observed market value of a company's equity and its expected future cash flows. We argue that due to its forward-looking character, this measure is best positioned to capture the market's expectations induced by political dynamics. ICC have been frequently employed in previous corporate finance studies, for example Hail and Leuz (2006) or Frank and Shen (2016), but also in asset pricing (Lee et al., 2009; Li et al., 2013).

In a first step, we calculate the ICC following the approaches suggested in previous studies by Claus and Thomas (2001), Gebhardt et al. (2001), Easton (2004) and Ohlson and Juettner-Nauroth (2005). We obtain cash flow forecasts from I/B/E/S, while assumptions regarding long-term growth vary with the calculation method. For details on calculations, the reader is referred to A. 25 in the Appendix. As we are interested in a robust estimate, we calculate the equally-weighted average of the four measures in line with Hail and Leuz (2006) and winsorize the result at the 1%-level.[4] This finally leads us to an unbalanced panel of 22,328 unique companies in 19 developed countries.

3.1.2. Implied Equity Risk Premia

As a variation to the ICC, we additionally use the implied equity risk premia as dependent variable. This measure is calculated by deducting the risk free rate from the ICC measure.

3.1.3. Dividend Yield

To test the robustness of the results, we use the dividend yield as additional outcome variable. The dividend yield is a measure of expected return used in the finance literature

[4]If one estimate is missing, we calculate the average over the remaining ones.

(Greenwood and Shleifer, 2014). Variation in dividend yields is mostly driven by changing expectations of future returns rather than future dividend growth (Campbell and Shiller, 1988; Cochrane, 1992; Campbell and Ammer, 1993; Cochrane, 2011). The main shortcoming of this measure is that it is limited to dividend paying stocks. The dividend yield is defined as the ratio of the dividend per share for a given year divided by the year-end stock price. The respective information is retrieved from Datastream using the data field *DY*.

3.2. Country-level Data

We combine the firm-level dataset with country-level variables. We add information on country stock indices, sovereign interest rates, inflation, GDP growth, and finally national parliamentary election outcomes and aggregated party manifesto data. Data on country stock indices is retrieved from *Datastream* similar to the procedure described above. We will describe the collection process for data from the *Manifesto Project*[5], *Parlgov*[6], and the *World Bank Group* in the following paragraphs.

3.2.1. Political Data from the Manifesto Project

Party programs (synonymously party manifestos) play a critical role in all democracies around the globe. Whilst they seem to be in the limelight mostly in months prior to election dates during electoral campaigns, they also constitute the inner compass of the respective party and hence play a key role in every political system. As Kropivnik (2013, p. 82), states:

> "*They [party programs] recognize the importance of critical issues, develop a party position on them, set the course of actions a party will take if elected, unite a party internally and, last but not least, advise party activists and supporters as well as inform the general electorate.*"

Since 1979, party manifestos have been systematically collected by the Manifesto Project and its predecessors.[7] This project has brought forward a dataset based on content analysis of electoral manifestos of the major political parties in OECD countries and Central and Eastern Europe. The dataset contains information on democratic elections since 1945; besides election results per party it provides manually coded data points on policy positions communicated in party manifestos by each relevant party, and several further characteristics of parliaments. In the structured and continuous human coding process, trained native-language coders split up electoral programs into statements and allocate each statement to a predefined set of policy positions within seven domains.[8] An overview of domains and policy positions is given in Table A. 1 below.

[5] See Volkens et al. (2017).

[6] See Döring and Manow (2016).

[7] Also known as the Manifesto Research Group from 1979 to 1989, the Comparative Manifestos Project from 1989 to 2009 and as Manifesto Research on Political Representation (MARPOR) from 2009 onwards. See Volkens et al. (2017).

[8] A detailed description of the coding instructions and process can be found in Werner et al. (2015).

[Table 1 about here.]

Policy domains covered by the dataset vary from positions on external relations to positions regarding social groups. For each policy position the dataset contains a score, which represents the percentage of fragments allocated to a certain topic compared to the total number of fragments identified in the document.

For the purpose of this paper, we focus solely on the policy positions within the domain 'Economy'. We argue that economic policy positions of parties and parliaments should have the most direct channel of influence on companies' cost of capital in the respective country. A detailed description of economic policy positions can be found in Appendix B. 6.

Before using the data for our analysis, we particularly focused on two main concerns in relation to the data: data quality and measurement errors. With regards to data quality, we observe the overall success of the dataset within academic research. Over the years, the dataset has become one of the most important sources for empirical tests in political science and has consequently been used in hundreds of studies on political parties.[9] Most notable within finance is the study of Dinc and Erel (2013), who utilize the database to estimate the effect of economic nationalism in parliaments on M&A returns. Today, the project is a EU/DFG funded Horizon 2020 research project and has won the award for the best dataset in comparative politics by the American Political Science Association.[10] Furthermore, the data collection process is of adequate standards, including detailed handbooks, direct training of coders with entry tests and regular training tests. With regards to measurement concerns, we find an overall positive sentiment within the literature. Cross-validation studies (Jensen and Seeberg, 2015; Horn et al., 2017) provide empirical evidence on construct validity. We observe some criticism of misclassification (Mikhaylov et al., 2012), and suggestions for data adjustments (Franzmann and Kaiser, 2006).

Independent of the dataset, there is still the question remaining whether party manifestos matter in a sense that parties are actually doing what they say they are planning to do. Empirical evidence in this regard is for instance provided by Finseraas and Vernby (2011) who look at welfare generosity and find that parties are able to implement policies in line with their ideologies.

On this basis, we consider party manifestos a crucial part of the information gathering process conducted by market participants when assessing the implications of election outcomes and forming expectations about the upcoming legislative period. We assume that scores in the Manifesto Project dataset mirror fundamental positions of parties that will influence policymaking during the upcoming legislative period and thereby directly affect a company's business environment.

Based on the dataset of the Manifesto Project, we calculate a variety of measures as

[9] See e.g. von dem Berge and Obert (2017) and Bosancianu (2017). At the time of writing this paper, the project's website lists more than 350 academic studies based on the dataset.

[10] See http://www.apsanet.org/section-2003-Award-Recipients.

proxies for our variables of interest - namely parliamentary disagreement and prevalent economic policy positions. We calculate these variables for each country and parliament individually and for two different frequencies: (i) for *election cycles*, defined as the time between two national elections, (ii) *government cycles*, defined as the period of a certain government in place.[11] To obtain information about the party composition of governments per country we complement our data with information from the cabinet information included in the *Parlgov* database.[12] Even though the Parlgov dataset contains party identifiers linking to the Manifesto Project dataset, it has been found to be unreliable over time in this regard. Hence, the matching of the two datasets is conducted manually on a party-election-level based on party name and election results.[13] For details on our measures, the reader is referred to Section 4. As for this step's completion, we merge the obtained variables to our company dataset using country and date as identifiers.

3.2.2. Poll Data

Poll data is used in this study to measure the extent to which election outcomes contain an unexpected element. We manually collect poll data on party level from country-specific polling institutes published in local newspapers for 80 elections in 16 countries between 1992 and 2013. France, Belgium and Japan are countries that are included in the main sample but are not covered in this dataset. We exclude France because of the two-round voting system that creates difficulties of measurement. Japan and Belgium are excluded due to the lack of adequate poll data for the parties contained in the Manifesto dataset. Through the exclusion of these three countries, we loose 21 elections compared to our main sample. Additional 29 elections, most of them in the late 1980's or early 1990's had to be omitted due to the lack of poll data.

The poll data reflect the consensus of the polls published by various polling institutes on, or shortly before, the last trading day before the election. The mean and the median of the difference between actual and expected (polled) vote shares is 0.00%. Figure B. 1 shows the distribution of differences on party level.

[Figure 1 about here.]

3.2.3. Economic Indicators from the World Bank Group

In a final step, we obtain country level economic indicators from *World Bank Group*. This data, i.e. information on country-wide inflation and GDP growth, is openly available via the website of *World Bank Group*.[14] We finally merge these variables to our company-level data by corresponding date and country.

[11] One election cycle is characterized by one or more government cycles, depending on whether there are any changes to the composition of the government. Government cycles are retrieved from the Parlgov cabinet dataset.

[12] Since the Parlgov dataset does not include the US, we collect the information on the US presidential party over time manually and match it analogously.

[13] Special thanks to Martin Moelder (http://www.martinmolder.com) whose matching table we used as a starting point.

[14] See http://www.worldbank.org/ for further information.

4. Methodology

In the following we introduce our parliamentary measures, control variables and outline our empirical strategy.

4.1. Parliamentary Disagreement

We calculate our parliamentary disagreement measures on national parliament level. These measures remain constant for a given country over an entire election cycle, or if stated, over a government cycle.

Early approaches to measure ideological dispersion in parliaments dates back to Taylor and Herman (1971). We model parliamentary disagreement as the seat-weighted dispersion of policy positions among all parties within a national parliament.[15] We propose that the less parties concentrate on the same policy positions, the higher the potential for parliamentary disagreement within a parliament about economic policies. When calculating our measures of dispersion, we take all parties represented in the parliament into account. We weight party scores based on the party representation in order to reflect power balances within the parliament. Consequently, deviant policy positions by weaker parties are weighted less than those of stronger parties.

As main measure of parliamentary disagreement we calculate the Herfindahl-Hirschman (HHI)[16] Index of the seat-weighted average economic policy positions defined as

$$HHI := \sum \left(\frac{x_i}{\sum x_i} \right)^2, \quad \text{with} \quad x_i := \sum w_p s_{p,i} \quad , \tag{1}$$

where w_p represents the party's p seat-based parliamentary representation, $s_{p,i}$ the policy score of party p with regards to policy position i. To align interpretation among our various measures of disagreement, we implement a minor adjustment to the index. As higher HHI values suggest higher concentration, i.e. higher agreement on economic policy positions, we derive our main measure of local parliamentary disagreement as:

$$Local\ Disagreement := -HHI \quad . \tag{2}$$

Hence, when interpreting our results, a higher level of our measure refers to a lower concentration of policy positions and therefore a higher level of disagreement.

As to meet the objection that our results could be driven by the definition of the disagreement measure, we additionally implement two further dispersion measures: (i) the Shannon's index[17] (also Shannon's H), often used as a metric for diversity, and (ii) the average seat-weighted standard deviation across all positions.

[15] We use vote shares instead of seats for weighting when calculating unexpected disagreement for the staggered difference-in-differences setting in Section 7, simply because polling institutions predict election outcomes in vote shares instead of seats.

[16] See Hirschman (1945), Herfindahl (1950), and Hirschman (1964) for a detailed description of this measure.

[17] See Shannon (1948).

We calculate the Shannon Index as follows:

$$Local\ Disagreement_{Shan} := H_S = -\sum x_i ln(x_i), \quad \text{with} \quad x_i := \sum w_p s_{p,i} \quad . \tag{3}$$

Higher values of $LocalDisagreement_{\text{Shan}}$ refer to higher diversity of economic policy positions, i.e. a higher level of disagreement.

For our third proxy for disagreement among parties, we calculate for each policy position the seat-weighted standard deviation of the individual party scores and then take the equally weighted average across all 16 economic policy positions. The measure is defined as

$$Local\ Disagreement_{WSD} := \frac{\sum \sigma_i}{16}, \quad \text{with} \quad \sigma_i := \sqrt{\frac{\sum w_p (s_p - \bar{s_w})^2}{\frac{(N-1)\sum w_p}{N}}} \quad , \tag{4}$$

where, in addition to the notation introduced above, N represents the number of parties and $\bar{s_w}$ the seat-weighted mean of the party scores. Higher values of $Local\ Disagreement_{WSD}$ refer to a higher average dispersion of parties regarding the importance of economic policy positions, and therefore to a higher level of parliamentary disagreement.

While *Local Disagreement* and $Local\ Disagreement_{Shan}$ measure the dispersion of parties across positions, the $Local\ Disagreement_{WSD}$ measures the dispersion of policy scores within each position and provides an aggregated view by taking the mean.

4.2. Policy Positions

We measure the representation of economic policy positions within parliaments to control for changes to the political orientation of parliaments in our regression analyses.

In a first step, we determine the governing parties in each country during the time horizon of our sample. Next, we aggregate scores for each government and individual policy positions of the ruling parties by calculating the seat-weighted mean[18] of the governing parties' policy scores as follows:

$$PP_i := \sum w_p s_{p,i}, \quad with \quad w_p = \frac{\text{seats in parliament of party p}}{\text{total parliament seats}}. \tag{5}$$

where w_p represents the party's p seat-based parliamentary representation, $s_{p,i}$ the policy score of party p with regards to policy position i.

It is important to note that we implicitly correct the measure PP for the combined representation of the ruling parties, by including only the political positions of governing parties but calculating parties' weights on the basis of total parliament seats. For example, suppose there are two countries A and B. In each country there is one ruling party. The

[18] We use vote shares instead of seats for weighting when calculating the unexpected representation of policy positions for the staggered difference-in-differences setting in Section 7, simply because polling institutions predict election outcomes in vote shares instead of seats.

parties have the same policy score of s for policy position i. The only difference is that the party in country A controls 90% of the parliament seats, whereby in country B the party only controls 45%. In this situation our measure PP will be higher for country A than for country B; specifically, in this particular example, it will be twice as high. Thereby we avoid ignoring the overall backing of ruling parties when measuring their positions.[19]

For the US, with its presidential democracy, we defined the president's party as the governing party, and base the party weights on the number of seats of each party in the House of Representatives.

4.3. Additional Variables

4.3.1. Control Variables

To determine our set of control variables, we compare the studies of Lee et al. (2009), Ortiz-Molina and Phillips (2014), Li (2015) and Core et al. (2015). We conclude that there is no clear consensus with regards to control variables for regression settings with ICC as independent variable. Hence, we first extract the control variables that have been used throughout all of these studies. After that, we decide on the remainder, if a clear link to ICC levels is existent. Finally, we end up with a total set of 13 control variables as detailed in Table A. 2, Table A. 3 and Table A. 20 below.

4.3.2. Sample Split Variable

We apply a sample split to refine and substantiate our results. We measure the internationality of firms as the percentage of foreign sales to total sales via the *Datastream/Worldscope* item *wc07101*. We use this variable to test our assumption that the more internationally positioned a firm is, the less it should be affected by local parliamentary disagreement.

4.4. Empirical Strategy

The empirical strategy to answer the research question of this study is twofold: First, we perform long-term yearly firm fixed-effects panel regressions. Second, we analyze a monthly panel around elections in short-term oriented staggered difference-in-differences regressions.

4.4.1. Panel Regressions

The first setting captures the long-term relations between our key variables of interest in a large, international panel. Besides firm-fixed effects, we include time-fixed effects. We control for a set of macroeconomic variables, firm-level financial variables as well as for the levels of economic policy positions.

$$Y_{it} = \phi_i + \delta_t + \beta local disagreement + \zeta_1 controls_{i,t} + \zeta_2 controls_{c,t} + \epsilon \tag{6}$$

[19]The mechanics are similar to interacting the policy positions of the ruling parties with their overall representation within the parliament.

, with ϕ_i as firm fixed effects, δ_t as year fixed effects, and β as the coefficient for the local disagreement measure (LD). $Controls_{i,t}$ and $controls_{c,t}$ denote firm-level and country-level control variables, respectively.

For each country, the political variables are recalculated either after each election (election cycle) or whenever the composition of the government changes (government cycle). Consequently, the explanatory variable varies over time and cross-sectionally. To address potential biases to our t-statistics, we cluster standard errors on country level, or country-year level. The panel regression setting is subject to endogeneity concerns. One potential concern is reverse causality. Previous literature has proposed that rather than politics influencing financial markets, it could be equally plausible to assume that current financial market indicators influence election outcomes. To address this concern, we run predictive regressions with parliamentary disagreement or policy positions as dependent variables and the lagged costs of capital as explanatory variable. We do not find any statistically significant link which would give rise to such concerns and conclude that the perceived level of financial risk is not driving election outcomes. The remaining endogeneity concerns are addressed by our second setting.

4.4.2. Staggered Difference-in-Differences Regressions

The second setting exploits exogenous variation in parliamentary disagreement introduced by elections with surprising outcomes. We hypothesize that the aggregated change to firms' cost of capital as a response to election results is driven by two main components: i) the resolution of general election uncertainty, ii) the unexpected component of the composition of the parliament due to deviations of actual vote shares from expected (polled) vote shares. The latter component can be split up in two distinct effects: i) the unexpected level of representation of policy positions, and ii) the unexpected dispersion of policy positions, i.e. disagreement. Formally, we can summarize the relation between the aggregated change in the firms' cost of capital (CoC) and unexpected election outcomes as follows:

$$\begin{aligned} CoC_{post} - CoC_{pre} = \Delta CoC \sim\ & general\ uncertainty\ resolution + \\ & \Delta policy\ position_1 + ... + \Delta policy\ position_n + \\ & \Delta localdisagreement, \end{aligned} \tag{7}$$

with

$$\Delta policy\ position_n = policy\ position_{n,actual} - policy\ position_{n,expected}, \tag{8}$$

and

$$\Delta localdisagreement = localdisagreement_{actual} - localdisagreement_{expected}. \tag{9}$$

By measuring the difference between actual and expected (polled) outcomes, we are able to calculate the unexpected parliamentary disagreement as well as the unexpected

representation of policy positions.

We use the unexpected parliamentary disagreement as a treatment variable in a staggered difference-in-difference setting. We limit the sample to firm-months around elections over a period of three months before and after the election. To illustrate, we compare the evolution of firms' cost of capital around elections without surprises (control group) and around elections with surprisingly more (or less) parliamentary disagreement than expected (treatment group). In our main specifications we use a ternary version of the treatment variable with cutoff points defined by the terciles of the distribution of the measure for unexpected disagreement. This specification mitigates concerns that it is not the fact of an election surprise per se that leads to a response in the outcome variable, but that the direction of the surprise actually matters.

The regression model is of the form:

$$\begin{aligned} Y_{ite} = \alpha_e + \phi_i + \delta_t + \kappa_{t,s} + \\ & \boldsymbol{\beta(post * \Delta localdisagreement)} + \\ & \beta_1(post * \Delta policy\ position_1) + ...\beta_n(post * \Delta policy\ position_n) + \\ & \zeta_1 controls_{i,t} + \zeta_2 controls_{e,t} + \epsilon \end{aligned} \tag{10}$$

We denote α_e as election fixed effects, ϕ_i as firm-fixed effects, δ_t as event-time fixed effects, and $\kappa_{t,s}$ as industry – event-time fixed effects. *post* is a treatment time dummy equal to one for the three (six) firm-months after an election, zero otherwise. $\Delta disagreement$ refers to the treatment variable measuring unexpected parliamentary disagreement as a ternary variable. $\zeta_1 controls_{i,t}$ and $\zeta_2 controls_{e,t}$ represent firm- and election-specific control variables, respectively. Standard errors are clustered on election level in the main specification.[20]

This setting allows us to derive a causal link between parliamentary disagreement and its effect on firms' cost of capital. We argue that the unexpected parliamentary disagreement variable almost randomly assigns countries to treatment and control groups at a given time. The distribution of differences in vote shares indicates that the expectation of the difference between actual and polled vote shares is indeed zero. We do not observe serial correlation of election surprises. Furthermore, we argue that this setting allows us to measure surprises to the parliamentary composition relatively well. To rule out confounding effects from the unexpected success or failure of certain policy directions we control for unexpected changes to the parliamentary representation of economic policy positions.

We test the robustness of the results of both settings using alternative measures of dependent and explanatory variables and alternative specifications.

[20] We do not explicitely show the post dummy in the model form, as it is perfectly multicollinear to our time dummies.

5. Descriptive Statistics

This section illustrates selected descriptive statistics. Table A. 2 provides an overview of firm-level variables, while Table A. 3 reports summary statistics on country-level:

[Table 2 about here.]

[Table 3 about here.]

Our main sample includes 19 developed, democratic countries with information on 22,328 unique companies from 1988 to 2014. As Table A. 4 describes, our main sample covers 130 elections between 1987 and 2014. It includes 18 parliamentary and one presidential democracy.[21]

Geographically, our sample covers North America, the majority of EU countries, and developed Australasian countries. All of the democracies covered are developed and have a healthy political system, where elected parliaments are the center of national politics. Out of our 164,166 firm-year observations, approximately 40% are US companies, which is common for this type of study. Following are Japan, the UK, Germany, Canada, France and Australia, while e.g. Ireland is contributing only 657 company-years to our sample.

[Table 4 about here.]

Figure B. 2 documents the distribution of countries graphically:

[Figure 2 about here.]

In Figure B. 3 we plot the Herfindahl-Hirschman Index of economic policy positions for the seven largest countries in our sample.[22]

[Figure 3 about here.]

The level of parliamentary disagreement in our sample is on average higher (in this graph indicated by values of HHI closer to zero) towards the second half of our sample, while it seems that at the beginning it rather stays at comparatively low levels. There is considerable variation between time and countries. The disagreement with regards to economic policy was especially high in France and Japan in the 1990s, while it was comparatively low in the UK.

As multicollinearity issues between economic policy positions and control variables might be an important caveat to our analyses, we analyze pairwise correlations in Table A. 21 and standard multicollinearity diagnostics in Table A. 22 in the Appendix. We observe that no pairwise correlation is higher than 0.5, while the mean (max) variance inflation factor is 1.52 (2.29), which is way below critical values. Hence we conclude that multicollinearity is not present in our analyses.

[21] See Section 3 and Section 4 for details on the calculation of our political measures.

[22] Note that we calculate the Local Disagreement Index used for regression as $HHI * -1$. For details on the calculation of measures of parliamentary disagreement see Section 4.

6. Panel Regressions

To investigate the relationship between parliamentary disagreement with regards to economic policies within national parliaments and domestic firms' cost of capital, we perform a set of panel regressions with a variety of specifications. Because higher levels of parliamentary disagreement theoretically imply a higher level of policy uncertainty, we expect that investors will demand higher returns on their investments as compensation for such additional, non-diversifiable risk. Hence, the cost of equity capital for companies should rise. All models are fixed effect panel regressions in which we vary clustering approaches as well as control variables used.

6.1. Main Specification

Table A. 5 presents an overview of our baseline findings. We find highly significant results for a positive relationship between local parliamentary disagreement and firms' cost of equity capital. Model (I) is estimated without control variables and provides evidence for this relationship at the 1%-level. Model (II) and (III) indicate that the explanatory power of our setting can be almost doubled with the control variables specified in Section 4.3, although this leads to a small decrease in significance levels of our main explanatory variable. The findings are robust to different approaches to clustering standard errors, as can be seen via the comparison of the models (II) and (III).

[Table 5 about here.]

The coefficients of the control variables are broadly in line with previous findings in the literature and our theoretical expectations. Leverage and idiosyncratic volatility are positively related to cost of capital, whereby the realized return over the past twelve months, firm size, return on assets and market to book ratio are negatively related to the cost of capital. Higher turnover is also related to a higher cost of capital at the 5% - significance level. Surprising at first sight, neither $BetaWorld_{24}$ is not significantly related to the cost of capital. However, after comparing our results with research questioning the influence of beta factors (Baker et al., 2011) and similar observations in previous studies (Lee et al., 2009; Ortiz-Molina and Phillips, 2014; Li, 2015; Core et al., 2015)[23] this observation does not remain a major concern.

To analyze the economic significance of parliamentary disagreement, we repeat the regressions with standardized variables and rank the economic significance of all variables.The results are shown in table A. 6 and table A. 7. According to the estimated coefficients, a change in the local disagreement index of one standard deviation is associated with an increase of the country-wide average cost of capital of 24 basis points. This represents the largest coefficient among country-level variables in our regressions.

[Table 6 about here.]

[23] See also Section 4.3

[Table 7 about here.]

Summing up, we find clear evidence of a significant positive relationship between levels of local parliamentary disagreement and firms' cost of equity capital. This relationship is of economic significance. The results are in line with the theoretical model by Pastor and Veronesi (2013, p.521), who predict a link between policy uncertainty and risk premia. They also suggest that "political uncertainty could have a negative effect [on asset prices] because it is not fully diversifiable"(Pastor and Veronesi, 2013, p.521). One of the questions thus remaining is whether companies can diversify against policy uncertainty, in our case local parliamentary disagreement. This question motivates the following analysis.

6.2. Internationality and Political Disagreement

Firms claim to reduce risks by diversification, e.g. by offering different products, entering new business sectors and markets or by optimizing the number of suppliers. Turning our attention towards political uncertainty, companies might also be able to diversify against this risk partially by distributing revenues over several countries. This should ultimately lead to a higher resilience of companies against local political discords. Exploiting this construct to test the plausibility of our previous results, we include an interaction term using a dummy variable equal to one if the percentage of *Foreign Sales to Total Sales* is higher than 5Ã§%, zero otherwise. The results provided in Table A. 8 below:

[Table 8 about here.]

Coloumn III provides the results including the interaction term of the local disagreement measure and the internationality dummy. While the baseline coefficient of the local disagreement measure is positive and significant, the coefficient for the interaction term is negative and statistically significant. This regression shows that the increase of cost of capital due to increasing disagreement in local parliaments is offset by a high share of foreign revenues. From this result we derive that the cost of equity capital of more internationally-oriented companies is less affected by local political uncertainty. Hence, we find a clear indication that companies can - at least partially - diversify against effects of political uncertainty, namely against political uncertainty induced by local parliamentary disagreement.

6.3. Tests of Reverse Causality

A major concern when interpreting the previous regression results is reverse causality.[24] As discussed in the literature review, previous researchers and their theoretical foundations

[24]We take note of the concern that also unobserved heterogeneity might be a concern to some readers. However, our firm and time fixed effects, which we use throughout all of our models, should diminish a major portion of these doubts.

suggest that instead of arguing that politics affecting financial markets, it is plausible to establish a causal link in the opposite direction. Voters' party preferences may be driven by the current economic state. Anticipating such shifts, parties might adjust their political positions accordingly. Or alternatively, difficult economic times could be associated with more disagreement about economic policy within parliaments.

[Table 9 about here.]

Following this logic, we should be able to predict political outcomes based on the cost of equity capital. To this end, we perform regressions with the key variables of interest as dependent variables. As explanatory variable we include the cost of capital, and both GDP growth as well as inflation as control variables. All explanatory variables are lagged by one year. Effectively, we predict national election outcomes based on the cost of capital, GDP growth and inflation observed in the year prior to the election. The regression results can be found in Table A. 9. Models (I) to (V) consider different variants of our political disagreement measure as dependent variable. None of the regressions shows a statistically significant relationship between the political variables and the implied cost of capital. Consequently, even though we cannot fully exclude the issue of endogeneity at this point, we do not find strong evidence that the results presented throughout this paper are driven by reverse causality.

6.4. Additional Robustness Tests

The following section investigates variations of models previously discussed in order to alleviate robustness concerns. We alter the specifications of the models with regards to (i) additional political control variables, (ii) the frequency of measurement (election cycle versus government cycles), (iii) the measurement of political disagreement, and (iv) the measurement of the dependent variable cost of capital.

6.4.1. Additional Political Control Variables

We test the robustness of the statistical relationship of the key variables of interest by adding the parliamentary representations of economic policy positions to the main model. Results are provided in Table A. 10:

[Table 10 about here.]

In the settings displayed in column (I) and (II), we observe that local parliamentary disagreement still has a positive and significant relationship to firms' cost of capital. This relations holds irrespective of measurement over government-(I) or election-cycles (II).

We additionally re-run the analyses testing the hypotheses on firms ability to diversify via foreign revenues. In Coloumn IIa and IIb, we show the estimates for domestically-oriented and internationally-oriented firms, respectively. Coloumn III presents the results including an interaction term of the local disagreement measure and the internationality dummy.

We retain full robustness throughout all specifications. However, the offsetting effect of international diversification seems a bit weaker than in previous results, where the coefficients of the baseline effect and the interaction effect were roughly of the same size.

6.4.2. Alternative Measures for Political Disagreement

A plausible caveat against the results presented in this study is related to our measurement of local political uncertainty. It might be argued that results are driven by measurement peculiarities. We utilize two alternative measures, namely the average weighted standard deviation of policy positions and Shannon's H, which both have been introduced to the reader in Section 4. In order to attenuate these concerns, Table A. 11 presents our basic specifications using the alternative measures.

[Table 11 about here.]

From left to right we show results of panel regressions first that use a weighted standard deviation method, where the model shown in column (Ia) is specified without controls, while (Ib) provides results including controls. For both settings the alternative approximation approach on local political disagreement yields equivalent results to our main section. Analogously, results remain unchanged if we approximate local uncertainty via Shannon's H, as shown in (IIa) and (IIb), respectively.

6.4.3. Alternating Frequency of Measurement

In this robustness test we switch the frequency of measurement from government cycles to election cycles. While government cycles only last as long as a certain government composition is in place, election cycles cover the entire period between two elections. Regression results comparable to our baseline regression on political disagreement are shown in Table A. 12.

[Table 12 about here.]

Models (I) to (III) show different settings with and without control variables as well as different cluster approaches. We observe that the alternative specification of local political disagreement still leads significant results at the 1- and 5%-percent level, while control variables demonstrate similar results as in our baseline Table A. 5 in Section 6. This leads us to the conclusion that results are independent of the measurement frequency.

6.4.4. Alternative Dependent Variables

As discussed in Section 3.1.1, our main proxy for a company's cost of capital is the ICC. This measure is used because it is our intention to cover shifts in expectations of market participants and investigate how these expectations are related to political characteristics within countries. We acknowledge that – although we view the ICC as the best available proxy for expected cost of equity capital – there might be readers that prefer results with other related measures. We conduct our main analyses additionally using dividend

yields, which we retrieve per company via *Thomson Reuters/Datastream*.[25] We choose the dividend yield as alternative measure because it contains information comparable to ICC.[26] Furthermore, given that dividends remain relatively stable over time, the measure contains a significant forward-looking element. As for valid controls, we trim down the number of our previous controls discussed in Section 4.3 to a minimum set that should also be relevant in the setting with dividend yield as the dependent variable. Results for our baseline setting are displayed in Table A. 13:

[Table 13 about here.]

Column (I) to (III) show our three different approaches to measure political disagreement in parliaments as introduced in Section 4. All three models contain year and firm fixed effects, the specified minimum set of controls as well as standard errors clustered at the county level.[27] While all controls show plausible coefficients, we can still observe a significant positive relationship between local political disagreement – independent of the measurement approach – and a company's cost of equity capital.

We further acknowledge the caveat that monetary policy, which should manifest itself in changes of a country's risk free rate, might distort our results. This could occur if differences in risk free rates between boom and bust cycles are the underlying driver of a firm's cost of equity capital instead of economic policy positions. Hence, we rerun our main analyses on political disagreement and the combination of political disagreement and economic policy positions with firms' implied equity risk premium. Results are provided in Table A. 23 and Table A. 24.

As results remain qualitatively unchanged with respect to all other specifications, we conclude that our findings remain robust to the choice of dependent variables and are not influenced by monetary policy.

6.4.5. Focus on Years around Elections

Given that the political variables of interest change only relatively infrequently, we should obtain similar results while only including the most relevant time periods in our sample. Consequently, we repeat our baseline regressions with a reduced sample including only observations from years around the election, namely the election year and the adjacent years, i.e. one year prior and one year after the election year.

[Table 14 about here.]

As can be seen from Table A. 14, the regression results remain virtually unchanged across all specifications

[25] Datastream field "DY".
[26] Results stay the same if we use an implied company risk premium instead.
[27] Observations drop because dividend yields are only available for a subset of covered companies.

7. Evidence from Election Surprises

7.1. Preparatory Analyses on Surprising Elections

We test the violation of the parallel trend assumption visually (see Figure B. 4) and statistically for both positive and negative unexpected disagreement in Table A. 15 and Figure A. 16.

[Figure 4 about here.]

[Table 15 about here.]

[Table 16 about here.]

The results are shown in Table A. 15 and Table A. 16 for positive and negative surprises, respectively. Before the election event, the evolution of the dependent variable in the treatment and control group is similar, i.e. the parallel trend assumption is not violated. After the election event, we observe a statistically significant treatment effect in the case of positive unexpected disagreement.

7.2. Main Specification

Table A. 17 summarizes the main results from the staggered difference-in-differences regression setting using a monthly firm panel.

As explained in the previous section, the treatment variable is defined as a ternary variable according to the first, second and third tercile of unexpected parliamentary disagreement. In our regressions, we estimate the coefficient for positive and negative surprises relative to elections with little or no surprising component.

We control for the unexpected components of policy positions. These control variables are coded analogous to the main treatment variable. The rational behind these control variables is that if there is a difference between expected (polled) and actual vote shares, the election outcome is not only surprising with regards to parliamentary disagreement, but also surprising in a sense that certain economic policy positions might be represented more (or less) than expected.

Column I shows the results for the regression without control variables. The results presented in column II include the standard set of control variables used in the panel regression setting. columns IIIa/b additionally includes control variables for policy position surprises. The results of the same setting but with a different approach to clustering standard errors (firm level rather than election level) is shown in column IIIb.

For column IV we limit the sample to observations from the United States and the United Kingdom to provide additional comfort on the validity of the results. The hypothesized effects should be most pronounced in this subsample. This setting should also alleviate concerns around the lack of comparability of the elections across our international sample. Both countries have highly liquid financial markets and the elections in these countries are subject to extensive scrutiny by public observers. In total this sample

includes eleven elections – six UK elections and five US elections. In this setting, the coefficients of the interaction terms and the statistical significance are more pronounced compared to columns Ia/Ib. Particularly, in this setting we observe a significantly negative coefficient for the treatment group containing elections with negative disagreement surprises. This result implies that – compared to elections with little to no surprises – election outcomes with less parliamentary disagreement than expected, cause a decline in the cost of capital of affected firms after the election. The coefficient indicates that the effect is – in absolute terms – smaller than the effect of positive surprises.

Irrespective of the set of control variables, we find a positive and statistically significant coefficient for the interaction term of the post-election dummy variable and the positive surprise treatment variable. This result implies that when countries are subject to the close to random treatment of an election surprise, the costs of capital of firms in this country react subject to the direction of the unexpected parliamentary disagreement. Higher than expected parliamentary disagreement causes an increase in the costs of equity capital. According to the estimated regression coefficients, higher than expected parliamentary disagreement causes an increase in cost of capital of 46 to 110 basis points compared to a control group of firms during elections with little to no surprises. This effect is not only statistically but also economically significant.

[Table 17 about here.]

7.3. Robustness Tests

To ensure robustness of the results obtained in the main setting, we test dividend yields and implied equity risk premia as alternative dependent variables.The results are shown in Table A. 18.

columns Ia/Ib present results without control variables. columns IIa/IIb include only observations for which the set of standard control variables is available. columns IIIa/IIIb present results including the standard control variables, while IVa/IVb show the results including controls for policy position surprises. The results of the main setting remain robust across all specifications. When using dividend yields as outcome variable, the magnitude of the coefficients is lower compared to the main setting. Dividend yields only reflect the change in the firms' stock price, while historical dividends per share remain constant. As we observe a stronger effect for the implied cost of capital (and the implied risk premium), this means that parts of the treatment effect stem from revisions of analyst forecasts that underlie the calculations of these variables.

[Table 18 about here.]

7.4. Speed of earnings forecast revision

Previous literature shows that analysts are sluggish in revising their earnings forecasts upon arrival of new information. Because the ICC measures rely on earnings forecasts, this sluggishness could drive the results of our analyses. If severe enough, the ICC would then

only change due to short-term changes in stock prices without taking into account changes to earnings expectations. This issue would bias the estimate of the ICC as a measure of the discount rate and we should observe a weakening of the effects when controlling for the speed of revision. To mitigate this concern, we analyze how quickly earnings estimates are revised following an election event. Figure B. 5 shows that by the end of the election month, earnings forecasts have been revised for approximately 60% of the firms. By the end of the third month post election, the percentage increases to approximately 90%.

[Figure 5 about here.]

To test whether this sluggishness has an impact on the main regression results, we run several alternative specifications of the main regression setting (see Table A. 19). Coloumn I shows the main specification, Coloumn II presents the results if only companies are taken into account, for which earnings forecasts are revised throughout the election month. It can be seen that the coefficient for positive surprise elections becomes more sizable and more statistically significant as compared to Coloumn I. The coefficient for negative surprises takes on a negative value, but remains statistically insignificant. In Coloumn III the regressions take interaction effects into account. The coefficient of the triple interaction of Positive Surprise, Post, and Fast Revision is not statistically different from zero. This means that in the case of positive disagreement surprises, there seems to be no difference in the reaction of companies with fast or slow earnings forecast revisions. Interestingly, this is different in the case of negative disagreement surprises. Here the coefficient of the triple interaction is statically significant and smaller than zero, while the baseline effect $Post * UnexpectedDisagreement(Neg.)$ remains statistically insignificant. In this case, the ICCs of firms with fast earnings forecast revisions seem to have a more pronounced reaction to the new information than other firms.

[Table 19 about here.]

The results of the regressions controlling for the speed of earnings revision provides additional comfort that the observed effects are truly related to the cost of capital, i.e. the discount rate.

8. Conclusion

Research on economic policy uncertainty and its influences on capital markets has been revived through theoretical work by Pastor and Veronesi (2013) and the introduction of a text-based proxy by Baker et al. (2016). The investigation of the actual components of the policy uncertainty is however still in its infancy.

We introduce parliamentary disagreement in national parliaments as one key component of policy uncertainty. Our study addresses various shortcomings of previous studies and establishes a causal link from parliamentary dynamics to financial markets.

We use the implied cost of capital as a forward-looking risk measure to analyze the association between parliamentary disagreement and financial markets expectations. Measuring parliamentary disagreement within national parliaments as the dispersion of economic policy positions among parties, we show that higher levels of disagreement entail a higher implied cost of equity capital of affected firms. Furthermore, we provide evidence for a geographical diversification effect. While the cost of capital of more domestically-oriented firms is affected by disagreement in national parliaments, firms with a higher share of international revenues are less affected by local parliamentary disagreement. The results imply that investors' risk perception is higher during times of higher political disagreement and that firms can reduce their exposure to political uncertainty through geographical diversification. Exploiting exogenous variation from surprising elections for our identification strategy, we derive causal estimates on the link between local parliamentary disagreement and firms' cost of capital from staggered difference-in-differences regressions. Additional analyses show that the observed effect is remarkably salient in the United States and the United Kingdom. The effect is consistent but smaller when using the dividend yield as the dependent variable. By controlling for the speed of earnings forecast revision, we can conclude that the results are truly related to the cost of capital and not biased by analysts' sluggish reaction to new information.

The empirical results presented in this paper are robust to a variety of alternative specifications of our dependent and independent variables. Tests of reversed causality yield negative results. Our study provides the empirical groundwork for extending the current understanding of the link between politics and financial markets. We suggest future research to focus on a better understanding of the sources of political uncertainty and the consequences of economic policy choices on capital markets.

9. Appendix

[Figure 6 about here.]

[Table 20 about here.]

[Table 21 about here.]

[Table 22 about here.]

[Table 23 about here.]

[Table 24 about here.]

[Table 25 about here.]

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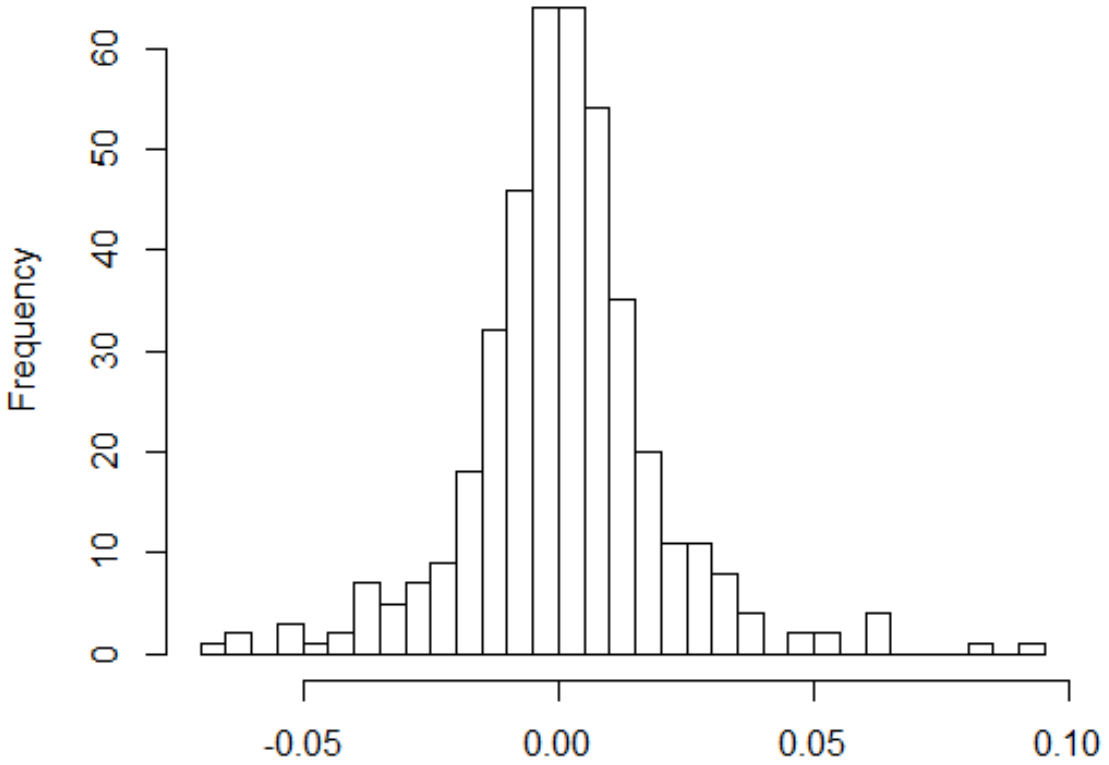
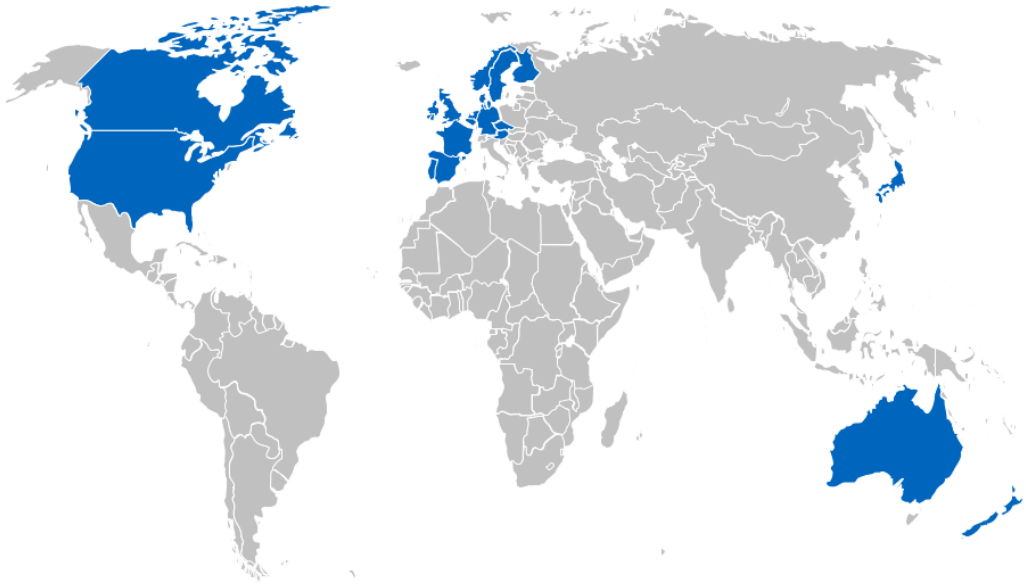
Figure B. 1: Histogramm of differences between actual and expected vote shares on party level



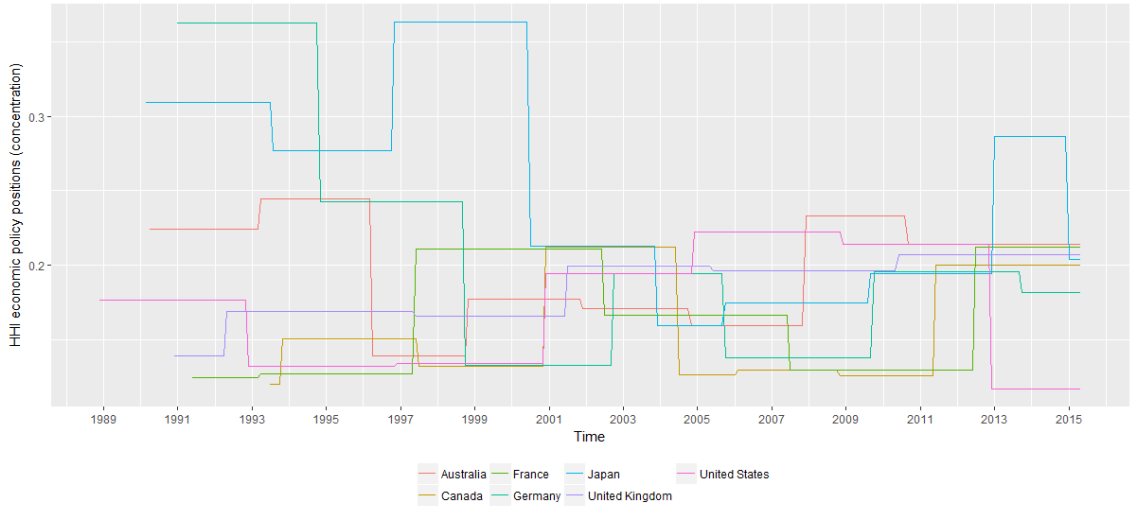
This graphs presents the distribution of poll forecast errors on party level, calculated as the difference of the consensus poll on the last trading day before the election and the actual vote share outcome. The mean and median of the forecast errors is equal to zero. This indicates that there is no systematic bias in the poll data used in this paper.

Figure B. 2: Geographic coverage of our sample (blue)



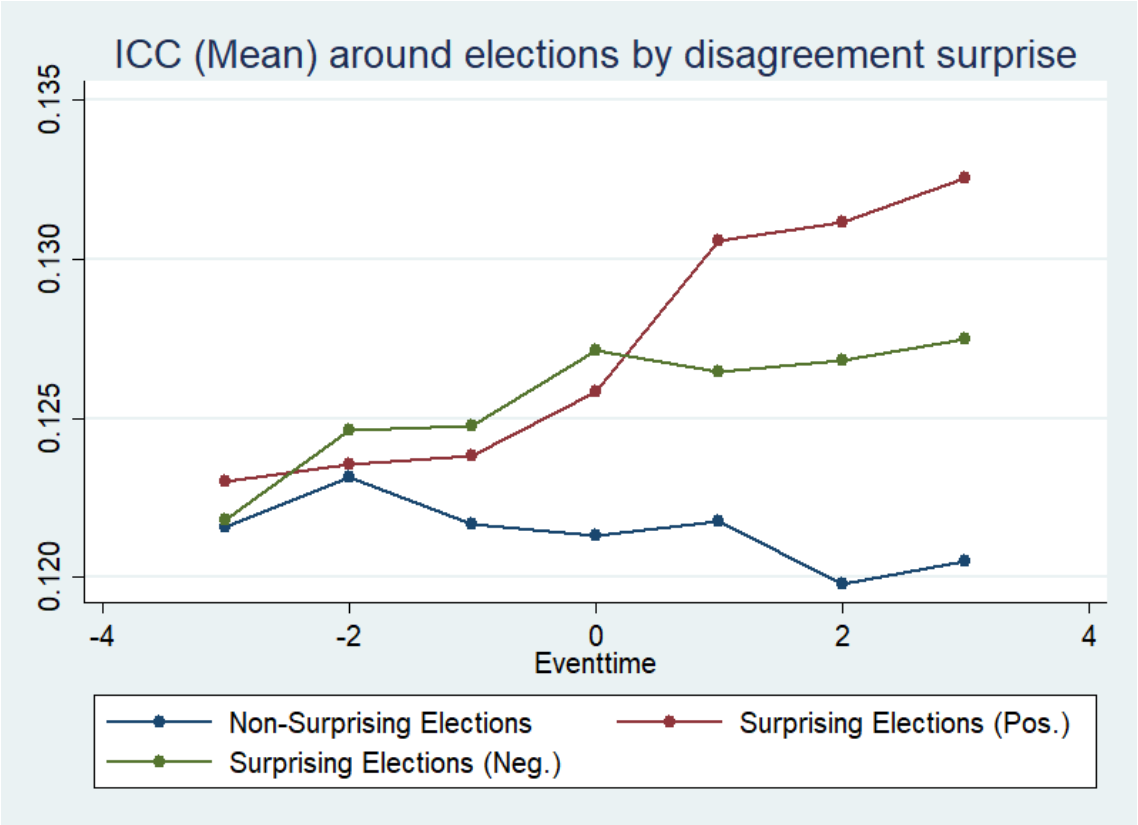
This study covers most of the main advanced economies with democratic systems and developed capital markets globally (in alphabetical order): Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Japan, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerlands, United Kingdom, United States.

Figure B. 3: Development of Political Concentration Over Time and Selected Countries



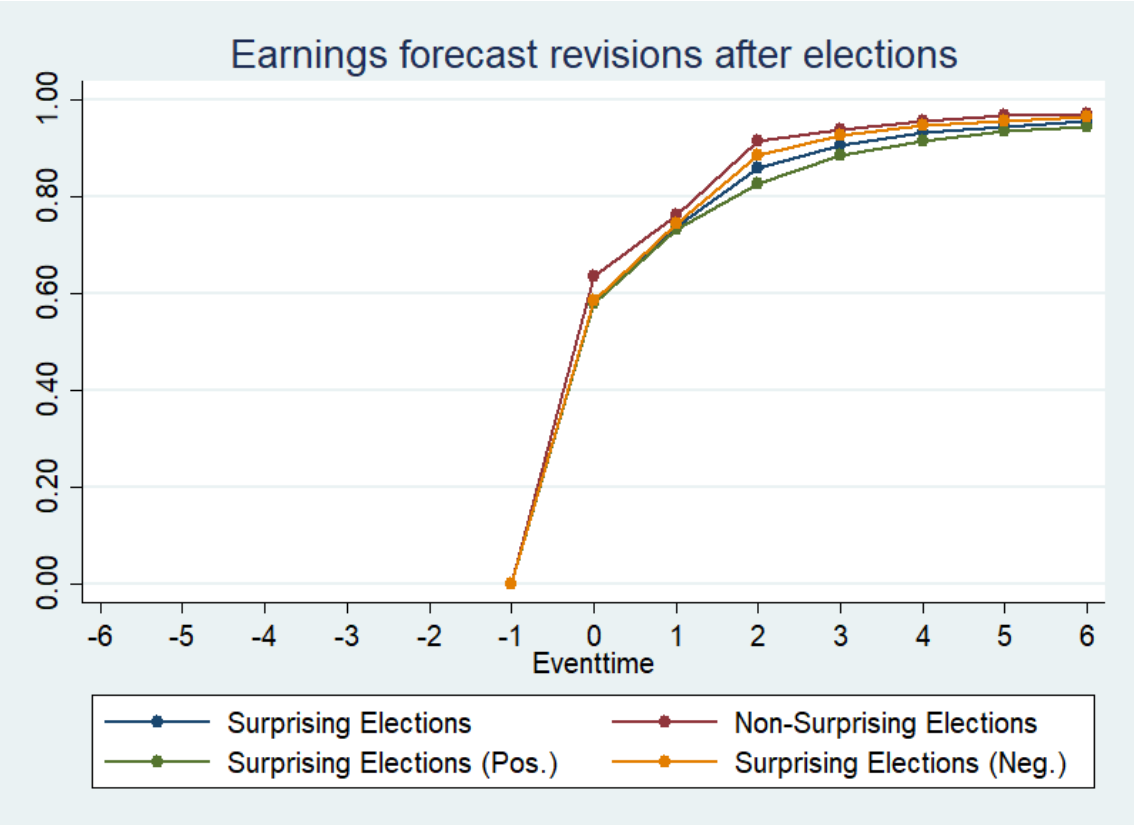
The depicted lines represent the Herfindahl-Hirschman Index of economic policy positions. A higher value of the HHI implies higher concentration of parties' policy position and therefore to a lower level of disagreement. In our regression analysis, we calculate the Local Disagreement Index as $HHI * -1$.

Figure B. 4: ICC around elections by disagreement surprise



This graph shows the level of the main outcome variable (ICC) around elections. Countries are equally weighted.
$t = 0$ represents the end of the election month, i.e. is the first treated time period.
The three lines correspond to the three treatment levels: 1) *meanx_nosurp* contains elections without surprises, i.e. actual vote shares reflect more or less the polled vote shares, 2) *meanx_surp_pos* contains elections for which actual parliamentary disagreement comes out above the expected (polled) level, and 3) *meanx_surp_neg* contains elections for which actual parliamentary disagreement comes out below the expected level.

Figure B. 5: Earnings forecast revisions around elections by election type



This graph plots the percentage of firms for which the consensus of earnings forecast changes compared to the month preceding the election month. By the end of the election month, earnings forecasts have been revised for approximately 60% of the firms. By the end of the third month post election, the percentage increases to approximately 90% .

Figure B. 6: Description of Economic Policy Positions in the Manifesto Project Dataset

Position	Description	Position	Description
Free Market Economy	Favourable mentions of the free market and free market capitalism as an economic model. May include favourable references to: • Laissez-faire economy; • Superiority of individual enterprise over state and control systems; • Private property rights; • Personal enterprise and initiative; • Need for unhampered individual enterprises.	Keynesian Demand Management	Favourable mentions of demand side oriented economic policies (assistance to consumers rather than businesses). Particularly includes increase private demand through • Increasing public demand; • Increasing social expenditures.
Incentives: Positive	Favourable mentions of supply side oriented economic policies (assistance to businesses rather than consumers)	Economic Growth: Positive	The paradigm of economic growth. Includes: • General need to encourage or facilitate greater production; • Need for the government to take measures to aid economic growth.
Market Regulation	Support for policies designed to create a fair and open economic market. May include: • Calls for increased consumer protection; • Increasing economic competition by preventing monopolies and other actions disrupting the functioning of the market; • Defence of small businesses against disruptive powers of big businesses; • Social market economy.	Technology and Infrastructure: Positive	Importance of modernisation of industry and updated methods of transport and communication. May include: • Importance of science and technological developments in industry; • Need for training and research within the economy (This does not imply education in general (see category 506); • Calls for public spending on infrastructure such as roads and bridges; • Support for public spending on technological infrastructure (e.g.: broadband internet, etc.).
Economic Planning	Favourable mentions of long-standing economic planning by the government. May be: • Policy plans, strategies, policy patterns etc.; • Of a consultative or indicative nature.	Controlled Economy	Support for direct government control of economy. May include, for instance: • Control over prices; • Introduction of minimum wages.
Corporatism/ Mixed Economy	Favourable mentions of cooperation of government, employers, and trade unions simultaneously. The collaboration of employers and employee organisations in overall economic planning supervised by the state.	Nationalisation	Favourable mentions of government ownership of industries, either partial or complete; calls for keeping nationalised industries in state hand or nationalising currently private industries. May also include favourable mentions of government ownership of land.
Protectionism: Positive	Favourable mentions of extending or maintaining the protection of internal markets (by the manifesto or other countries). Measures may include: • Tariffs; • Quota restrictions; • Export subsidies.	Economic Orthodoxy	Need for economically healthy government policy making. May include calls for: • Reduction of budget deficits; • Retrenchment in crisis; • Thrift and savings in the face of economic hardship; • Support for traditional economic institutions such as stock market and banking system; • Support for strong currency.
Protectionism: Negative	Support for the concept of free trade and open markets. Call for abolishing all means of market protection (in the manifesto or any other country	Marxist Analysis	Positive references to Marxist-Leninist ideology and specific use of Marxist-Leninist terminology by the manifesto party (typically but not necessary by communist parties)
Economic Goals	Broad and general economic goals that are not mentioned in relation to any other category. General economic statements that fail to include any specific goal. Note: Specific policy positions overrule this category!	Anti-Growth Economy: Positive	Favourable mentions of anti-growth politics. Rejection of the idea that all growth is good growth. Opposition to growth that causes environmental or societal harm. Call for sustainable economic development.

This table provides textual definitions for the 16 economic policy positions according to the Manifesto Project (Volkens et al., 2017) to dissect the economic policy program of parties. This study uses the party-level scores for these positions to derive the main explanatory variables. For more information, please refer to the Methodology section.

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Table A. 1: Overview of Domains and Party Policy Preferences in the Manifesto Project Dataset

	per401	Free Market Economy: Positive
	per402	Incentives: Positive
	per403	Market Regulation: Positive
	per404	Economic Planning: Positive
	per405	Corporatism: Positive
Domain 1: External Relations	**per406**	Protectionism: Positive
Domain 2: Freedom and Democracy	**per407**	Protectionism: Negative
Domain 3: Political System	**per408**	Economic Goals
Domain 4: Economy	**per409**	Keynesian Demand Mgmt.: Positive
Domain 5: Welfare and Quality of Life	**per410**	Economic Growth
Domain 6: Fabric of Society	**per411**	Technology and Infrastructure: Positive
Domain 7: Social Groups	**per412**	Controlled Economy: Positive
	per413	Nationalisation: Positive
	per414	Economic Orthodoxy: Positive
	per415	Marxist Analysis: Positive
	per416	Anti-Growth Economy: Positive

This table presents an overview of the policy dimensions covered by the Manifesto dataset. There are seven domains. Each domain is subdivided into several policy positions. This study focuses on the domain "Economy" and the respective policy positions per401-per416. For details about the policy position scores, please refer to the Methodology section of this study.

Table A. 2: Descriptive Statistics - Yearly Firm-Level Data

	Obs.	Mean	σ	P25	P50	P75
Dependent Variables						
$\text{Icc}_{\text{Hail/Leuz}}$	101,250	0.1118	0.0460	0.0831	0.1026	0.1295
Dividend Yield	101,248	0.0214	0.0244	0.0000	0.0149	0.0318
Company Controls						
Return(12M)	101,250	0.1318	0.4855	-0.1656	0.0820	0.3515
Size	101,250	13.8799	1.9431	12.4624	13.7626	15.116
ROA	101,250	0.0354	0.0772	0.0090	0.0344	0.0691
Leverage	101,250	0.2225	0.1806	0.0611	0.2011	0.3435
M/B	101,250	2.5056	2.4036	1.1525	1.7821	2.8897
Trading Volume (12M)	101,250	0.0247	0.0563	0.001	0.0049	0.0195
$\text{Election}_{\text{Domestic}}$	101,250	0.2621	0.4398	0.0000	0.0000	1.0000
σ_{12M}	101,250	0.3707	0.2042	0.2298	0.3206	0.4541
$Beta_{World24}$	101,250	0.9677	0.8348	0.4142	0.8806	1.4181

This table presents descriptive statistics for the dependent variables and control variables on firm-level. The sample matches the baseline regression setting in Table A. 5, Model (II).

Table A. 3: Descriptive Statistics - Yearly Country-Level Data

	Obs.	Mean	σ	P25	P50	P75
Political Uncertainty						
Local Disagreement	454	-0.1880	0.0515	-0.2123	-0.1823	-0.1516
Local Disagreement$_{\text{Govcycle}}$	454	-0.1885	0.0516	-0.2128	-0.1820	-0.1524
Local Disagreement$_{\text{WSD}}$	454	1.1060	0.4416	0.7600	0.9940	1.5063
Local Disagreement$_{\text{WSD/Govcycle}}$	454	1.0988	0.4378	0.7600	0.9573	1.5063
Local Disagreement$_{\text{Shan}}$	454	0.7786	0.1692	0.6552	0.7903	0.8748
Local Disagreement$_{\text{Shan/Govcycle}}$	454	0.7772	0.1696	0.6499	0.7916	0.8748
Economic Policy Positions						
Free Market Economy	454	1.1048	1.1377	0.2370	0.6980	1.6308
Incentives Positive	454	1.7471	1.6488	0.799	1.4679	2.0196
Market Regulation	454	1.2788	1.2359	0.3923	0.9264	1.7192
Economic Planning	454	0.2887	0.4929	0.0000	0.0695	0.4364
Corporatism / Mixed Economy	454	0.1676	0.2333	0.0000	0.0554	0.3053
Protectionism Positive	454	0.1161	0.3640	0.0000	0.0000	0.0394
Protectionism Negative	454	0.1765	0.3260	0.0000	0.0576	0.2121
Economic Goals	454	1.4019	1.7334	0.2384	0.9689	1.8873
Keynesian Demand Management	454	0.1350	0.5165	0.0000	0.0000	0.0614
Economic Growth Positive	454	1.2479	1.2744	0.3459	0.8081	1.9200
Technology and Infrastructure: Positive	454	3.4136	2.0857	2.0307	3.0768	4.7049
Controlled Economy	454	0.3148	0.9034	0.0000	0.0000	0.1649
Nationalisation	454	0.1227	0.2621	0.0000	0.0000	0.1290
Economic Orthodoxy	454	1.5126	1.6646	0.4044	0.9590	1.9434
Marxist Analysis	454	0.0099	0.0739	0.0000	0.0000	0.0000
Anti-Growth Economy Positive	454	0.2802	0.4890	0.0000	0.0121	0.3384
Country Level Control Variables						
Inflation	454	2.1442	1.5645	1.2536	2.1040	2.8033
ΔGDP	454	2.1267	2.3522	0.9198	2.3660	3.5900

This table presents descriptive statistics for all country-level variables. The statistics are based on all available data points in our yearly dataset. Political positions shown are calculated for governments over government cycles.

Table A. 4: Overview of Countries and Elections Covered

Country name	**Political system**	**First election included**	**Last election included**	**Number of elections**	**Number of observations**
Australia	Parliamentary	1990	2013	9	6,983
Austria	Parliamentary	1990	2008	7	1,038
Belgium	Parliamentary	1991	2010	6	1,631
Canada	Parliamentary	1993	2011	7	8,347
Denmark	Parliamentary	1990	2011	7	1,859
Finland	Parliamentary	1987	2011	7	1,969
France	Parliamentary	1988	2012	6	8,053
Germany	Parliamentary	1990	2013	7	8,349
Ireland	Parliamentary	1992	2011	5	657
Japan	Parliamentary	1990	2014	9	28,145
Netherlands	Parliamentary	1994	2012	7	2,261
New Zealand	Parliamentary	1990	2011	8	1,147
Norway	Parliamentary	1989	2009	6	1,869
Portugal	Parliamentary	1991	2011	7	815
Spain	Parliamentary	1993	2011	6	2,226
Sweden	Parliamentary	1988	2010	7	3,301
Switzerland	Parliamentary	1991	2011	6	3,049
United Kingdom	Parliamentary	1987	2010	6	17,482
United States	Presidential	1988	2012	7	64,985
19 countries	**18:01**	**Min: 1987**	**Max: 2014**	**130**	**164,166**

This table presents an overview of countries included in the main dataset, along with information on the political system of the country, the first and last election covered, the number of elections and the number of firm-year observations.

Table A. 5: Political disagreement, measured as the dispersion of economic policy positions represented in the parliament, is related to higher implied cost of equity capital.

VARIABLES	(I)	(II)	(III)
Local Disagreement$_{\text{Govcycle}}$	**0.053*** **	**0.045*** **	**0.045** **
	(3.33)	**(2.90)**	**(2.57)**
Return(12M)		-0.019***	-0.019***
		(-12.6)	(-8.76)
Size		-0.0084**	-0.0084**
		(-2.66)	(-2.70)
ROA		-0.018***	-0.018**
		(-3.30)	(-2.70)
Leverage		0.034***	0.034***
		(9.06)	(8.04)
M/B		-0.0032***	-0.0032***
		(-5.24)	(-5.12)
Trading Volume (12M)		0.061***	0.061***
		(5.35)	(5.19)
Inflation		0.0013	0.0013
		(1.59)	(1.38)
ΔGDP		-0.000068	-0.000068
		(-0.16)	(-0.11)
Election$_{\text{domestic}}$		-0.00014	-0.00014
		(-0.18)	(-0.14)
σ_{12M}		0.018***	0.018***
		(4.95)	(4.00)
$BetaWorld_{24}$		0.00034*	0.00034
		(1.85)	(0.59)
Observations	159,623	101,250	101,250
No. Clusters	19	19	19x25
$Adj.R^2{}_{\text{witin}}$	0.0034	0.086	0.086
$Adj.R^2$	0.42	0.49	0.49
Fixed Effects	Year	Year	Year
	Firm	Firm	Firm
Controls	No	Yes	Yes
Cluster	Country	Country	Country-Year

The dependent variable is the ICC measure of Hail/Leuz (average of estimates). Year and firm fixed effects are included as indicated. Robust standard errors are clustered as displayed. The underlying estimation algorithm used by the command $reghdfe$ removes the constant in the within transformation. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 6: Economic Significance - Standardized Regression Setting

VARIABLES	(I)	(II)	(III)
Local Disagreement$_{\text{Govcycle}}$	**0.0018***	**0.0024*****	**0.0024****
	(1.85)	**(2.92)**	**(2.59)**
Return(12M)		-0.0090***	-0.0090***
		(-12.6)	(-8.76)
Size		-0.016**	-0.016**
		(-2.65)	(-2.69)
ROA		-0.0014***	-0.0014**
		(-3.30)	(-2.69)
Leverage		0.0061***	0.0061***
		(9.06)	(8.03)
M/B		-0.0077***	-0.0077***
		(-5.24)	(-5.15)
Trading Volume (12M)		0.0034***	0.0034***
		(5.30)	(5.09)
Inflation		0.0016	0.0016
		(1.37)	(1.24)
ΔGDP		-0.00018	-0.00018
		(-0.22)	(-0.15)
Election$_{\text{domestic}}$		-0.000058	-0.000058
		(-0.17)	(-0.13)
σ_{12M}		0.0037***	0.0037***
		(4.96)	(4.00)
$BetaWorld_{24}$		0.00028*	0.00028
		(1.86)	(0.60)
Observations	101,250	101,250	101,250
No. Cluster	19	19	19 x 25
$Adj.R^2{}_{\text{within}}$	0.0015	0.086	0.086
$Adj.R^2$	0.44	0.49	0.49
Fixed Effects	Year	Year	Year
	Firm	Firm	Firm
Controls	No	Yes	Yes
Cluster	Country	Country	Country-Year

The dependent variable is the ICC measure of Hail/Leuz (average of estimates). Year and firm fixed effects are included as indicated. Robust standard errors are clustered as displayed. The underlying estimation algorithm used by the command $reghdfe$ removes the constant in the within transformation. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 7: Importance of Local Political Disagreement as a Determinant of Firms' Cost of Capital

	Economic impact	x-standard. regression coeff.	Marginal effect	Firm/Macro-Level
Local Disagreement$_{\text{Govcycle}}$	**0.0024**	**7**	**2.15%**	**Macro**
Return(12M)	-0.0090	2	-8.05%	Firm
Size	-0.016	1	-14.31%	Firm
ROA	-0.0014	9	-1.25%	Firm
Leverage	0.0061	4	5.45%	Firm
M/B	-0.0077	3	-6.89%	Firm
Trading Volume (12M)	0.0034	6	3.04%	Firm
Inflation	0.0016	8	1.43%	Macro
ΔGDP	-0.00018	11	-0.16%	Macro
Election$_{\text{domestic}}$	-0.000058	12	-0.05%	Macro
σ_{12M}	0.0037	5	3.31%	Firm
$BetaWorld_{24}$	0.00028	10	0.25%	Firm

Marginal effects are calculated for the empirical model presented in Table A. 6. The rank of the economic impact in the second column shows the relative importance of a variable as a determinant of the implied cost of capital. These ranks are based on the absolute size of the x-standardized regression coefficients, as presented in the third column. The fourth column shows the percentage change of the dependent variable if the independent variable – all else equal – is changed by one standard deviation. A detailed description of all variables can be found in Table A. 20.

Table A. 8: International firms are less affected by (local) political disagreement. (Robustness: Threshold foreign sales to total sales at 50%)

Variables	(I)	(II)	(III)
$LD_{Gov.}$	**0.036****	**0.038****	**0.055*****
	(2.27)	**(2.47)**	**(3.53)**
Int_{50} *** $LD_{Gov.}$**			**-0.056*****
			(-3.42)
Int_{50}	**0.0020*****	**0.0019****	**-0.0086*****
	(4.57)	**(2.36)**	**(-2.89)**
Return(12M)		-0.018***	-0.018***
		(-9.18)	(-9.26)
Size		-0.0086***	-0.0084***
		(-3.05)	(-3.11)
ROA		-0.019***	-0.020***
		(-4.75)	(-4.82)
Leverage		0.036***	0.036***
		(6.89)	(6.77)
M/B		-0.0030***	-0.0030***
		(-5.56)	(-5.62)
Tra. Vol.(12M)		0.071***	0.069***
		(4.10)	(4.13)
Inflation		0.0016**	0.0016**
		(2.14)	(2.14)
ΔGDP		0.000089	0.000027
		(0.21)	(0.065)
$\text{Election}_{\text{dom.}}$		-0.00051	-0.00056
		(-0.59)	(-0.66)
σ_{12M}		0.016***	0.016***
		(4.13)	(4.17)
$BetaWorld_{24}$		-0.000075	-0.000054
		(-0.24)	(-0.18)
Observations	65,334	53,085	53,085
No. Clusters	19	19	19
$Adj.R^2_{\text{within}}$	0.0020	0.082	0.083
$Adj.R^2$	0.42	0.48	0.48
Fixed Effects	Year	Year	Year
	Firm	Firm	Firm
Controls	No	Yes	Yes
Cluster	Country	Country	Country

The dependent variable is the ICC measure of Hail/Leuz (average of estimates). All models are fixed effect regressions. Year and firm dummies are included as indicated. Robust standard errors are clustered as displayed. The underlying estimation algorithm used by the command *reghdfe* removes the constant in the within transformation. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 9: Reverse Causality Analysis (Robustness Predicting Political Variables with ICC)

	(I)	(II)	(III)	(IV)	(V)
Variables	LDI (Govcyc.)	LDI (Govcyc.)	LDI (Ecycles)	LDI (Shan. H)	LDI (WSD)
$\mathbf{ICC_{Hail/Leuz}}$-(lag12M)	**0.0056**	**0.0056**	**0.0065**	**0.13**	**-0.059**
	(0.31)	**(0.15)**	**(0.35)**	**(1.56)**	**(-0.35)**
Inflation-(lag12M)	0.0041	0.0041	0.0040	-0.034**	-0.089**
	(0.66)	(0.60)	(0.64)	(-2.29)	(-2.17)
$\Delta GDP-(lag12M)$	-0.014*	-0.014	-0.014*	-0.013*	-0.022
	(-1.94)	(-1.65)	(-1.94)	(-1.87)	(-1.15)
Observations	24,497	24,497	24,497	24,497	24,497
No. Clusters	19	19	19	19	19
$Adj.R^2_{\text{within}}$	0.10	0.10	0.10	0.057	0.084
$Adj.R^2$	0.44	0.44	0.44	0.65	0.77
Fixed Effects	Firm	Firm	Firm	Firm	Firm
	Year	Year	Year	Year	Year
Controls	Yes	Yes	Yes	Yes	Yes
Cluster	Country	Country-Year	Country	Country	Country

This table presents results from predictive regression to test for reverse causality. The dependent variable is either one of our uncertainty indices or policy positions as indicated. All models are fixed effect regressions. Year and firm dummies are included as indicated. Robust standard errors are clustered as displayed. The underlying estimation algorithm used by the command *reghdfe* removes the constant in the within transformation. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 10: Combining Political Disagreement and Economic Policy Positions

VARIABLES	(Ia)	(Ib)	(IIa) < 50%	(IIb) >= 50%	(III)
Local Disagreement$_{Govcycle}$	**0.045****		**0.061*****	**0.032***	**0.059*****
	(2.85)		**(3.21)**	**(1.75)**	**(3.35)**
int_{50}***Local Disagreement$_{Govcycle}$**					**-0.027****
					(-2.67)
int_{50}					**-0.0036***
					(-1.94)
Local Disagreement$_{Ecycle}$		**0.045*****			
		(2.93)			
Free Market Economy	-0.0019*	-0.0019*	-0.0025**	-0.0021*	-0.0024**
	(-1.95)	(-1.92)	(-2.70)	(-1.90)	(-2.31)
Incentives – Positive	0.00058	0.00057	0.0011*	0.0014***	0.0013**
	(0.97)	(0.97)	(1.73)	(2.91)	(2.36)
Market Regulation	0.0021**	0.0021**	0.0020**	0.0011	0.0017*
	(2.39)	(2.39)	(2.36)	(1.70)	(2.08)
Economic Planning	0.0032*	0.0032*	0.0031	0.00097	0.0021
	(1.75)	(1.74)	(1.51)	(1.00)	(1.66)
Corporatism/Mixed Economy	-0.0013	-0.0013	-0.0019	-0.00094	-0.0016
	(-0.43)	(-0.43)	(-0.58)	(-0.46)	(-0.58)
Protectionism–Positive	-0.0099***	-0.0099***	-0.0083***	-0.0027	-0.0078**
	(-4.31)	(-4.26)	(-4.75)	(-0.72)	(-2.66)
Protectionism – Negative	0.0035	0.0035	0.0015	0.0022	0.0027
	(1.51)	(1.48)	(0.63)	(0.64)	(0.83)
Economic Goals	-0.00032	-0.00036	-0.000058	7.5e-06	-0.000048
	(-0.85)	(-0.95)	(-0.13)	(0.022)	(-0.15)
Keynesian Demand Management	0.0042	0.0042	0.0057**	0.000091	0.0035
	(1.71)	(1.71)	(2.68)	(0.033)	(1.33)
Economic Growth – Positive	0.0013	0.0013	0.0010	-0.00058	0.00061
	(1.45)	(1.45)	(1.25)	(-0.66)	(0.62)
Technology and Infrastructure: Positive	0.0016***	0.0016***	0.0016***	0.0013*	0.0017***
	(3.70)	(3.67)	(3.91)	(1.83)	(3.16)
Controlled Economy	-0.0015	-0.0015	-0.0044*	0.0021	-0.00060
	(-0.50)	(-0.50)	(-1.97)	(0.75)	(-0.19)
Nationalisation	-0.0021	-0.0021	-0.0014	0.00020	-0.0012
	(-0.64)	(-0.63)	(-0.34)	(0.065)	(-0.34)
Economic Orthodoxy	0.00038	0.00039	0.00041	0.00063	0.00042
	(0.99)	(1.02)	(0.91)	(1.49)	(0.93)
Marxist Analysis	0.012***	0.012***	-0.011**	0.013**	0.0071*
	(2.93)	(2.93)	(-2.37)	(2.88)	(1.77)
Anti-Growth Economy – Positive	-0.0013	-0.0013	-0.00084	0.00046	0.00031
	(-0.69)	(-0.69)	(-0.44)	(0.42)	(0.21)
Observations	101,250	101,250	33,076	19,194	53,085
No. Clusters	19	19	19	19	19
$Adj.R^2_{\text{witin}}$	0.10	0.10	0.11	0.073	0.097
$Adj.R^2$	0.50	0.50	0.51	0.47	0.49
Fixed Effects	Year Firm	Year Firm	Year Firm	Year Firm	Year Firm
Controls	No	Yes	Yes	Yes	Yes
Cluster	Country	Country	Country	Country	Country

The dependent variable is the ICC measure of Hail/Leuz (average of estimates). All models are fixed effect regressions. Year and firm dummies are included as indicated. Robust standard errors are clustered as displayed. The underlying estimation algorithm used by the command *reghdfe* removes the constant in the within transformation. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 11: Political disagreement, measured via weighted standard deviation and Shannon's H, is related to higher implied cost of equity capital. (Robustness independent variables)

VARIABLES	(I)	(II)	(III)	(IV)
Local Disagreement$_{\text{WSD}}$	**0.014****	**0.0081****		
	(2.19)	**(2.76)**		
Local Disagreement$_{\text{Shannon's H}}$			**0.029****	**0.019****
			(2.35)	**(2.17)**
Return(12M)		-0.018***		-0.019***
		(-11.9)		(-12.2)
$ln(Size)$		-0.0085**		-0.0083**
		(-2.66)		(-2.85)
ROA		-0.017***		-0.018***
		(-3.12)		(-3.22)
Leverage		0.033***		0.034***
		(9.43)		(9.13)
M/B		-0.0032***		-0.0032***
		(-5.43)		(-5.51)
Trading Volume (12M)		0.060***		0.060***
		(4.94)		(5.40)
Inflation		0.00056		0.00067
		(0.55)		(0.65)
ΔGDP		0.00017		0.00029
		(0.46)		(0.71)
Election$_{\text{domestic}}$		0.00018		-0.000046
		(0.20)		(-0.055)
σ_{12M}		0.018***		0.018***
		(5.15)		(4.86)
$BetaWorld_{24}$		0.00028		0.00038*
		(1.08)		(1.85)
Observations	159,623	101,250	159,623	101,250
No. Clusters	19	19	19	19
$Adj.R^2_{\text{within}}$	0.0052	0.086	0.0069	0.087
$Adj.R^2$	0.42	0.49	0.42	0.49
Fixed Effects	Year	Year	Year	Year
	Firm	Firm	Firm	Firm
Controls	No	Yes	No	Yes
Cluster	Country	Country	Country	Country

This table presents results from robustness tests. In comparison to the main specification, we use different definitions of the local disagreement measure. Instead calculating disagreement via the Herfindahl Index, the weighted standard deviation and the Shannon Index are used. The dependent variable remains unchanged and is defined as the ICC measure of Hail/Leuz (average of estimates). All models are fixed effect regressions. Year and firm dummies are included as indicated. Robust standard errors are clustered at the country level. The underlying estimation algorithm used by the command *reghdfe* removes the constant in the within transformation. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 12: Political disagreement, measured as the dispersion of economic policy positions represented in the parliament, is related to higher implied cost of equity capital. (Robustness Election Cycles)

VARIABLES	(I)	(II)	(III)
Local Disagreement$_{\text{Ecycle}}$	**0.056*** (3.15)**	**0.047** (2.83)**	**0.047** (2.52)**
Return(12M)		-0.019***	-0.019***
		(-12.6)	(-8.78)
Size		-0.0084**	-0.0084**
		(-2.68)	(-2.72)
ROA		-0.018***	-0.018**
		(-3.30)	(-2.70)
Leverage		0.034***	0.034***
		(9.03)	(8.01)
M/B		-0.0032***	-0.0032***
		(-5.25)	(-5.14)
Trading Volume (12M)		0.061***	0.061***
		(5.38)	(5.22)
Inflation		0.0013	0.0013
		(1.56)	(1.36)
ΔGDP		-0.000044	-0.000044
		(-0.11)	(-0.071)
Election$_{\text{domestic}}$		-0.00015	-0.00015
		(-0.19)	(-0.15)
σ_{12M}		0.018***	0.018***
		(4.96)	(4.01)
$BetaWorld_{24}$		0.00033*	0.00033
		(1.81)	(0.59)
Observations	159,623	101,250	101,250
No. Clusters	19	19	19x25
$Adj.R^2{}_{\text{within}}$	0.0036	0.086	0.086
$Adj.R^2$	0.42	0.49	0.49
Fixed Effects	Year	Year	Year
	Firm	Firm	Firm
Controls	No	Yes	Yes
Cluster	Country	Country	Country-Year

The dependent variable is the ICC measure of Hail/Leuz (average of estimates). Year and firm fixed effects are included as indicated. Robust standard errors are clustered as displayed. The underlying estimation algorithm used by the command *reghdfe* removes the constant in the within transformation. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 13: Political disagreement, measured as the dispersion of economic policy positions represented in the parliament, is related to higher implied cost of equity capital. (Robustness using dividend yield as dependent variable)

VARIABLES	(I)	(II)	(III)
Local Disagreement$_{\text{Govcycle}}$	**0.015****		
	(2.74)		
Local Disagreement$_{\text{WSD}}$		**0.0029****	
		(2.18)	
Local Disagreement$_{\text{Shan}}$			**0.0059*****
			(3.23)
Size	0.0011*	0.0010*	0.0011*
	(1.94)	(1.81)	(2.07)
Inflation	0.00094***	0.00069**	0.00073**
	(4.21)	(2.73)	(2.87)
ΔGDP	-0.00026	-0.00018	-0.00014
	(-0.97)	(-0.70)	(-0.53)
Return(12M)	-0.0066***	-0.0066***	-0.0066***
	(-4.01)	(-3.94)	(-3.97)
σ_{12M}	-0.0050***	-0.0049***	-0.0050***
	(-4.03)	(-3.91)	(-4.10)
$BetaWorld_{24}$	-0.00065**	-0.00067**	-0.00063**
	(-2.30)	(-2.34)	(-2.30)
Trading Volume (12M)	-0.0070	-0.0075	-0.0075
Observations	104,647	104,647	104,647
No. Clusters	19	19	19
$Adj.R^2_{\text{within}}$	0.048	0.048	0.048
$Adj.R^2$	0.66	0.66	0.66
Fixed Effects	Year	Year	Year
	Firm	Firm	Firm
Controls	Yes	Yes	Yes
Cluster	Country	Country	Country

The dependent variable is the dividend yield. Year and firm fixed effects are included as indicated. Robust standard errors are clustered as displayed. The underlying estimation algorithm used by the command *reghdfe* removes the constant in the within transformation. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 14: Combining Political Disagreement and Economic Policy Positions (Robustness: Focus on pre-election, election and post-election years)

VARIABLES	(I)	(II)	(III)	(IVa) ¡50	(IVb) ¿=50	(V)
Local Disagreement$_{Govcycle}$	**0.042****		**0.036****	**0.043*****	**0.027***	**0.047*****
	(2.63)		**(2.81)**	**(3.09)**	**(1.99)**	**(3.22)**
int_{50}*Local Disagreement$_{Govcycle}$						**-0.024***
						(-2.02)
int_{50}						**-0.0028**
						(-1.23)
Local Disagreement$_{Ecycle}$		**0.043****				
		(2.61)				
Free Market Economy			-0.0020*	-0.0023**	-0.0022*	-0.0024**
			(-1.97)	(-2.28)	(-1.77)	(-2.17)
Incentives – Positive			0.00045	0.00080	0.0014**	0.0011
			(0.59)	(1.04)	(2.74)	(1.52)
Market Regulation			0.0017*	0.0017*	0.00042	0.0012
			(2.05)	(2.06)	(0.63)	(1.35)
Economic Planning			0.0035*	0.0039*	0.0011	0.0025*
			(2.00)	(1.95)	(1.12)	(1.81)
Corporatism/Mixed Economy			-0.0013	0.00039	-0.0027	-0.0012
			(-0.49)	(0.13)	(-0.99)	(-0.40)
Protectionism – Positive			-0.010***	-0.0087***	-0.0040	-0.0086***
			(-5.80)	(-7.01)	(-1.03)	(-3.41)
Protectionism – Negative			0.0069***	0.0049***	0.0066**	0.0062**
			(4.25)	(3.22)	(2.28)	(2.51)
Economic Goals			-0.00059*	-0.00043	-0.00010	-0.00032
			(-1.87)	(-1.09)	(-0.31)	(-0.97)
Keynesian Demand Management			0.0040*	0.0053**	0.00022	0.0034
			(1.88)	(2.76)	(0.078)	(1.47)
Economic Growth – Positive			0.0014	0.0011	-0.000060	0.00078
			(1.73)	(1.51)	(-0.059)	(0.85)
Technology and Infrastructure: Positive			0.0022***	0.0021***	0.0017**	0.0022***
			(5.37)	(5.61)	(2.70)	(4.83)
Controlled Economy			-0.0020	-0.0049**	0.0016	-0.0012
			(-0.70)	(-2.57)	(0.75)	(-0.40)
Nationalisation			0.0024	0.0039	0.0048	0.0037
			(0.90)	(1.21)	(1.63)	(1.20)
Economic Orthodoxy			0.00080**	0.0010**	0.00074	0.00085*
			(2.29)	(2.60)	(1.43)	(1.92)
Marxist Analysis			-0.0032	-0.034***	0.0037	-0.0031
			(-0.73)	(-5.35)	(0.83)	(-0.68)
Anti-Growth Economy – Positive			-0.0017	-0.0011	-0.00088	-0.00071
			(-0.86)	(-0.54)	(-0.54)	(-0.42)
Observations	74,267	74,267	74,267	24,399	13,526	38,672
No. Clusters	19	19	19	19	19	19
$Adj.R^2_{\text{within}}$	0.087	0.087	0.11	0.12	0.072	0.11
$Adj.R^2$	0.50	0.50	0.51	0.52	0.48	0.50
Fixed Effects	Year Firm	Year Firm	Year Firm	Year Firm	Year Firm	Year Firm
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Country	Country	Country	Country	Country	Country

The dependent variable is the ICC measure of Hail/Leuz (average of estimates). All models are fixed effect regressions. Year and firm dummies are included as indicated. Robust standard errors are clustered as displayed. The underlying estimation algorithm used by the command *reghdfe* removes the constant in the within transformation. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 15: Time Trend Causality Analyses (Positive Surprises)

VARIABLES	(Ia) ICC	(Ib) ICC	(IIa) ICC-Premium	(IIb) ICC-Premium	(IIIa) Dividend Yield	(IIIb) Dividend Yield
t-5*Unexpected Disagreement (Pos.)	0.0016	0.00065	0.00092	-0.00012	0.00029	0.00052
	(1.34)	(0.55)	(0.66)	(-0.10)	(0.43)	(0.75)
t-4*Unexpected Disagreement (Pos.)	0.0028	0.0027	0.0022	0.0022	-0.00058	-0.000021
	(0.86)	(0.87)	(0.65)	(0.66)	(-0.73)	(-0.024)
t-3*Unexpected Disagreement (Pos.)	-0.00055	-0.0010	-0.0011	-0.0016	-0.0010	-0.00059
	(-0.26)	(-0.59)	(-0.49)	(-0.74)	(-1.32)	(-0.66)
t-2*Unexpected Disagreement (Pos.)	0.0035	0.00081	0.0024	-0.00020	-0.00058	-0.00071
	(0.96)	(0.31)	(0.59)	(-0.065)	(-0.63)	(-0.78)
t-1*Unexpected Disagreement (Pos.)	0.0083	0.0060	0.0070	0.0045	0.00030	0.00021
	(1.03)	(0.99)	(0.86)	(0.76)	(0.20)	(0.15)
t-0*Unexpected Disagreement (Pos.)	0.014*	0.012**	0.017*	0.015*	0.0017	0.0021
	(1.85)	(2.09)	(1.85)	(1.99)	(1.10)	(1.49)
t+1*Unexpected Disagreement (Pos.)	0.011**	0.0081***	0.016**	0.014**	0.0017	0.0020
	(2.18)	(2.79)	(2.19)	(2.51)	(1.30)	(1.62)
t+2*Unexpected Disagreement (Pos.)	0.013**	0.012**	0.017**	0.016**	0.0022	0.0023
	(2.25)	(2.14)	(2.35)	(2.03)	(1.33)	(1.39)
t+3*Unexpected Disagreement (Pos.)	0.015**	0.013**	0.018***	0.016**	0.0027	0.0033*
	(2.62)	(2.53)	(2.76)	(2.46)	(1.37)	(1.74)
t+4*Unexpected Disagreement (Pos.)	0.011**	0.010**	0.017**	0.016**	0.0014	0.0023
	(2.11)	(2.31)	(2.53)	(2.42)	(0.83)	(1.42)
t+5*Unexpected Disagreement (Pos.)	0.0067*	0.0054*	0.010**	0.0084**	0.00052	0.0014
	(1.70)	(1.84)	(2.24)	(2.07)	(0.41)	(1.24)
t+6*Unexpected Disagreement (Pos.)	0.0075**	0.0051**	0.010**	0.0070**	0.00011	0.00061
	(2.10)	(2.08)	(2.24)	(1.99)	(0.081)	(0.51)
Observations	333,118	225,800	333,118	225,800	333,278	226,380
No. Clusters	80	75	80	75	80	75
$Adj.R^2_{\text{within}}$	0.0088	0.10	0.014	0.11	0.0052	0.058
$Adj.R^2$	0.55	0.60	0.58	0.63	0.74	0.77
Fixed Effects	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime
Controls	Pol. Surpr.	Standard Pol. Surpr.	Pol. Surpr.	Standard Pol. Surpr.	Pol. Surpr.	Standard Pol. Surpr.
Cluster	Election	Election	Election	Election	Election	Election

This table presents results from staggered difference-in-differences regressions in which we test the violation of the parallel trend assumption for three closely related outcome variables: the ICC measure of Hail/Leuz (average of estimates), the implied equity premium calculated as the ICC measure of Hail/Leuz less the risk free rate (ICC-Premium), and the Dividend Yield. The sample consists of monthly firm-level observations six months before and after an election. The exogenous treatment variable *Unexpected Disagreement (Pos.)* is a binary variable equal to one for all elections falling in the third tercile of unexpected parliamentary disagreement (higher than expected), zero otherwise. The regression models include interaction terms between the time dummy variables for each month around the elections (t-5 to t+6; t-6 omitted intentionally) and the treatment variable. Fixed effects are included as indicated. Robust standard errors are clustered as displayed. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 16: Time Trend Causality Analyses (Negative Surprises)

VARIABLES	(Ia) ICC	(Ib) ICC	(IIa) ICC-Premium	(IIb) ICC-Premium	(IIIa) Dividend Yield	(IIIb) Dividend Yield
t-5*Unexpected Disagreement (Neg.)	-0.0014	-0.0016	-0.0014	-0.0014	-0.000040	-0.00043
	(-1.05)	(-1.63)	(-0.95)	(-1.33)	(-0.095)	(-1.11)
t-4*Unexpected Disagreement (Neg.)	0.00037	-0.0012	0.00017	-0.0013	0.00057	-0.00028
	(0.13)	(-0.58)	(0.066)	(-0.67)	(1.23)	(-0.64)
t-3*Unexpected Disagreement (Neg.)	0.0027	0.00072	0.0024	0.00067	0.00072	-0.00035
	(1.40)	(0.44)	(1.38)	(0.44)	(1.63)	(-0.71)
t-2*Unexpected Disagreement (Neg.)	0.00100	-0.00032	0.0016	0.00049	0.00059	-0.00041
	(0.34)	(-0.15)	(0.55)	(0.25)	(1.13)	(-0.76)
t-1*Unexpected Disagreement (Neg.)	-0.0021	-0.0032	-0.00074	-0.0014	0.00045	-0.00037
	(-0.40)	(-0.81)	(-0.15)	(-0.39)	(0.51)	(-0.48)
t-0*Unexpected Disagreement (Neg.)	-0.0042	-0.0048	-0.0049	-0.0055	-0.0016	-0.0024**
	(-0.68)	(-1.04)	(-0.64)	(-0.90)	(-1.47)	(-2.52)
t+1*Unexpected Disagreement (Neg.)	-0.0034	-0.0037	-0.0058	-0.0060	-0.0013	-0.0020**
	(-0.66)	(-1.13)	(-0.83)	(-1.15)	(-1.26)	(-2.17)
t+2*Unexpected Disagreement (Neg.)	-0.0023	-0.0049	-0.0032	-0.0048	-0.00082	-0.0013
	(-0.42)	(-1.06)	(-0.45)	(-0.75)	(-0.69)	(-1.23)
t+3*Unexpected Disagreement (Neg.)	-0.0023	-0.0048	-0.0045	-0.0062	-0.00077	-0.0017
	(-0.40)	(-1.10)	(-0.64)	(-1.06)	(-0.49)	(-1.29)
t+4Unexpected Disagreement (Neg.)	-0.00100	-0.0038	-0.0057	-0.0077	0.00021	-0.00088
	(-0.17)	(-0.97)	(-0.78)	(-1.38)	(0.14)	(-0.72)
t+5*Unexpected Disagreement (Neg.)	0.0015	-0.0019	-0.00024	-0.0030	0.00063	-0.00072
	(0.32)	(-0.67)	(-0.044)	(-0.82)	(0.55)	(-0.84)
t+6*Unexpected Disagreement (Neg.)	0.0025	-0.0014	0.0033	-0.00024	0.00060	-0.00066
	(0.59)	(-0.70)	(0.60)	(-0.074)	(0.46)	(-0.66)
Observations	333,118	225,800	333,118	225,800	333,278	226,380
No. Clusters	80	75	80	75	80	75
$Adj.R^2_{\text{within}}$	0.0064	0.099	0.0099	0.11	0.0048	0.057
$Adj.R^2$	0.55	0.60	0.58	0.63	0.74	0.77
Fixed Effects	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime
Controls	Pol. Surpr.	Standard Pol. Surpr.	Pol. Surpr.	Standard Pol. Surpr.	Pol. Surpr.	Standard Pol. Surpr.
Cluster	Election	Election	Election	Election	Election	Election

This table presents results from staggered difference-in-differences regressions in which we test the violation of the parallel trend assumption for three closely related outcome variables: the ICC measure of Hail/Leuz (average of estimates), the implied equity premium calculated as the ICC measure of Hail/Leuz less the risk free rate (ICC-Premium), and the Dividend Yield. The sample consists of monthly firm-level observations six months before and after an election. The exogenous treatment variable *Unexpected Disagreement (Neg.)* is a binary variable equal to one for all elections falling in the first tercile of unexpected parliamentary disagreement (lower than expected), zero otherwise. The regression models include interaction terms between the time dummy variables for each month around the elections (t-5 to t+6; t-6 omitted intentionally) and the treatment variable. Fixed effects are included as indicated. Robust standard errors are clustered as displayed. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 17: Surprising elections: Staggered difference-in-differences regressions

VARIABLES	(I)	(II)	(IIIa)	(IIIb) Cluster Firm	(IV) Only U.S. & UK
Post*Unexpected Disagreement (Pos.)	**0.0082****	**0.0048****	**0.0080*****	**0.0080*****	**0.011****
	(2.27)	**(2.35)**	**(4.98)**	**(10.9)**	**(3.03)**
Post*Unexpected Disagreement (Neg.)	**0.0012**	**-0.00051**	**0.00025**	**0.00025**	**-0.0027****
	(0.43)	**(-0.25)**	**(0.19)**	**(0.44)**	**(-3.24)**
Return(12M)		-0.021***	-0.021***	-0.021***	
		(-10.4)	(-10.8)	(-35.1)	
Size		-0.0037***	-0.0036***	-0.0036***	
		(-5.44)	(-5.39)	(-5.08)	
ROA		-0.0086	-0.0087	-0.0087*	
		(-1.10)	(-1.12)	(-1.65)	
Leverage		0.031***	0.031***	0.031***	
		(7.60)	(7.62)	(8.82)	
M/B		-0.0024***	-0.0024***	-0.0024***	
		(-9.58)	(-9.49)	(-15.0)	
Trading Volume (12M)		0.047***	0.047***	0.047***	
		(2.69)	(2.70)	(4.84)	
Inflation		-0.00019	0.00015	0.00015	
		(-0.38)	(0.41)	(0.88)	
ΔGDP		0.0013***	0.0013***	0.0013***	
		(3.15)	(3.86)	(8.70)	
σ_{12M}		0.032***	0.031***	0.031***	
		(5.28)	(5.40)	(14.3)	
$BetaWorld_{24}$		0.00067	0.00065	0.00065	
		(0.94)	(0.93)	(1.55)	
Observations	122,540	122,540	122,540	122,540	71,939
No. Clusters	75	75	75	8517	10
$Adj.R^2_{\text{within}}$	0.0032	0.099	0.10	0.10	0.011
$Adj.R^2$	0.59	0.63	0.63	0.63	0.58
Fixed Effects	Firm	Firm	Firm	Firm	Firm
	Election	Election	Election	Election	Election
	Eventtime	Eventtime	Eventtime	Eventtime	Eventtime
	Industry	Industry	Industry	Industry	Industry
	x	x	x	x	x
	Eventtime	Eventtime	Eventtime	Eventtime	Eventtime
Controls		Standard	Standard	Standard	
			Policy Surprises	Policy Surprises	
Cluster	Election	Election	Election	Firm	Election

This table presents results from the main staggered difference-in-differences regression setting. The dependent variable is the ICC measure of Hail/Leuz (average of estimates). The sample consists of monthly firm-level observations three months before and after an election. The exogenous treatment variables *Unexpected Disagreement (Pos.)* and *Unexpected Disagreement (Neg.)* are binary variable equal to one for all elections falling in the third (first) tercile of – i.e. higher (lower) than expected –unexpected parliamentary disagreement, zero otherwise. Fixed effects and control variables are included as indicated. Standard control variables include i) on firm level (monthly frequency): market to book, 12-month stock return, 12-month trading turnover, stock return volatility, 24-month beta (world index), ii) on firm level (yearly frequency): return on asset, leverage, iii) on country level (yearly frequency): inflation, GDP growth. Policy Surprises controls include Post*$\Delta PolicyPosition$ interactions for all 16 economic policy positions. Robust standard errors are clustered as displayed. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 18: Surprising elections: Staggered difference-in-differences regressions (Robustness)

VARIABLES	(Ia)	(Ib)	(IIa)	(IIb)	(IIIa)	(IIIb)	(IVa)	(IVb)
	Dividend Yield	ICC-Premium	Dividend Yield Only Obs. from (III)	ICC-Premium Only Obs. from (III)	Dividend Yield	ICC-Premium	Dividend Yield	ICC-Premium
Post*Unexpected Disagreement (Pos.)	**0.0024****	**0.011****	**0.0024****	**0.013****	**0.0019****	**0.0095****	**0.0025*****	**0.014*****
	(2.60)	**(2.00)**	**(2.27)**	**(2.19)**	**(2.47)**	**(2.52)**	**(3.72)**	**(4.96)**
Post*Unexpected Disagreement (Neg.)	**0.00066**	**-0.00024**	**0.00090**	**0.00079**	**0.0010**	**-0.00075**	**0.00028**	**0.00065**
	(0.90)	**(-0.059)**	**(1.03)**	**(0.21)**	**(1.37)**	**(-0.25)**	**(0.54)**	**(0.30)**
Return(12M)					-0.0061***	-0.021***	-0.0060***	-0.021***
					(-6.19)	(-10.6)	(-6.21)	(-11.2)
Size					0.00057	-0.0038***	0.00061	-0.0037***
					(0.97)	(-5.53)	(1.05)	(-5.47)
ROA					0.031***	-0.0079	0.030***	-0.0083
					(4.94)	(-1.01)	(4.93)	(-1.07)
Leverage					0.00051	0.031***	0.00045	0.031***
					(0.23)	(7.61)	(0.20)	(7.64)
M/B					-0.00060***	-0.0024***	-0.00060***	-0.0024***
					(-4.83)	(-9.64)	(-4.84)	(-9.42)
Trading Volume (12M)					0.0018	0.047***	0.0020	0.048***
					(0.23)	(2.71)	(0.25)	(2.74)
Inflation					-0.00039	-0.00011	-0.00033	0.00069
					(-1.25)	(-0.21)	(-1.39)	(1.53)
ΔGDP					-0.00012	0.00062	-0.000047	0.00078
					(-0.70)	(0.92)	(-0.41)	(1.41)
σ_{12M}					-0.0030	0.033***	-0.0034	0.032***
					(-1.45)	(5.28)	(-1.63)	(5.50)
$BetaWorld_{24}$					-0.0012***	0.00054	-0.0013***	0.00061
					(-3.49)	(0.75)	(-3.56)	(0.87)
Observations	186,596	186,406	122,533	122,540	122,533	122,540	122,533	122,540
No. Clusters	80	80	75	75	75	75	75	75
$Adj.R^2_{\text{within}}$	0.0012	0.0053	0.0014	0.0082	0.052	0.11	0.055	0.11
$Adj.R^2$	0.75	0.61	0.76	0.63	0.78	0.66	0.78	0.66
Fixed Effects	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime
Controls					Standard	Standard	Standard Policy Surprises	Standard Policy Surprises
Cluster	Election	Election	Election	Election	Election	Election	Election	Election

This table presents results from the staggered difference-in-differences regression setting with alternative dependent variables as robustness test. The dependent variables are the implied equity premium calculated as the ICC measure of Hail/Leuz less the risk free rate (ICC-Premium), and the Dividend Yield. The sample consists of monthly firm-level observations three months before and after an election. The exogenous treatment variables *Unexpected Disagreement (Pos.)* and *Unexpected Disagreement (Neg.)* are binary variable equal to one for all elections falling in the third (first) tercile of – i.e. higher (lower) than expected –unexpected parliamentary disagreement, zero otherwise. Fixed effects and control variables are included as indicated. Standard control variables include i) on firm level (monthly frequency): market to book, 12-month stock return, 12-month trading turnover, stock return volatility, 24-month beta (world index), ii) on firm level (yearly frequency): return on asset, leverage, iii) on country level (yearly frequency): inflation, GDP growth. Policy Surprises controls include Post*$\Delta PolicyPosition$ interactions for all 16 economic policy positions. Robust standard errors are clustered as displayed. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 19: Surprising elections: Staggered differene-in-differences regressions (Robustness - Speed of earnings forecast revision

VARIABLES	(I) Base	(II) $FastRev = 1$	(III) Interaction
Post*Unexpected Disagreement (Pos.)	0.0080***	0.0083***	0.0070***
	(4.98)	(5.31)	(3.90)
Post*Unexpected Disagreement (Neg.)	0.00025	-0.00070	0.0016
	(0.19)	(-0.54)	(1.08)
Post*Unexpected Disagreement (Pos.)*Fast Revision			0.0015
			(1.22)
Post*Unexpected Disagreement (Neg.)*Fast Revision			-0.0021***
			(-2.97)
Unexpected Disagreement (Pos.)*Fast Revision			-0.0011
			(-0.64)
Fast Revision			0.00012
			(0.11)
Unexpected Disagreement (Neg.)*Fast Revision			-0.00044
			(-0.31)
Observations	122,540	79,392	122,540
No. Clusters	75	75	75
$Adj.R^2_{\text{within}}$	0.10	0.10	0.10
$Adj.R^2$	0.63	0.64	0.63
Fixed Effects	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime	Firm Election Eventtime Industry x Eventtime
Controls	Standard Policy Surprises	Standard Policy Surprises	Standard Policy Surprises
Cluster	Election	Election	Election

This table presents results from a robustness test to the staggered difference-in-differences regression setting. In addition to the main specification, this setting controls for the speed of forecast revision. The variable $FastRevision$ is a dummy equal to one if the consensus earnings forecast at the end of the election month is different to the end of the month preceding the election month, zero otherwise. The dependent variable is the ICC measure of Hail/Leuz (average of estimates). The sample consists of monthly firm-level observations three months before and after an election. The exogenous treatment variables *Unexpected Disagreement (Pos.)* and *Unexpected Disagreement (Neg.)* are binary variable equal to one for all elections falling in the third (first) tercile of – i.e. higher (lower) than expected –unexpected parliamentary disagreement, zero otherwise. Fixed effects and control variables are included as indicated. Standard control variables include i) on firm level (monthly frequency): market to book, 12-month stock return, 12-month trading turnover, stock return volatility, 24-month beta (world index), ii) on firm level (yearly frequency): return on asset, leverage, iii) on country level (yearly frequency): inflation, GDP growth. Policy Surprises controls include Post*$\Delta PolicyPosition$ interactions for all 16 economic policy positions. Robust standard errors are clustered as displayed. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 20: Definition of Variables

Variable	Description
Firm level data	
$\text{Icc}_{\text{Hail/Leuz}}$	Mean of ICC measures; cf. Section 4.1
Dividend Yield	End-of-year dividend yield (DY)
Return(12M)	Cumulative total return over past 12 months.
Size	Natural logarithm of total assets (wc02999)
ROA	(Net Income bottom line / Total Assets) = (wc01651/wc02999)
Leverage	(Total Debt / Total Assets) = (wc03255/WC02999)
M/B	(Market Value of Equity / Common Equity) = (wc08001 / wc03501)
Trading Volume (12M)	Trading Turnover over the last 12 months by volume, divided by 10^7
$\text{Election}_{\text{Domestic}}$	Dummy variable for election years per respective country
σ_{12M}	Fill in description here
$Beta_{World24}$	Beta of company's monthly returns and MSCI Global index returns over the last 24 months
Country-level data	
Inflation	Year-on-year change in annual consumer prices
ΔGDP	Year-on-year change in GDP per country
Political Disagreement	
$\text{Local Disagreement}_{\text{Ecycle}}$	Local political disagreement calculated over all parties in parliament via election cycles; cf. Section 4
$\text{Local Disagreement}_{\text{Govcycle}}$	Local political disagreement calculated over all parties in parliament via government cycles; cf. Section 4
$\text{Local Disagreement}_{\text{WSD/Ecycle}}$	Local political disagreement calculated as weighted standard deviation over all parties in parliament via election cycles; cf. Section 4
$\text{Local Disagreement}_{\text{WSD/Govcycle}}$	Local political disagreement calculated as weighted standard deviation over all parties in parliament via government cycles; cf. Section 4

Definition of Variables - continued

Variable	Description
Local Disagreement$_{\text{Shan/Ecycle}}$	Local political disagreement calculated as Shannon's H over all parties in parliament via election cycles; cf. Section 4
Local Disagreement$_{\text{Shan/Govcycle}}$	Local political disagreement calculated as Shannon's H over all parties in parliament via government cycles; cf. Section 4

Table A. 21: Correlations of Economic Policy Positions

	per401	per402	per403	per404	per405	per406	per407	per408	per409	per410	per411	per412	per413	per414	per415	per416
per401	1.00															
per402	0.07	1.00														
per403	0.05	0.03	1.00													
per404	-0.04	0.22***	0.05	1.00												
per405	-0.22***	0.22***	0.16***	0.21***	1.00											
per406	-0.05	0.11**	0.01	-0.04	-0.04	1.00										
per407	-0.05	0.10**	0.07	0.02	-0.07	0.28***	1.00									
per408	0.14***	-0.05	0.02	0.31***	0.16***	0.07	0.03	1.00								
per409	0.06	0.05	-0.02	-0.08*	0.04	0.42***	0.00	0.01	1.00							
per410	0.14***	0.24***	-0.05	-0.01	0.00	0.15***	0.07	-0.00	0.18***	1.00						
per411	0.05	0.28***	0.21***	-0.05	0.13***	-0.02	0.02	-0.16***	-0.03	-0.00	1.00					
per412	-0.00	-0.02	-0.03	-0.01	0.04	0.08	-0.13***	-0.11**	0.21***	0.01	-0.02	1.00				
per413	-0.16***	0.14***	0.09**	0.13***	0.12**	-0.04	0.03	-0.12**	0.17***	-0.04	0.00	-0.00	1.00			
per414	0.32***	0.19***	-0.00	0.03	-0.04	0.20***	-0.04	0.19***	0.33***	0.48***	-0.10**	-0.03	-0.06	1.00		
per415	-0.11**	-0.04	-0.05	-0.03	-0.00	0.02	0.01	-0.10**	-0.01	0.02	-0.06	-0.04	0.14***	-0.08*	1.00	
per416	-0.06	-0.12***	0.09**	-0.12***	0.12**	-0.02	-0.00	0.02	-0.03	-0.12**	0.05	-0.02	-0.04	-0.14***	0.01	1.00

Correlation matrix of economic policy positions as introduced in Section 3.2.1.

Table A. 22: Multicollinearity Diagnostics - Yearly Firm-Level Data

Variable	*VIF*	*SQR-VIF*	*Tolerance*	*R-Squared*
Local Disagreement$_{\text{Govcycle}}$	2.28	1.51	0.44	0.56
Free Market Economy	1.51	1.23	0.66	0.34
Incentives – Positive	1.74	1.32	0.58	0.42
Market Regulation	1.76	1.33	0.57	0.43
Economic Planning	1.84	1.36	0.54	0.46
Corporatism/Mixed Economy	1.48	1.22	0.67	0.33
Protectionism – Positive	1.30	1.14	0.77	0.23
Protectionism – Negative	1.64	1.28	0.61	0.39
Economic Goals	2.29	1.51	0.44	0.56
Keynesian Demand Management	1.96	1.40	0.51	0.49
Economic Growth – Positive	1.38	1.18	0.72	0.28
Technology and Infrastructure: Positive	1.55	1.25	0.65	0.35
Controlled Economy	1.52	1.23	0.66	0.34
Nationalisation	1.66	1.29	0.60	0.40
Economic Orthodoxy	1.86	1.36	0.54	0.46
Marxist Analysis	1.04	1.02	0.96	0.04
Anti-Growth Economy – Positive	1.24	1.11	0.81	0.19
Return(12M)	1.03	1.02	0.97	0.03
Size	1.66	1.29	0.60	0.40
ROA	1.21	1.10	0.83	0.17
Leverage	1.13	1.06	0.89	0.11
M/B	1.19	1.09	0.84	0.16
Trading Volume (12M)	1.40	1.18	0.71	0.29
Inflation	1.49	1.22	0.67	0.33
ΔGDP	1.30	1.14	0.77	0.23
Election$_{\text{domestic}}$	1.04	1.02	0.96	0.04
σ_{12M}	1.58	1.26	0.63	0.37
$BetaWorld_{24}$	1.34	1.16	0.75	0.25
Mean VIF	**1.52**			

This table presents multicollinearity diagnostics for variables used in the firm-level panel data set. The sample matches the baseline regression setting in Table A. 5, Model (II).

Table A. 23: Political disagreement, measured as the dispersion of economic policy positions represented in the parliament, is also related to a higher risk premium.

VARIABLES	(I)	(II)	(III)
Local Disagreement$_{\text{Govcycle}}$	**0.039****	**0.029****	**0.029***
	(2.64)	**(2.35)**	**(2.05)**
Return(12M)		-0.019***	-0.019***
		(-12.4)	(-8.29)
Size		-0.0083***	-0.0083***
		(-3.15)	(-3.18)
ROA		-0.017***	-0.017**
		(-3.26)	(-2.61)
Leverage		0.035***	0.035***
		(8.13)	(7.29)
M/B		-0.0032***	-0.0032***
		(-5.57)	(-5.28)
Trading Volume (12M)		0.054***	0.054***
		(7.98)	(7.98)
Inflation		-0.00061	-0.00061
		(-0.83)	(-0.75)
ΔGDP		-0.0010*	-0.0010
		(-1.74)	(-1.26)
Election$_{\text{domestic}}$		0.00040	0.00040
		(0.37)	(0.32)
σ_{12M}		0.018***	0.018***
		(4.91)	(3.83)
$BetaWorld_{24}$		0.00051*	0.00051
		(1.96)	(0.89)
Observations	159,623	101,250	101,250
No. Clusters	19	19	19
$Adj.R^2{}_{\text{within}}$	0.0018	0.086	0.087
$Adj.R^2$	0.45	0.53	0.53
Fixed Effects	Year	Year	Year
	Firm	Firm	Firm
Controls	No	Yes	Yes
Cluster	Country	Country	Country-Year

The dependent variable is the risk premium, i.e. the difference of the ICC based on Hail/Leuz (average of estimates) minus the risk free rate. Year and firm fixed effects are included as indicated. Robust standard errors are clustered as displayed. The underlying estimation algorithm used by the command *reghdfe* removes the constant in the within transformation. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 24: Combining Political Disagreement and Economic Policy Positions - Risk Premium as Dependent Variable

Variables	(I)	(II)	(IIIa) ¿50%	(IIIb) ¡=50%	(IV)
Local Disagreement$_{Govcycle}$	**0.027***		**0.036****	**0.020**	**0.038****
	(1.95)		**(2.23)**	**(1.37)**	**(2.67)**
int_{50}***Local Disagreement$_{Govcycle}$**					**-0.021****
					(-2.39)
int_{50}					**-0.0028**
					(-1.64)
Local Disagreement$_{Ecycle}$		**0.026***			
		(1.90)			
Free Market Economy	-0.0012	-0.0012	-0.0020**	-0.0012	-0.0016
	(-1.35)	(-1.32)	(-2.13)	(-1.42)	(-1.69)
Incentives – Positive	0.000038	0.000030	0.00058	0.00077**	0.00074*
	(0.098)	(0.078)	(1.19)	(2.23)	(1.97)
Market Regulation	0.0026**	0.0026**	0.0026**	0.0015*	0.0023**
	(2.60)	(2.60)	(2.70)	(1.85)	(2.45)
Economic Planning	0.0023	0.0023	0.0022	0.00051	0.0015
	(1.41)	(1.41)	(1.20)	(0.50)	(1.30)
Corporatism/Mixed Economy	-0.0018	-0.0018	-0.0025	0.00078	-0.0012
	(-0.65)	(-0.63)	(-0.84)	(0.39)	(-0.47)
Protectionism – Positive	-0.0079***	-0.0079***	-0.0065***	-0.00027	-0.0055*
	(-3.45)	(-3.42)	(-3.56)	(-0.073)	(-1.90)
Protectionism – Negative	0.00028	0.00031	-0.0012	-0.00055	-0.00045
	(0.12)	(0.13)	(-0.50)	(-0.17)	(-0.15)
Economic Goals	0.00031	0.00028	0.00044	0.00058**	0.00054*
	(0.90)	(0.81)	(1.08)	(2.67)	(1.95)
Keynesian Demand Management	0.0027	0.0027	0.0037*	-0.00080	0.0019
	(1.16)	(1.16)	(1.84)	(-0.33)	(0.82)
Economic Growth – Positive	0.0020*	0.0020*	0.0020**	-0.00049	0.0012
	(1.96)	(1.96)	(2.17)	(-0.45)	(1.09)
Technology and Infrastructure: Positive	0.0012***	0.0012***	0.0012***	0.0010**	0.0013***
	(3.58)	(3.56)	(3.46)	(2.19)	(3.38)
Controlled Economy	-0.0014	-0.0015	-0.0043	0.0021	-0.00039
	(-0.44)	(-0.44)	(-1.73)	(0.75)	(-0.12)
Nationalisation	0.0018	0.0018	0.0033	0.0027	0.0027
	(0.60)	(0.60)	(0.82)	(1.15)	(0.86)
Economic Orthodoxy	0.00057	0.00059	0.00093*	0.00046	0.00055
	(1.20)	(1.23)	(2.08)	(0.96)	(1.23)
Marxist Analysis	0.016***	0.016***	-0.0092*	0.016***	0.0100**
	(4.17)	(4.17)	(-1.83)	(4.13)	(2.85)
Anti-Growth Economy – Positive	-0.00059	-0.00055	0.00025	0.00099	0.0013
	(-0.33)	(-0.30)	(0.14)	(1.06)	(1.01)
Observations	101,250	101,250	33,076	19,194	53,085
No. Clusters	19	19	19	19	19
$Adj.R^2_{\text{witin}}$	0.099	0.099	0.10	0.071	0.092
$Adj.R^2$	0.54	0.54	0.56	0.52	0.53
Fixed Effects	Year	Year	Year	Year	Year
	Firm	Firm	Firm	Firm	Firm
Controls	Yes	Yes	Yes	Yes	Yes
Cluster	Country	Country	Country	Country	Country

The dependent variable is the The dependent variable is the risk premium, i.e. the difference of the ICC based on Hail/Leuz (average of estimates) minus the risk free rate. All models are fixed effect regressions. Year and firm dummies are included as indicated. Robust standard errors are clustered as displayed. The underlying estimation algorithm used by the command *reghdfe* removes the constant in the within transformation. Significance is indicated by ***, ** and * at the 1%-, 5%- and 10%-level, respectively.

Table A. 25: Overview of ICC computation methods (taken from Azevedo et al. (2017))

Model	Formulas and Implementation Details	Source
GLS	$$M_t = B_t + \sum_{\tau=1}^{11} \frac{E_t[ROE_{t+\tau} - ICC \times B_{t+\tau-1}]}{(1+ICC)^k} + \frac{E_t[(ROE_{t+12} - ICC) \times B_{t+11}]}{ICC \times (1+ICC)^{11}} \quad (11)$$ where M_t is the market equity in year t. ICC is the Implied Cost of Capital. B_t is the book equity. $E_t[]$ represents market expectations based on information available in year t, and $(ROE_{t+\tau} - ICC) \times B_{t+\tau-1}$, denotes the residual income in year $(t+\tau)$, i.e., the difference between the return on book equity and the ICC multiplied by the book equity in the previous year. We compute the ROE from years t+1 to t+3 as $FEPS_t/B_{t-1}$, where the $FEPS_t$ is the consensus mean I/B/E/S analysts' earnings per share of period t. After year t+3, we linearly fade for the next nine years to a target industry median. We calculate this proxy as a rolling industry median over 5 years, considering only firms that have a positive ROE. Our industry definition is based on Fama and French (1997). Finally, after the period t+12, the terminal value is a simply perpertuity of the residual incomes. We estimate the book value based on clean surplus accounting and a constant payout ratio PO, i.e., $B_t = B_{t-1} + FEPS_t + (1 - PO)$.	Gebhardt et al. (2001)
CT	$$M_t = B_t + \sum_{\tau=1}^{5} \frac{E_t[ROE_{t+\tau} - ICC \times B_{t+\tau-1}]}{(1+ICC)^k} + \frac{E_t[(ROE_{t+5} - ICC) \times B_{t+4}](1+g)}{(ICC-g) \times (1+ICC)^5} \quad (12)$$ where M_t is the market equity in year t. ICC is the Implied Cost of Capital. B_t is the book equity. $E_t[]$ represents market expectations based on information available in year t, and $(ROE_{t+\tau} - ICC) \times B_{t+\tau-1})$, denotes the residual income in year $t+\tau$, i.e., the difference between the return on book equity and tee ICC multiplied by the book equity in the previous year. We compute the ROE from years t+1 to t+5 as $FEPS_t/B_{t-1}$, where the $FEPS_t$ is the consensus mean I/B/E/S analysts' earnings per share of period t. we estimate the forecasts in the years t+4 and t+5 using a long-term growth forecast, g, and the three-year ahead forecast. We estimate g as 10-year government bond minus an assumed real risk-free rate of three percent. Finally, after the period t+5, the terminal value is a simply perpetuity of the residual incomes. We estimate the book value based on clean surplus accounting and a constant payout ratio PO, i.e., $B_t = B_{t-1} + FEPS_t + (1 - PO)$.	Claus and Thomas (2001)

Overview of ICC computation methods - continued

Model	Formulas and Implementation Details	Source
MPEG	$$M_t = \frac{E_t[E_{t+2}] + ICC \times E_t[D_{t+1}] - E_t[E_{t+1}]}{ICC^2} \quad (13)$$ where M_t is the market equity in year t. ICC is the Implied Cost of Capital. $E_t[]$ represents market expectations based on information available in year t, E_{t+1} and E_{t+2} are, the earnings forecast in years t+1 and t+2, respectively. D_{t+1} is the dividend in year t+1.	Easton (2004)
OJ	$$ICC = A + \sqrt{A^2 + \frac{E_t[E_{t+1}]}{M_t}} + (g - (\gamma - 1)) \quad (14)$$ where: $A = 0.5((\gamma - 1) + \frac{E_t[D_{t+1}]}{M_t})$, M_t is the market equity in year t. ICC is the Implied Cost of Capital. $E_t[]$ represents market expectations based on information available in year t, E_{t+1} is the earnings forecast in years t+1. D_{t+1} is the dividend in year t+1. g is the short-term growth, computed as the rate between EPSt+1 and EPSt+2. γ is the perpetual growth rate in abnormal earnings beyond the forecast horizon, calculated as 10-year government bond minus an assumed real risk-free rate of three percent.	Ohlson and Juettner-Nauroth (2005)