Are regime changes always bad economics? Evidence from daily financial data *

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Abstract

Political instability is commonly thought to discourage investment and reduce economic growth. We challenge this consensus by showing that instability does not systematically depress investment. Using an event study approach, we examine daily returns of national financial indices in every country that experienced an irregular regime change subject to data availability. Returns following resignations are large and positive (+4%), while those following assassinations are negative and smaller in magnitude (-2%). The impact of coups tends to be negative (-2%), but we show that a pro-business coup results in large positive returns (+10%). We also find evidence that authoritarian or anti-business regime changes are more likely to lead to capital flight than democratic or pro-business changes. The immediate impact of political instability on investment is therefore dependent on the type of regime change and its expected impact on future growth.

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