Does Democracy Shape International Merger Activity?*

M. Farooq Ahmad[†] Thomas Lambert[§]

José M. Martín-Flores[‡] Arthur Petit-Romec[¶]

First version: April 30, 2022

This version: November 20, 2022

Abstract

Using a sample of 101,834 cross-border deals announced between 1985 and 2018, we show that merger flows involve acquirers from more democratic countries than their targets. This result is primarily driven by a "pull" factor, that is, firms in countries with weaker democratic institutions attract cross-border deals. The democracy effect is higher if target countries have lower accounting standards and poorer shareholder protection. Moreover, target abnormal returns around deal announcements are larger when acquirers come from more democratic countries. Combined, our findings suggest that firms in less-advanced democracies engage in cross-border deals to benefit from improved corporate governance.

JEL classification codes: F21, G34, P16

Keywords: mergers and acquisitions, cross-border deals, democracy, political economy, investor protection

*We appreciate the helpful comments from Eric de Bodt, Audra Boone, Agustin Casas, Carlo Chiarella, Riccardo Ciacci, Jean-Gabriel Cousin, Federico Curci, François Derrien, Alberta Di Giuli, Logan Emery, Alexandre Garel, Max Miller, Vesa Pursiainen, Alexander Wagner, Fei Xie, Guosong Xu, and participants at various conferences and seminars. Lambert gratefully acknowledges the Dutch Research Council (grant VI.Veni.191E.055) and Martín-Flores the Spanish Ministry of Science and Innovation (project PID2019-111066GA-100) for financial support. All errors are ours.

[†]SKEMA Business School, farooq.ahmad@skema.edu

[‡]CUNEF Universidad, josemaria.martin@cunef.edu

[§]Rotterdam School of Management, t.lambert@rsm.nl

[¶]Toulouse Business School, arthur.romec@gmail.com

1 Introduction

Cross-border merger flows have substantially increased in the past decades, sparking academic interest in understanding their determinants and underlying frictions (e.g., Erel et al., 2012).[1] An important strand of the literature has shown that laws and regulations protecting outside investors explain differences across country pairs (e.g., Rossi and Volpin, 2004; Bris and Cabolis, 2008; Albuquerque et al., 2019). The argument is that legal protection of outside investors facilitates transfers of control by reducing agency costs and information asymmetries and therefore improves corporate governance (La Porta et al., 2000). However, investor protection remains a proximate cause of cross-border merger activity, rather than its fundamental determinant.

In this paper, we show that democratic institutions have a fundamental influence on cross-border merger flows around the world. In the tradition of classical political economy, we argue that democratic institutions are fundamental ("come first") because they determine contracting institutions such as investor protection (Acemoglu et al., 2005; Lambert and Volpin, 2018).[2] Understanding the fundamental role of democracy on cross-border merger activity might be important in light of populism spreading globally, and weakening countries' democratic foundations (Guriev and Papaioannou, 2022).[3] Moreover, cross-border mergers and acquisitions (M&As), as foreign investments, might be an important mechanism through which democracy affects long-run development (Acemoglu et al., 2019). However, to what extent democracy matters for cross-border merger flows and what is the main underlying mechanism behind the "democracy effect" remain open questions.

If democracy matters, it is likely that mergers flow between countries with similar democratic institutions, consistent with an expansive literature showing that measures of affinity between regions, such as social ties, trust, common ancestry, strongly correlate with foreign investments (e.g., Guiso et al., 2009; Leblang, 2010; Ahern et al., 2015; Burchardi et al., 2019). Differences in democracy can also underlie legal, administrative, and bureaucratic constraints that are too difficult to be overcome by contracting parties, in turn impeding the completion of deals or the

[1] In 2018 alone, cross-border mergers represented 29 percent of total deal volume—that is, $1.33 trillion worth of merger activity globally, or 1.6 percent of the world GDP (sources: Thomson's Securities Data Corporation (SDC) and International Monetary Fund (IMF)).

[2] Giuliano et al. (2013), among others, show that the quality of democratic institutions leads to reforms that aim to improve various contracting institutions, but the reverse is not true.

[3] Indices measuring countries' degree of democracy reflect this trend clearly. One of such indices is the Polity2 index as produced by Polity IV that ranges from +10 (strongly democratic) to -10 (strongly autocratic). For example, after the election of Donald J. Trump, the Polity2 index for the United States dropped from +10 (the score assigned to the United Stated without discontinuing since 1974) to +8. The United States even dropped below the "democracy threshold" of +6 at the end of 2020. This observation based on other sources, including the Freedom House, is also made by Dinorah Azpuru and Michael Hall in "Yes, our 'flawed' democracy just got downgraded. Here's why," *The Washington Post*, February 23, 2017.

realization of synergies. However, the democracy effect can also be directional. On the one hand, mergers may be more likely to involve acquirers from less-advanced democracies than the targets. Firms in autocracies can more easily form monopolies and obtain extensive state support (Li and Resnick, 2003; Karolyi and Liao, 2017). These firms may in turn have easier access to financial and non-financial resources to engage in cross-border M&A activities in countries with comparatively better democratic institutions. On the other hand, mergers may be more likely to involve acquirers from more advanced democracies than the targets. The cross-border M&A literature has shown that differences in corporate governance can motivate a merger if the target firm's shareholders can benefit from "bonding" to higher governance standards after being acquired by a firm from a country with better accounting standards and stronger shareholder protection (Rossi and Volpin, 2004; Bris and Cabolis, 2008; Ellis et al., 2011; Starks and Wei, 2013). To the extent that stronger democratic institutions promote better corporate governance (Bushman et al., 2004; Gomez and Korine, 2005), the bonding view implies that firms from less democratic countries are more likely to engage in cross-border deals with acquirers from more democratic countries. We note that an "economic development" view can also account for this possibility, to the extent that democracy promotes the pace of economic development (Persson and Tabellini, 2009). Firms in established democracies can benefit from the economic dynamism or even international political influence of their home country to conduct many cross-border mergers (including in less-advanced democracies).

We use a sample of 101,834 cross-border mergers in 58 countries from 1985 to 2018 to examine whether democracy shapes international M&A activity. We apply a gravity model to explain cross-border merger ratio as a function of various country characteristics, measured as differences between acquirer and target countries. This approach allows us to identify the effect of differences in democracy between country pairs on the intensity of their cross-border flows, similarly to the international trade literature. Specifically, we focus on differences in democratic institutions—that is, the set of formal rules typically laid down by explicit constitutional provisions guaranteeing that citizens can express their preferences about policies and leaders and ensuring constraints on the exercise of executive power.

Our analysis first suggests that the closer two countries are in terms of levels of democracy, the more intense the merger flows between them. This result is perhaps not surprising, but is consistent with the general idea that cross-border deals are facilitated when contracting costs associated with combining two firms across borders are low. Figure 1 illustrates this result by

plotting merger flows across country pairs along their differences in democracy. The visualization is taken directly from the data. The vertical axis represents the differences in democracy between acquirer and target countries, while the horizontal axis reports the cross-border merger ratio. As we can seen, there is a clustering of cross-border deals around zero in the vertical axis—that is, for small absolute differences between country pairs in our main measure of democracy (the Polity2 index).

Our analysis also reveals that the "democracy effect" is directional: there are substantial merger flows that involve acquirers from countries with better democratic institutions than their targets. This result holds after controlling for standard gravity factors (economic size, trade flows, etc.), time trends, and country-pair fixed effects. The size of the effect is meaningful: a one-standard-deviation increase in the differences in democracy is associated with a 2.23 percentage points (pp) higher cross-border ratio, which corresponds to 51 percent of the sample mean. Comparing with other important determinants of cross-border mergers, the democracy effect we document is almost two times larger than the effect of culture and more than three times larger than geography (Erel et al., 2012; Ahern et al., 2015). Figure 1 clearly depicts this result. We observe non-negligible cross-border merger flows, the larger the differences in democracy between acquirer and target countries (top of Figure 1). However, the opposite is not true as there is no clustering of deals at the bottom of Figure 1. That is, deals do not seem to involve acquirers from less democratic countries than the targets, with the notable exception of China and Singapore (highlighted in turquoise and green, respectively). These key findings are also robust to different deal and country samples, subperiods, measures of democracy and cross-border mergers, and combinations of country-level controls. In particular, these results continue to hold if we exclude deals occurring in the United States, the United Kingdom, or Canada, which are established democracies characterized by vibrant markets for corporate control. Conversely, these results remain unchanged if we drop countries that are more peripheral in the cross-border M&A network and only involved in a small number of deals. Further robustness tests also indicate that mergers involving firms from developed and developing economies do not explain the directional effect of democracy.

Although our gravity model accounts for the influence of fixed unobserved characteristics and various time-varying country differences, important concerns are the possibility that time-varying omitted variables simultaneously affect democracy and merger activity or that the relation goes in the other way around. We address these endogeneity concerns using an instrumental variable (IV) approach. The political science literature (e.g., Huntington, 1993) has shown that changes in

democracy often occur in regional waves, as in the 1990s after the fall of the Soviet Union or in the 2010s possibly as a result of the Arab Spring experience. Based on this observation, we instrument country-level of democracy using the regional waves in transitions to and away from democracy, following recent studies on the effect of democracy on corporate and asset pricing outcomes (Delis et al., 2020; Duong et al., 2022; Miller, 2022). The exclusion restriction requires that regional waves are not themselves caused by regional trends in future M&A activity. This presumption is plausible in light of detailed available evidence suggesting that democratization waves are not explained by regional economic shocks (Bonhomme and Manresa, 2015; Acemoglu et al., 2019). Furthermore, the gravity equation implies that we take the difference in the level of democracy between acquirer and target countries, and we do so with the instrument. The IV estimates of the impact of democracy on cross-border merger flows confirm our key finding that merger flows involve acquirers from more democratic countries than their targets.

In addition, we make use of a dichotomous measure of democracy, similar to Papaioannou and Siourounis (2008) and Acemoglu et al. (2019). We rely on a dichotomous measure to overcome concerns related to the fact that our results may be driven by small, spurious changes in the Polity2 index. With this approach, we exploit democratic transitions and autocratic reversals as exogenous sources of variation to identify the effect of democracy on cross-border merger activity. The result with this approach is consistent with the insight about the directional effect of democratic institutions: a discrete change in the differences in democracy between acquirer and target countries (which corresponds to a situation where the target country becomes an autocracy, for instance) is associated with a roughly 3 pp higher cross-border ratio.

Our analysis sheds light on the mechanism behind the democracy effect. International law prescribes that the nationality of a firm changes when 100 percent of it is acquired by a foreign firm (see Bris and Cabolis, 2008). A direct implication of this is that the law that applies to the target firm—and thereby the protection provided by such law to the target firm's shareholders—changes as well. Interestingly, we uncover that the increased cross-border merger flows from acquirers with stronger democratic institutions are fully due to the 100-percent mergers. To further understand the motives behind these mergers, we examine whether "push" or "pull" factors, or both, are at work. We find that our results on cross-border merger flows are primarily driven by pull factors. That is, merger flows are more influenced by the weaker democratic institutions in the target's home country than the superior democratic institutions in the acquirer's home country. These results are consistent with the bonding view whereby the target firm usually adopts the

governance standards of the country of the acquiring firm. However, push factors do not seem to motivate these cross-border deals, which is inconsistent with a pure "economic development" view because firms in established democracies—enjoying enhanced economic dynamism—would be incentivized to *also* find deal opportunities abroad. Furthermore, the pull factor should be weaker for countries with stronger corporate governance as target firm's shareholders would benefit less from bonding after being acquired. Therefore, we explore the cross-sectional heterogeneity of the relationship. We find that the pull factor is less pronounced when the target's home country has higher accounting standards and stronger shareholder protection. This finding adds support to the bonding hypothesis.

Next, we look at share price reactions to cross-border deal announcements. Cross-border mergers allow target firms to alter the level of protection they provide to their shareholder, because target firms usually import the corporate governance standards of the acquiring firm by law. Therefore, the market should assign more value to better protection. We find that target firms' cumulative abnormal returns (CAR) around deal announcements are positive and significantly larger when acquirers are from more democratic countries, which is again consistent with the bonding view. However, we do not find a symmetric and significant effect on acquiring firms' CAR. The asymmetry in the effect implies that the cross-border mergers involving acquirers from stronger democracies than targets are not value-destroying, and primarily benefit target firms' shareholders. Overall, the collage of evidence appears to be consistent with a bonding view, even though it is hard to firmly establish that some other considerations (discussed below) do not drive also cross-border mergers in our context.

Last, we connect our corporate governance results with our evidence on the relation between differences in democracy and cross-border merger flows. Using a two-step procedure, we find that the positive effect of investor protection on cross-border merger flows is primarily explained by democratic institutions, consistent with our premises about the fundamental role of political institutions over contracting institutions.

2 Related Literature

Our study contributes to several strands of the literature. It advances the political economy and development literature by pointing out a new and potentially important mechanism through which democracy impacts long-run growth (Papaioannou and Siourounis, 2008; Persson and Tabellini, 2009; Madsen et al., 2015; Acemoglu et al., 2019). The role of cross-border M&A flows has

received, thus far, no attention in this literature. Indeed, not only does the democracy effect on cross-border M&As may result in more growth for democracies, but it is a transfer of growth opportunities, stunting the growth of nondemocracies. Moreover, Grosjean and Senik (2011), Rode and Gwartney (2012), and Giuliano et al. (2013) highlight that democracies tend to enact economic reforms that are conducive to growth. This paper further shows that reforms aimed to improve accounting standards and shareholder protection accounts for the impact of democracy on international merger activity.

We further contribute to the cross-country literature on the politics of financial development (e.g., Rajan and Zingales, 2003; Pagano and Volpin, 2005, 2006; Perotti and Von Thadden, 2006; Roe, 2006; Perotti and Schwienbacher, 2009; Degryse et al., 2018). In particular, Perotti and Von Thadden (2006) show that in democracies the political support for strong shareholder protection reflects the median voter's endowment with financial wealth. Pagano and Volpin (2006) also develop a median-voter model in which the political support for stronger shareholder protection at the country level is determined by the mutual interaction between shareholder protection and stock market development. Consistent with their model, they present empirical evidence of global convergence in shareholder protection to best-practice standards, and show that it is positively related to cross-border merger activity. Our paper corroborates their findings by showing that firms from countries with weaker democratic institutions attract cross-border deals, and that targets in such cross-border deals effectively benefit from a transfer of good corporate governance. Our findings, like theirs, support the idea that cross-border merger activity is an important channel for global convergence in corporate governance standards (Coffee, 1998).

Our paper is also related to a few studies focusing on corporate outcomes. Delis et al. (2020) examine the cost of credit, finding that democracy has a sizable negative effect on corporate loan spreads. Duong et al. (2022) find that democracy reduces IPO underpricing, and more strongly so in countries where institutional quality is low and shareholder protection weak. Using patent data, Gao et al. (2017) explore whether democracy fosters innovation.

More broadly, we contribute to the literature on the determinants of cross-border M&As. An important body of work highlights that governance-related differences affect cross-border deal flows (Rossi and Volpin, 2004; Bris et al., 2008; Bris and Cabolis, 2008; Martynova and Renneboog, 2008; Ellis et al., 2011; Starks and Wei, 2013; Albuquerque et al., 2019). In this paper, we build on and complement this literature by emphasizing the fundamental role of modern democratic institutions in shaping cross-border merger flows. We show that firms in less-advanced democracies attract

cross-border deals to benefit from better governance standards in more established democracies (which are conducive of higher-quality corporate governance). Other studies also find that valuation (Erel et al., 2012), national culture (Ahern et al., 2015), economic nationalism (Dinc and Erel, 2013), trade barriers (Hijzen et al., 2008; Ahmad et al., 2021), double taxation (Huizinga and Voget, 2009), labor laws (Alimov, 2015; Levine et al., 2020), political uncertainty (Cao et al., 2019), industry specialization (Frésard et al., 2017), foreign institutional ownership (Ferreira et al., 2010), environmental laws (Li et al., 2022) affect M&As between countries. Our paper adds to this literature by providing evidence that differences in democracy matter for cross-border M&A flows.[4] In that sense, our paper joins a broader literature examining the institutional and political factors of cross-border capital flows. Alfaro et al. (2008) show that low institutional quality accounts for the lack of capital flows from rich to poor countries. Papaioannou (2009) find that poorly performing institutions, such as weak protection of property rights, legal inefficiency, and a heightened risk of expropriation, impede foreign bank flows. Kempf et al. (2022) provide evidence that investors' ideological alignment with foreign governments shapes international capital flows. Closer to our line of inquiry, Gupta and Yu (2007) highlight the importance of bilateral political relations for foreign direct investment (FDI), while Julio and Yook (2016) show that countries with good institutions experience significantly less variation in FDI around elections. A few papers have also studied how democratic institutions affect FDI flows (e.g., Li and Resnick, 2003; Asiedu and Lien, 2011).

3 Data and Descriptive Statistics

We obtain data on cross-border merger activity from Thomson's SDC Platinium database. Our initial sample includes all cross-border mergers between all countries with information available on SDC from January 1985 to December 2018. As is customary, we exclude all recapitalization, spinoffs, leveraged buyouts, divestitures, share repurchases, and privatizations. We further restrict the sample to majority acquisitions in which the acquirer owns less than 50 percent of the target stocks before the deal and more than 50 percent after the deal. We place no restrictions on the public status of the acquirer or target and we include both completed and withdrawn deals. In addition, we require that a target country in a year has at least one cross-border M&A deal and

[4] Karolyi and Liao (2017) examine the motives of government-controlled acquirers and show that these entities are more likely than corporate acquirers to come from autocratic countries, in particular from China and Singapore. In their sample of 4,759 cross-border government-controlled acquisitions, more than 25 percent are indeed led by Chinese or Singaporean authorities.

that information on democracy is available for both acquirer and target countries. These filters result in a sample of 101,834 cross-border M&A deals covering 58 countries.

We present the deal distribution by year in Table 1 and by acquire country in Table 2. The numbers reported are in line with prior studies, including for instance Erel et al. (2012) and Ahern et al. (2015), and thus do not warrant detailed discussion. We observe that the number of cross-border deals increases substantially over the sample period, with a yearly average of about one thousand in the early 1990s to more than four thousands in the 2010s. The top three acquirer countries in terms of number of deals are the United States (with 27,368 deals), the United Kingdom (13,609), and Canada (8,892). A significant number of cross-border deals happens in China (1,079) and Singapore (1,617), which is in line with what Karolyi and Liao (2017) document.[5] The value of transactions is available for approximately 40 percent of the sample deals—that is, 38,873 deals totaling $13.136 trillion.

To examine whether differences in democracy affect the propensity of firms from one country to acquire firms from another country, we use variables measuring the flow of M&A activity between any ordered pairs of acquirer and target countries. We arrange our data set to produce a worldwide matrix of 58×57 matched pairs each year. Working with ordered country-pairs implies that there would be a Canada-France observation as well as a France-Canada observation. For a given ordered country-pair in a given year, we define the cross-border ratio as the number of majority cross-border deals in which the target is from country i and the acquirer is from country j $(i \neq j)$, as a percentage of the total number of (domestic and cross-border) deals in country i in year t. In line with the literature, the inclusion of domestic deals in the denominator allows us to implicitly control for factors that can affect both domestic and cross-border deals (see, e.g., Rossi and Volpin, 2004; Ferreira et al., 2010; Erel et al., 2012; Karolyi and Taboada, 2015). Our primary cross-border ratio variable is based on the number of deals rather than on deal value because information on value is available for less than 40 percent of deals. However, in subsection 4.2, we show that our results continue to hold if we use alternative measures of cross-border merger flows, including value-based cross-border ratio.

To measure countries' degree of democracy, we mainly use the Polity2 index produced by Polity IV. This widely-used index in the literature is based on experts' assessments that combine *de jure* and *de facto* elements of institutionalized democracy in terms of political preferences and executive constraints. Specifically, the composite Polity2 index—ranging from +10 (full democracy) to -

[5]These observations motivate our robustness checks in subsection 4.2 excluding these countries.

10 (full autocracy)—captures the competitiveness and regulation of political participation, the openness and competitiveness of executive recruitment, and constraints on the chief executive (see Polity IV user's manual for more details).

Table 1 presents descriptive statistics on the Polity2 index by year. The mean value of the Polity2 index gradually increases over our sample period, from 3.78 in 1985 to 7.14 in 2018. This increasing trend partly captures what Huntington (1993) dubbed the "Third Wave" of democratization that took place from the mid-1970s to the 1990s. We can also observe a dip in the mean value of the Polity2 index in the recent years, which reflects the ascent of populist movements in several countries (see Footnote 3). The Polity2 index also shows a significant dispersion (standard deviation of 4.83), meaning that our sample comprises companies located in countries with significant differences in democracy (see also Table 2).

For robustness purposes, we use other indices of democracy from different sources. One of such indices is the Freedom House that also comprises a bundle of *de jure* and *de facto* elements of democracy. It differs from the Polity2 index in that it captures additional elements such as the guarantee of civil liberties, rule of law, freedom of the press, and other political rights. Following relatively common practice in the literature, we define Freedom House as a dummy variable equal to one if the Freedom House status of a country in a given year is "Free" or "Partially Free", and zero otherwise. Another index we use is the one put together by Boix, Miller, and Rosato (2013)—henceforth BMR—who extend the work by Przeworski et al. (2000). In contrast with the other indices, the BMR index is based solely on *de jure* elements of democracy consisting of free and fair elections as well as minimum threshold value of suffrage. We also use the democratic index supplied by the Varieties of Democracy (V-Dem) database. V-Dem is an index ranking the level of democratic institutions in every country on five overarching principles of democracy: electoral, deliberative, liberal, participatory, and egalitarian (see Coppedge et al., 2019, for more information on the construction of the V-Dem index). In addition, we use the consolidated and dichotomous measure of democratization constructed by Acemoglu, Naidu, Restrepo, and Robinson (2019)—henceforth ANRR—who build on the work by Papaioannou and Siourounis (2008). As explained previously, the use of the ANRR index allows to address the issue of measurement error in democracy indices such as Polity2 and Freedom House. The countries and years in which democratizations and reversals from democracy to nondemocracy took place are reported in Table 2.[6] We count 28 democratizations and 9 reversal events in our sample.

[6]Transition and reversal dates until 2010 are retrieved from Acemoglu et al. (2019) that we extended until 2018 using the same methodology.

We also consider several measures of country-level development and institutions that have been shown to influence cross-border merger flows across country pairs. To capture economic development, we use GDP per capita and GDP growth obtained from the World Bank's World Development Indicators (WDI) database. We proxy for institutional environment by including time-varying indices taken from the International Country Risk Guide's (ICRG) database and capturing the state of investment environment and the quality of institutions. The trade literature has shown that bilateral trade, geographical and cultural distance, and same language and colony are important determinants of cross-border trade flows. We obtain bilateral trade data from the IMF Direction of Trade Statistics to measure the maximum of bilateral exports and imports between country i and country j as a percentage of the total imports by country j. Controlling for bilateral trade ensures determining whether differences in democracy can explain cross-border merger flows over and above those influenced by trade. Geographical distance is retrieved from CEPII and is defined as the logarithm of the circle distance in kilometers between countries' capitals. Cultural distance is retrieved from Geert Hofstede's website and is calculated based on four dimensions (that is, individualism, uncertainty avoidance, power distance, and future orientation) using the Euclidean distance formula.[7] We also include dummy variables capturing whether countries share a common language or have had a colonial link. We get these data from the World Factbook. Finally, for robustness purposes, we further control for stock market development, banking sector development, and exchange rate volatility and return using data from WDI and Worldscope, respectively.

All these and other (deal-level) variables we use in our analyses are summarized in Appendix A. Table 3 provides descriptive statistics for all the variables.

4 Does Democracy Affect Cross-Border Merger Flows?

In this section, we provide our empirical results on the relation between democratic institutions and international merger activity.

[7] To preserve sample size, we do not consider in our baseline model measures of national cultural values (trust, hierarchy, and individualism) based on the World Values Survey as in Ahern et al. (2015). However, in the Internet Appendix, we observe that our results are even stronger if we include them.

4.1 Baseline Panel Estimates

To formally evaluate the effect of differences in democracy on cross-border merger flows, we estimate the following gravity model:

$$\text{Cross-border ratio}_{i,j,t} = \alpha_i + \alpha_j + \alpha_t + \beta \Delta\text{Democracy}_{j-i,t-1} + \gamma \Delta X'_{j-i,t-1} + \varepsilon_{i,j,t}, \quad (1)$$

where i and j denote target and acquirer country, respectively, and t denotes a year. The dependent variable, Cross-border ratio$_{i,j,t}$, is (unless specified otherwise) the total number of majority cross-border mergers of firms in a target country by firms in an acquirer country, scaled by the sum of the number of domestic and cross-border deals in the target country. The focus is on ΔDemocracy$_{j-i,t-1}$, that is, the lagged difference in democracy between acquirer and target countries. We measure democracy using the Polity2 index (unless specified otherwise). The specification includes the standard gravity controls ($\Delta X'_{j-i,t-1}$). The set of controls considers (lagged) time-varying country-pair differences (ΔGDP per capita, ΔGDP growth, ΔInvestment profile, ΔInstitutional quality, Bilateral trade) as well as time-invariant country-pair characteristics (Geographical distance, Cultural distance, Common language, Same colony). α_i and α_j are fixed effects that account for time-invariant unobserved characteristics in the target and acquirer country, respectively. In many models, we will rather include a vector of country-pair fixed effects ($\alpha_{i,j}$) because this fully accounts for unobserved heterogeneity in cross-border merger activity between target and acquirer countries. α_t are year fixed effects controlling for any macro movements. $\varepsilon_{i,j,t}$ is the error term. In all cases, standard errors are corrected for clustering of observations at the country-pair level.

We start by testing the hypothesis positing that cross-border deals are more likely to occur when target and acquirer countries have similar democratic institutions. To do so, we run equation (1) by taking the absolute differences in democracy between country pairs (as in Ahern et al., 2015). Table 4 presents the results. Column 1 reports the absolute differences in democracy together with the absolute differences in the controls and year fixed effects. The effect of democracy is negative, though not statistically significant at conventional levels. Column 2 reports the specification including instead acquirer country $\times$ year fixed effects and target country $\times$ year fixed effects to absorb time-varying unobserved characteristics in the target and acquirer country, respectively. The effect of democracy is still negative and almost statistically significant at the 10-percent level (note that the p-value, reported between brackets, based on robust standard errors is significant

at the 5-percent level). The more precise estimate of β in column 2 of -0.034 implies that a one-standard-deviation decrease in the absolute differences in democracy (that is, an increase of 0.047 in Table 3) is associated with a 0.2 pp higher cross-border ratio.[8] In the Internet Appendix, we use alternative measures of cross-border mergers and generally find stronger results, both statistically and economically. All in all, the effect of democratic proximity we observe—albeit weak both economically and statistically—is in line with the general idea that the closer two countries are in terms of level of democracy, the higher their bilateral merger flows. Most coefficients on controls display the sign expected based on the prior literature. In particular, we find that bilateral trade increases the likelihood of mergers between two countries. There are also significantly more cross-border mergers between countries that are geographically closer and that share the same culture.

Next, we explore the direction of the effect of democracy on cross-border merger flows. Table 5 reports main results from estimating equation (1) using as independent variable of interest the difference in democracy between acquirer and target countries. We find that merger flows involve acquirers from more advanced democracies than their targets. Column 1 represents the most parsimonious specification, with our independent variable of interest together with the controls and year fixed effects. The estimate of β is 0.131, statistically significant at the 1-percent level. Column 2 adds both acquirer- and target-country fixed effects to the previous specification, which means that we are now interested in *within* variation. The result is stronger: the within estimate of β is 0.424 and statistically significant at the 1-percent level. In column 3, besides controlling for the usual gravity factors and time trends, we include country-pair fixed effects. Accounting for country-pair fixed effects is important, since geographical and cultural distance but also same language and colony might not fully capture geographical, cultural, and historical linkages that affect cross-border merger flows. The within estimate of β in our preferred specification reported in column 3 is again positive and statistically significant at the 1-percent level (0.474, p-value = 0.000), which indicates that the intensity of cross-border merger activity increases with the differences in democracy between acquirer and target countries. In terms of economic magnitude, a one-standard-deviation increase in the differences in democracy is associated with a 2.23 pp higher cross-border ratio (0.047×0.474), which represents 51 percent of the sample mean reported in Table 3. In the remainder of the paper, we will focus on the specification with country-pair fixed effects as our baseline model.

The coefficients on the controls in columns 1 to 3 are overall similar to those in Table 4.

[8] A one standard deviation of 0.047 means approximately an increase in the Polity2 index of 5 points. For example, this is equivalent for a country to drop from a full democracy (+10) to the "democracy threshold" of +6.

Interestingly, a one-standard-deviation increase in geographical (cultural) distance implies a 0.60 (1.28) pp higher cross-border ratio (using estimates from column 2). Regarding international trade in column 2, a one-standard-deviation increase implies a 2.01 pp higher cross-border ratio. Unlike in Table 4, we also find that country differences in economic and institutional environment boost cross-border merger activity. To put our main result further in perspective, comparing with these well-established factors driving cross-border merger activity, we observe from column 2 that the democracy effect is three times larger than the effect of geography (0.60 pp) and almost two times larger than culture (1.28 pp) (Erel et al., 2012; Ahern et al., 2015). The economic effect of bilateral trade (2.01 pp) is of similar order of magnitude with the effect of differences in democracy we document.

In the Internet Appendix, we show that these results are robust to alternative treatments of standard errors, to different subperiods, to specifications adding gravity controls in absolute values, and to the use of the Freedom House, BMR, and V-Dem indices as other measures of democracy. In the Internet Appendix, we further look at the institutional variation that our main democracy measure (the Polity2 index) captures. The Polity2 index ranges from -10 to +10 as it is obtained by combining an "Autoc" score (0 for non-autocracy to +10 for autocracy) and a "Democ" score (0 for non-democracy to +10 for democracy). Both scores comprise several components, which include free elections, the existence of institutional checks on the executive, inclusive participation and representation, that non-ruling parties are organized and compete for political influence regularly. We first find that the differences in the democracy score exhibits a positive and significant coefficients, meaning that merger flows are higher between countries involving acquirers from more democratic countries than their targets. The opposite is also true: the coefficient on the differences in the autocracy score enters negatively and significantly, which in turn indicates that merger flows are lower between countries involving acquirers from more autocratic countries than their targets. We also show that differences in all components of the democracy score but the component EC (that is, the institutional checks on the executive) are positively and significantly associated with cross-border mergers across country pairs.

4.2 Sensitivity Tests

Table 6 probes the robustness of our main results to alternative sample choices, variable definitions, estimation techniques, and model specifications. To conserve space, we focus on the specification of column 3 of Table 5 and only report the within estimates of the coefficients on democracy.

First, in Panel A, we exclude from our sample the countries with the higher number of cross-border deals, namely the United States (column 1), the United Kingdom (column 2), Canada (column 3). To the extent that these countries are established democracies, their weight in our sample may drive the democracy effect we observe. Conversely, China and Singapore are autocratic countries with developed M&A markets that could also affect our results (cf. Figure 1). Therefore, in column 4, we drop China and Singapore. In column 5, we exclude from our sample countries that are more peripheral in the M&A network. Specifically, we drop countries for which the total number of deals over the entire sample period is lower than 15.[9] Moreover, advanced economies in Western Europe are also typically endowed with good democratic institutions and as such may drive the results. We exclude these countries from our sample in column 6.[10] In all cases, the results are similar to those shown in Table 5. Although our results do not seem to be due to some outlier countries or regions, there is still a possibility that they are just showing that firms in rich countries tend to buy (some) firms in emerging markets, but not vice versa. We find no evidence suggesting so. In the Internet Appendix, we get qualitatively similar results if we drop acquiring firms from developed countries or target firms from developing countries.

Second, in Panel B, we impose different sample selection criteria to compute our main dependent variable. These alternative sample selection criteria are as follows: selecting only completed deals (column 1); keeping only deals with value reported (column 2); limiting only to deals worth more than $50 million (column 3); and dropping deals involving firms in the financial sector (column 4). Our baseline results are again unchanged.

Third, in Panel C, we test whether the effect of democracy is robust to the use of alternative dependent variables and another estimation technique. In column 1, we calculate the cross-border ratio using deal values. In column 2, we rather take the logarithm of one plus the total $ amount of cross-border deals between the acquirer and target countries in a given year. In column 3, we consider the likelihood of cross-border mergers. Specifically, we replace the outcome in equation (1) with a dummy variable equal to one if any cross-border deal occurs between two countries in a given year, and zero otherwise. The number of observations is higher than in other regressions because we keep all theoretical country pairs, for which there are at least one deal during the entire sample period. In column 4, we re-estimate our main specification using Tobit regression models to account for the truncation of observed merger activity at zero. The evidence shown

[9] These "peripheral" countries dropped in column 5 include Bangladesh, El Salvador, Morocco, Pakistan, and Serbia.

[10] These Western European countries dropped in column 6 include Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, and the United Kingdom.

in Panel C still indicates a positive impact of differences in democracy on cross-border mergers across country pairs.

Last, the validity of our estimates of the effect of differences in democracy on international merger activity may be sensitive to the presence of other time-varying factors that simultaneously impact democracy and cross-border mergers. Of particular importance are differences in valuation, which can vary substantially over time for any pair of countries through stock market movements and fluctuations in exchange rates (Erel et al., 2012). In columns 1 to 4 of Panel D, we report results from specifications in which we include variables proxying for stock market development, banking sector development, and exchange rate environment, respectively. The specification in column 5 includes all these variables together. Although these specifications tend to substantially reduce the number of observations due to missing data and although some of these additional controls enter the model with a significant coefficient, the democracy effects continue to be statistically and economically significant.

4.3 IV Estimates

One potential concern with the results above is that the variable of interest $\Delta\text{Democracy}_{j-i,t-1}$ is correlated with the error term $\varepsilon_{j,i,t}$, leading to inconsistent and biased estimates of β. Time-varying omitted differences between countries might drive both democracy and international merger activity, affecting both $\Delta\text{Democracy}_{j-i,t-1}$ and $\text{Cross-border ratio}_{i,j,t}$. For example, differences in democracy could simply proxy for other institutional arrangements between countries or differences in underlying economic environment that could motivate cross-border mergers. Arguably, democratic reforms might also be the result of the firms' expectation and willingness to merge, rather than its driver.[11] These challenges are not unique to our data, but are likely concerns with any data where democracy and economic outcomes are simultaneously observed.

We tackle these challenges by exploiting variation in democratization waves that is exogenous to international merger activity. The political science literature has long established that the advent of democracy around the world comes in waves (Huntington, 1993). These waves, and the "Third Wave" in particular, happen within specific regions and time periods, as in the 1980s in Latin America following the Carnation Revolution in Portugal and the Spanish Transition, or in the 1990s in Eastern Europe after the fall of the Soviet Union, or also in the early 2010s in North Africa possibly as a result of the Arab Spring experience. Although there is no consensus on the

[11] Igan et al. (2022) provide evidence suggesting that private capital inflows induce institutional changes at the country level.

factors triggering such regional waves, available evidence rejects the notion that they are explained by economic trends affecting all countries within a region (e.g., Bonhomme and Manresa, 2015). Rather, it is the demand for democracy that diffuses across countries within a region and with common political histories that appear to trigger waves (see Buera et al., 2011; Aidt and Jensen, 2014, for compelling empirical evidence).[12] Therefore, we use regional waves of democratization for countries with common political histories to instrument for differences in democracy, following recent papers examining the causal effect of democracy on corporate and asset pricing outcomes (Delis et al., 2020; Duong et al., 2022; Miller, 2022).

We construct our IV, derived from the above intuition, using the procedure of Acemoglu et al. (2019). Specifically, for each country c, we set R_c as one of the seven regions the country belongs and D_{ct0} as whether or not the country is a democracy in 1960 (that is, prior to our sample period).[13] We also assume that democracy in country c is influenced by democracy in the other countries in the same region, meaning an equal value for D_{ct0}. Then, we can define Regional waves$_{ct}$ as $\frac{1}{I_c}\sum_{c' \in I_c} D_{c't}$, where I_c is the set of countries c' in the region of country c that had the same democratic status in 1960, leaving out country c. Regional waves$_{ct}$ is thus the average of democracy in a region in a given year, which excludes the own-country observation.

Our IV approach aims to estimate a 2SLS version of our gravity equation (1) using as IV Regional waves$_{ct}$. In this equation, we are interested in the differences in democracy across country pairs; hence, in the first stage we take the difference in the value of our IV between the acquirer and target countries (that is, ΔRegional waves$_{j-i,t-1}$). We also include the same set of lagged controls and fixed effects in the first stage and cluster the standard errors at the country-pair level. This means that we impose that, conditional on standard gravity factors and year and country(-pair) fixed effects, the IV ΔRegional waves$_{j-i,t-1}$ has no direct effect on the cross-border ratio of country c in year t. Hence, the exclusion restriction requires that regional waves significantly affect democracy but are not themselves caused by merger waves or other economic trends in the region.

[12] Several factors explain democratic reforms or reversals in a specific country, which in turn may lead to democratic changes in other countries—through an information cascade process. Some important factors that have been shown in the literature are within-elite fragmentation, threats of revolution, and riots and wars. However, we do not consider these factors in our IV approach because they are typically associated with periods and contexts not covered by our study. The idea that the divergence of interests within governing elites led to franchise extensions is linked to the nineteenth century's context (Lizzeri and Persico, 2004; Llavador and Oxoby, 2005), the threat of widespread social unrest and revolution is typically associated with the first wave of democratization that occurred in the nineteenth and early twentieth century Europe (Acemoglu and Robinson, 2000; Aidt and Jensen, 2014; Aidt and Franck, 2015), wars relate to the suffrage reforms undertook after countries' involvement in international wars and in particular the World War I and World War II (Hicks, 2013; Aidt and Jensen, 2014), while riots also relate to democratic episodes in Sub-Saharan Africa at the turn of the twentieth century (Aidt and Leon, 2016).

[13] The seven regions are Africa, East Asia and the Pacific, Eastern Europe and Central Asia, Western Europe and other developed countries, Latin America and the Caribbean, the Middle East and the North of Africa, and South Asia.

We think this presumption is plausible for the reasons given above. A potential correlation between regional M&A activity and regional democracy (not working through the impact of differences in democracy between two countries on their bilateral merger flows) is the main threat to the validity of our IV approach. We pay special attention to ruling out this possibility of obtaining results contaminated by such correlated regional economic trends. In the Internet Appendix, we show additional IV results controlling for other potential economic trends and factors that may also spread across countries in the same region.

Panel B of Table 7 presents the first-stage relations that underlie our 2SLS estimates. The first-stage estimates are positive and statistically significant at the 1-percent level, suggesting that differences in regional waves of democratization are significant determinants of differences in democracy. The sizable efficient first-stage F-statistics suggested by Olea and Pflueger (2013) and reported at the bottom of the table is above the critical value required for a 2SLS estimation with one IV, meaning that our IV is strong and thus satisfies the relevance condition. The 2SLS estimates reported in Panel A of Table 7 show that our inferences from Table 5 remain overall qualitatively the same. The 2SLS estimate of β in column 1 (0.224, p-value = 0.001) is in the same order of magnitude than the corresponding baseline estimate in column 1 of Table 5 (0.131). In economic terms, this 2SLS estimate implies that a one-standard-deviation increase in the differences in democracy is associated with a 1.05 pp larger cross-border ratio (0.047×0.224). Relative to the sample mean, this effect represents an increase of 24 percent.

However, we note that the 2SLS estimates in columns 2 and 3 are much larger than their corresponding baseline *within* estimates from Table 5. We can see that the large set of fixed effects reduces the IV's incremental explanatory power. However, given the size of the F-statistic and the fact that we use LIML estimates, the result does not seem to mask a severe weak instrument problem (Jiang, 2017). What can therefore explain the larger 2SLS estimates? Here, the identification is accomplished using a relatively thin slice of "compliers"—that is, the country pairs that actually respond to the IV. Recall that in columns 2 and 3 (unlike in column 1), the set of fixed effects used means that we exploit within country(-pair) variation. The difference between the baseline and 2SLS estimates of β is capturing this difference between complier and non-complier country pairs. Therefore, the positive effect of the *change* in differences in democracy on cross-border M&A activity is not an artifact due to the action of some omitted factors, but does not provide an estimate of the magnitude of the causal effect for the whole cohort of countries that we look at in our sample. In other words, being the LATE of the population is the reason for

the 2SLS estimates being larger than the baseline within estimates (Angrist and Pischke, 2009). This is expected as a relatively small fraction of countries in our sample (see Table 2) experiences a full-fledged transition (reversal) to democracy (nondemocracy). The difference between LATE and ATE is much smaller in column 1 precisely because there are more differences in democracy (that is, in *level*) between country pairs that are affected by the IV. The findings in this subsection motivate the investigation in subsection 4.5 of the long-run (between) effect of differences in democracy.

4.4 Democratic Transitions and Autocratic Reversals

The Polity2 index we use may give a disproportionate weight on small constitutional changes. We now consider a dichotomous measure of democracy to overcome concerns related to the fact that our results may be due to small (spurious) changes in the Polity2 index. The use of a discrete democratic reform (reversal) indicator as opposed to a continuous measure of democracy, such as the Polity2 index, first eases the interpretation of economic magnitudes but has also the potential to be more powerful if countries respond only to substantively large constitutional changes because of fixed costs in doing deals.

To create our treatment indicator, we follow Papaioannou and Siourounis (2008) and Acemoglu et al. (2019), by focusing on those transition periods that led countries to democracy (or autocracy). These authors have developed a dichotomous measure of democracy combining information from several indices (including Polity2 and Freedom House) to purge spurious changes in each. We label this indicator Democracy (ANRR). Distinguishing between reforms that lead to democracy and reversals that lead to nondemocracy, we obtain $R_{c,t}$ that takes the value of $+1$ (if a democratization happened in country c in year t), -1 (if a reversal from democracy to nondemocracy is undertook in country c in year t), and 0 otherwise. As already mentioned above, Table 2 lists the countries having experienced democratizations and reversals from democracy to nondemocracy. Our indicator, $\text{Democracy (ANRR)}_{c,t}$, is then defined recursively starting either from $\text{Democracy (ANRR)}_{c,1985} = 1$ if country c in year t is a democracy or from $\text{Democracy (ANRR)}_{c,1985} = 0$ if country c in year t is a nondemocracy. For any given country c in year t, $\text{Democracy (ANRR)}_{c,t} = \text{Democracy (ANRR)}_{c,t-1} + R_{c,t}$. By construction, this indicator treats all reforms (reversals) equally. It is designed to capture large changes in democracy/autocracy over time and is not comparable across countries.

We then exploit intertemporal variations between country pairs in transitions to and away from

democracy. This means that we estimate a gravity model of the form of equation (1) by replacing the continuous variable ΔDemocracy (Polity2) by the dichotomous variable ΔDemocracy (ANRR).

The results are shown in Table 8. The results across columns 1 to 3 are in line with the ones above and indicate that discrete changes in the differences in democracy are positively associated with cross-border M&A activity. Column 1, the most parsimonious specification, reports an estimate of β, 0.007, statistically significant at the 10-percent level. Columns 2 and 3, however, are more demanding specifications including country(-pair) fixed effects, and show that the estimates of β are positive and statistically significant the the 1-percent level (respectively, 0.025 and 0.029). Hence, the economic magnitude of the effect of differences in democracy is comparable to the ones estimated in the previous subsections. From column 3, for instance, a discrete change in the differences in democracy between acquirer and target countries—which corresponds to a situation where, e.g., the target country becomes a full autocracy—implies a 2.9 pp higher cross-border ratio. Relative to the sample mean, this effect implies an increase of 66 percent. Importantly, our estimates in this subsection also imply that our key findings are not driven by small, spurious differences in democracy between acquirer and target countries but are mostly driven by meaningful differences in institutional democracy.

4.5 Between Estimates

Our results thus far mainly stress the short-run effect of differences in democracy on cross-border merger ratio by exploiting within country(-pair) variation. As highlighted in subsection 4.3, only a fraction of countries experience full-fledged transitions to and away from democracy, while differences in democracy across country pairs remain important and can be sustained over long period of time. These country-differences in democracy may lead to long-run effects on cross-border merger flows. We now examine whether differences in democracy also lead to permanent (long-run) effect on cross-border merger flows by separating the between variation from the within variation that rather captures the transitory (short-run) effect (Mundlak, 1978).

Table 9 displays the between estimates. This method removes the time-series dimension by using mean values of the dependent and explanatory variables. Column 1 reports the unconditional between estimate, while columns 2 and 3 show the between estimates conditional on country controls. The estimates of β are positive and statistically significant at the 1-percent level across the columns. However, the size of the effect of differences in democracy is smaller compared to analogous within estimates. The effect of institutional democracy explaining future international

merger flows is economically meaningful. The between estimates in columns 1 to 3 imply that a one-standard-deviation increase in average differences in democracy is associated with an increased cross-border merger flows of 0.72-0.99 pp—that is, 16-23 percent of the sample mean.

The results in this subsection are interesting because they characterize the important permanent effect of differences in democracy on the dynamism of international merger activity—next to the shorter-run effect documented in the previous subsections. In other words, these findings highlight that long-lasting differences in democracy between countries motivate cross-border mergers as much as around episodes of democratization or reversal from democracy to nondemocracy.

5 How Does Democracy Drive Cross-Border Merger Flows?

In this section, we explore the "bonding" mechanism through which differences in democracy might affect cross-border merger flows, even though we cannot definitively rule out the possibility that there are other mechanisms at work.

5.1 100-Percent Mergers

We have shown previously that the democracy effect is directional, in that mergers flows involve on average acquiring firms from more advanced democracies than the target firms. As a prequel to our examination of the bonding mechanism—which suggests changes in corporate governance induced by cross-border mergers—we analyze whether the democracy effect mainly goes through complete control (100-percent) deals or any other types of deals. Indeed, the target firm in a cross-border merger effectively adopts the nationality of the foreign firm when the acquisition involves 100-percent of the target shares, and consequently the target firm adopts the accounting standards, disclosure practices, and governance structures of the acquiring firm (Bris and Cabolis, 2008).

Table 10 presents the results. We run equation (1) by employing different deal selection criteria in determining the dependent variable, Cross-border ratio: in column 1, we restrict the deals involving complete control (100-percent stake in target); in column 2, we keep majority "non-complete" deals (between 50- and 99-percent stake in target); and, in column 3, we restrict deals involving minority stakes (less than 50 percent of the target). (The exact definitions are provided in the note of Table 10.) From columns 1 to 3, we observe that merger flows involve acquiring firms from more democratic countries than their target firms, only so when acquirers pursue 100-percent

control deals. Indeed, in column 1, the estimate of β is positive and statistically significant at the 1-percent level (0.459, p-value = 0.000), consistent with our premise. However, democracy does not enter significantly, neither in column 2, nor in column 3. In the Internet Appendix, we provide evidence corroborating these findings: we observe that deals using stock as a method of payment also drive the democracy effect—that is, deals for which target firms' shareholders remain shareholders of the resulting combined firm.

5.2 Push and Pull Factors in Cross-Border Mergers

To assess the motives behind these 100-percent mergers, we examine whether M&A flows are driven by "push" and/or "pull" factors. Our evidence shows increased cross-border merger flows from acquires with stronger democratic institutions. But, at this stage, it is not clear whether merger flows are influenced as much by the superior democratic institutions in the acquirer's home country or as by the weaker democratic institutions in the target's home country. In the former case, a push factor is at work, whereby firms in more democratic countries make more cross-border deals. In the latter case, it is a pull factor, whereby firms in less democratic countries attract more cross-border deals.

To test the impact of push and pull factors, we re-estimate equation (1) using the levels of democracy of the acquirer and target countries, instead of differences—similar to, e.g., Karolyi and Taboada (2015). The results in Table 11 show that pull factors influence cross-border flows to a much greater extent than push factors, which are not significant but in column 2. Column 1 reports the levels of both acquirer and target countries together with controls and year fixed effects. Target democracy appears negative and statistically significant at the 1-percent level (-0.216, p-value = 0.000), while acquirer democracy does not enter the regression significantly. Column 2 augments the previous specification with country-pair fixed effects. Acquirer democracy is now positive and statistically significant at the 1-percent level, while target democracy remains negative and statistically significant at the 1-percent level (the estimate is now -0.653 with a p-value = 0.000). The next columns strengthen the specification by modifying the set of fixed effects to the inclusion of target (acquirer) country fixed effects and acquirer (target) country $\times$ year fixed effects. By including acquirer (target) country $\times$ year fixed effects, which absorb the variable Acquirer democracy (Target democracy), we are able to fully control for the direct economic consequences of the level of democracy in the acquirer (target)'s home country. The results in columns 3 and 4 confirm that the strong influence of the pull factors but show, at the same time,

that the influence of the push factors being significant in column 2 is at best fragile. The effect of the level of democracy in the target country is sizable. In column 3, the estimate of -0.506 (p-value 0.000) implies that a one-standard-deviation drop in the variable Target democracy (that is, 0.036, not tabulated) is associated with a 0.76 pp increase in the Cross-border ratio, or 41 percent of its mean. In the Internet Appendix, we instrument the democracy variables to address endogeneity concerns. The results are even more striking. Target democracy is consistently negative and statistically significant at the 1-percent level, whereas acquirer democracy is never significant. The IV estimates confirm the findings that pull factors affect cross-border merger flows.

The results in this subsection clearly indicate that merger flows are more influenced by the weaker democratic institutions in the target's home country (pull factors) than the better democratic institutions in the acquirer's home country (push factors). These results are consistent with the bonding view. Indeed, to the extent that democracy fosters an institutional environment capable of improving corporate governance (which is the case as shown in the Internet Appendix), firms in countries endowed with weak democratic institutions are likely to be acquired by firms in countries with relatively better democratic institutions as the target firms' shareholders are consequently subject to their corporate governance system.[14] Consistent with this idea, an expansive literature (cited at the outset) shows that governance-related differences across countries motivate mergers if the combined firm has better protection for target firm's shareholders due to higher governance standards in the acquiring firm's home country. We deepen this analysis in the next subsections.

5.3 Cross-Sectional Heterogeneity: Investor Protection

The pull factors we identified in the previous subsection should be weaker for countries with stronger corporate governance. Indeed, in these countries target firms' shareholders would benefit less from bonding after being acquired. Therefore, we now look at the cross-sectional heterogeneity of the relation previously uncovered.

To test whether the effect of pull factors is mitigated in target firms' home countries with higher-quality corporate governance system, we augment the specifications in column 3 of Table

[14]In the Internet Appendix, we provide cross-country evidence that democracies are conducive to reforms aimed at improving investor protection. Our results are consistent with other works. For example, Bushman et al. (2004) find in a sample of 46 countries that autocratic political regimes are negatively associated with corporate transparency at the country level, which includes the timeliness and intensity of accounting disclosures and the intensity of private information acquisition and communication (e.g., analyst following). Gomez and Korine (2005) examine the long-term evolution of corporate governance reforms in France, Germany, the United Kingdom, and the United States. They find that democratic procedures played a key role in shaping the corporate governance system in these countries.

11 with the variable Target democracy interacted with several proxies for investor protection in the target firms' countries commonly used in the literature. Table 12 shows the results. The interaction terms in columns 1 and 2 use indicators capturing the strength of shareholder protection and the quality of accounting disclosure, respectively, in the target country (based on measures developed by La Porta et al., 1998; Djankov et al., 2008). The coefficients on Target democracy are still negative and statistically significant at the 5- or 1-percent level. The coefficients on the interaction terms are positive and also statistically significant at the 5- or 1-percent level. These results indicate that the effect of pull factors is less pronounced in target countries with higher-quality corporate governance—that is, with higher shareholder protection and accounting standards.

Column 3 uses instead a time-varying indicator of M&A laws enacted in target firms' home country. Specifically, these are the M&A laws, as identified by Lel and Miller (2015), that are passed to foster takeover activity by reducing legal and administrative barriers to M&A transactions, encouraging information dissemination, and increasing minority shareholder protection. The coefficient on Target democracy is again negative and statistically significant at the 1-percent level, underscoring the strong direct effect of pull factors on cross-border merger flows. The interaction term is also positive and statistically significant at the 1-percent level, indicating that the effect of pull factors is mitigated in target countries with strong corporate governance regime. These results provide additional support to the bonding hypothesis.

5.4 Stock Price Reactions to Merger Announcements

To further assess the bonding hypothesis, we examine how differences in democracy affect the stock price reactions to cross-border deal announcements. Bris and Cabolis (2008) have shown, among others, that better shareholder protection and accounting standards in the acquiring firms' country result in higher merger premiums. In an 100-percent merger, international law prescribes the target firm to take the nationality of the acquiring firm and, thereby, the corporate governance regime of the acquiring firm is imposed on the target firm. Indeed, a change in nationality implies, among other things, that the law applicable to the target firm—including shareholder protection and accounting standards—changes as well. Therefore, the resulting corporate governance improvements should lead the market to assign more value on the reforming firm.

To test this hypothesis, we look at the relation between differences in democracy and share price reactions to cross-border merger announcements at both target and acquiring firms. Specifically,

we estimate the following model:

$$\text{CAR}_{i,j,k,t} = \alpha_{i,j} + \alpha_t + \beta \Delta \text{Democracy}_{j-i,t-1} + \gamma \Delta X'_{j-i,t-1} + \delta X'_{k,t-1} + \varepsilon_{i,j,k,t}, \quad (2)$$

where i, j, k, and t denote, respectively, target country, acquirer country, deal, and year. The dependent variable, $\text{CAR}_{i,j,k,t}$, is the (target or acquiring) firm's 3-day CAR (-1,+1) or 7-day CAR (-3,+3) surrounding the deal announcement date. Abnormal returns are calculated using the market model relative to a local equity market index. The focus is, as before, on $\Delta\text{Democracy}_{j-i,t-1}$. To isolate the relation between CAR and differences in democracy across country pairs, we include a host of gravity controls ($\Delta X'_{j-i,t-1}$) and deal-level controls ($X'_{k,t-1}$). The set of gravity controls is the same time-varying country-pair differences as previously, while the deal-level controls consist of Firm size, Financial acquirer, Number of bidders, Toehold, and Hostile (see Appendix A for the exact variable definitions). This set of controls further includes both acquirer-industry and target-industry fixed effects. $\alpha_{i,j}$ and α_t are country-pair fixed effects and year fixed effects, respectively. $\varepsilon_{i,j,k,t}$ denotes the error term. Standard errors are corrected for clustering of observations at the country-pair level.

The coefficient of interest is β, which is identified from the changes in differences in democracy between countries on CAR of either target firms or acquiring firms.[15] The results from estimation of equation (2) are reported in Table 13. We find that differences in democracy between acquirer and target countries positively affect target firms' CAR around the announcement date, but have no incidence on acquiring firms' CAR. Column 1 focuses on 3-day target CAR and reports an estimate of β, 7.524, statistically significant at the 1-percent level. In terms of economic magnitude, this estimate implies that a one-standard-deviation increase in differences in democracy boosts the target CAR by 35.36 pp (that is, 0.047×7.524) from its unconditional average of 20.2 percent (as reported in Table 3). In $ terms, this translates into a value creation for average-size target firms of ca. $600M. Column 2 mirrors the specification of column 1 using the 7-day target CAR as dependent variable. We uncover a somewhat smaller effect: a one-standard-deviation increase in differences in democracy increases the target CAR by 29.19 pp (0.047×6.210) relative to an average 7-day target CAR of 22.2 percent. The remaining columns of Table 13 report the specifications using the acquirer CAR as dependent variable. As can be observed, we find no statistically significant relation between democracy and acquirer CAR. These results (not tabulated to conserve

[15] Our analysis on target CAR is restricted, by definition, on the sample of publicly listed target firms. However, our analysis on acquirer CAR is limited to the sample of publicly listed acquiring firms, but not on the listing status of the target.

space but available upon request) are unchanged if we use the same sample that in columns 1 and 2 restricted to publicly listed target firms.

The asymmetry in the effect indicates that the cross-border (100-percent) mergers involving acquirers from stronger democracies than targets are not value-destroying, and primarily benefit target firms' shareholders, which further characterizes "bonding" as the main mechanism behind the democracy effect.[16] The asymmetric effect we document in this subsection is also consistent with Bris and Cabolis (2008) who find positive and significant stock price reactions for target firms, but not for acquiring firms, when the latter's are from a country with a strong shareholder orientation (relative to the former's).

5.5 Cross-Border Merger Flows, Investor Protection, and the Fundamental Role of Democracy

The results in the previous subsections suggest that the bonding view likely accounts for the directional effect of democracy on cross-border merger flows. To close the loop, we relate these results back to the results from Section 4 to confirm that investor protection indeed feeds through to cross-border merger flows.

Specifically, we gauge the effect of investor protection on international merger activity using a two-step approach aimed to isolate the fundamental effect of democratic institutions. In a first step, we estimate the following model:

$$\Delta\text{Investor protection}_{i,j,[t]} = \alpha_0 + \alpha_i + \alpha_j + [\alpha_t] + \beta\Delta\text{Democracy}_{j-i,[t]} + \varepsilon_{i,j,[t]}, \tag{3}$$

where ΔInvestor protection$_{i,j,[t]}$ is one of our measures of investor protection, namely ΔShareholder protection, ΔAccounting standards, ΔM&A laws. α_0 is a constant term. The other parameters and variables are the same as in equation (1). The model is cross-sectional (i.e., no time dimension t) when estimating the effect on ΔShareholder protection and ΔAccounting standards.[17] The model is, however, in panel when estimating the effect on ΔM&A laws and thus includes year fixed effects. Then, in a second step, we estimate the gravity model in equation (1) using Cross-border ratio as dependent variable and the predicted and residual values as calculated in the first step. Therefore, the predicted value of the investor protection variable captures the fun-

[16] In the Internet Appendix, we also examine the effect of differences in democracy on CAR by only focusing on 100-percent deals. The results are unchanged.

[17] For the former variable we use the year 2008 and the latter variable the year 1990, that is, the year for which these indices are constructed.

damental effect of democracy, while the residual value captures the effect of investor protection that is not explained by democracy.

The results from the second-step shown in Table 14, Panel A, indicate that investor protection affects cross-border mergers largely through the predicted value. From column 1, focusing on shareholder protection, we can see that the predicted value is positive and statistically significant at the 1-percent level, while the residual value does not enter significantly. In column 2, we find that both predicted and residual values on accounting standards are positive and statistically significant at the 1-percent level. This means that accounting standards affect M&As directly but also indirectly via the fundamental effect of democratic institutions. Economically, the latter effect is slightly larger: a one-standard-deviation increase in the predicted value of accounting standards (that is, 0.156, in Panel B) implies an increase in cross-border merger flows of 1.59 pp (that is, 0.156×0.102), whereas a one-standard-deviation increase in the predicted value leads to an 1.33-pp increase (that is, 0.113×0.118). From column 3, we draw the same conclusions by focusing on M&A laws: the effect of the predicted value is much larger statistically and economically than the effect of the residual value.

These results directly speak to the classical political economy literature, which stresses the fundamental role played by political institutions on economic outcomes by shaping contracting institutions (North, 1990; Acemoglu et al., 2005). Specifically, we show that democratic institutions are a more fundamental determinant of cross-border merger flows, with investor protection being rather a "proximate" determinant.

6 Alternative Mechanisms

In this section, we provide a discussion on other non-mutually exclusive mechanisms that could be present. Although we cannot exclude all potential alternative explanations, our evidence in the previous section allows us to rule out several plausible alternative mechanisms.

Economic Development. To the extent that democracies promote economic prosperity, firms located in democratic regions may perform better than if they were in less democratic countries (Persson and Tabellini, 2009). Higher level of economic development may thus increase economic opportunities available to firms, including takeover deals, and thus confound with the democracy effect we uncover. However, country-differences in economic development are unlikely to explain our results for at least three reasons. First, we systematically control for differences in countries'

economic development and performance. The inclusion (or not) of these controls does not affect our results. Second, we only observe that pull factors motivate cross-border deals, but not push factors. Firms located in flourishing democracies should indeed benefit from enhanced economic dynamism there and would thus be incentivized to also find deal opportunities abroad. The evidence on pull factors only is therefore inconsistent with an economic-development view. Third, the fact that acquirer CAR surrounding deal announcements are insignificant is inconsistent with the differences in economic development for similar reasons than the lack of evidence supporting the push factors.

Labor Bargaining Power. Another potential explanation for our results relates to labor bargaining power. Miller (2022) finds that risk premia are significantly elevated during periods of democratization, despite little evidence of a negative effect on GDP. Miller (2022) argues that increased risk premia are due to risk over redistribution in the event of a successful democratization. Drautzburg et al. (2022) consistently show that the bargaining power of labor rises and the capital share of income declines after episodes of democratization. Therefore, it could be that as countries become more democratic, firms seek cross-border deals in autocracies to diversify risks emerging from the changes that a democratization might bring (e.g., as a way to have greater bargaining power against their current labor force). These "risks" might be correlated with the positive pull factors we document as both may occur if a country transitions. In the Internet Appendix, we examine the effect of pull factors interacted with the degree of employment protection afforded by target countries' laws as a proxy for labor bargaining power. We find evidence (though statistically significant only at the 10-percent level) that the effect of pull factors is less pronounced in target countries with more stringent labor laws. This result may thus suggest that risk diversification through increased bargaining power vis-a-vis labor can also account for the directional effect of democracy on cross-border merger flows.[18]

Natural Resources. The use of country-pair fixed effects in our gravity model ensures that differences in democracy can explain cross-border merger flows over and above those influenced by fixed differences between countries. However, a potential remaining concern could be that certain industry characteristics impact foreign investments differently in democratic versus nondemocratic regimes. Natural resources in host countries may affect the relation between democracy and foreign

[18]In the Internet Appendix, we also verify whether a similar diversification explanation based on climate-related risk can account for our results (Li et al., 2022). We do not find that the effect of pull factors is affected by target countries' adoption of environmental laws.

investments, including international merger deals (Asiedu and Lien, 2011). This explanation does not seem to account for our results. In the Internet Appendix, we re-run equation (1) by excluding target countries for which the value of the share of minerals and oil in total exports is larger than some critical value (as determined by Asiedu and Lien, 2011). We obtain similar results after excluding deals in target countries where exports are dominated by natural resources. The differences in democracy between acquirer and target countries continue to influence cross-border merger flows in this subsample, while pull factors are still driving this relation.

7 Conclusion

In this paper, we report two novel empirical regularities in the analysis of the determinants of cross-border M&As. First, we show suggestive (though inconclusive) evidence that the closer two countries are in terms of levels of democracy, the more intense the merger flows between them. This result is certainly not surprising but is consistent with the general idea that the completion of cross-border transactions is facilitated when contracting costs associated with merging two firms located in different countries are low. Second, we find that there is a democracy effect, which is directional. There are substantial merger flows involving acquirers from countries with better democratic institutions than their targets. This democracy effect is sizeable: a one-standard-deviation increase in the differences in democracy between acquirer and target countries is associated with more than 2 pp increase in their cross-border merger flows, which represents about fifty percent of the sample mean. This result is remarkable because compared to other important determinants of cross-border mergers shown in prior work, such as geography, culture, and trade, the democracy effect is economically larger. We also highlight a potential important mechanism behind this democracy effect. We uncover evidence consistent with the "bonding" view, whereby target firms benefit from better democratic institutions, and the resulting corporate governance regime, after being acquired by firms from more advanced democracies. Combined, our findings imply that democracy is a fundamental, omitted determinant in models of cross-border merger flows.

References

Acemoglu, D., S. Johnson, and J. A. Robinson (2005). Institutions as a fundamental cause of long-run growth. *Handbook of Economic Growth 1*, 385–472.

Acemoglu, D., S. Naidu, P. Restrepo, and J. A. Robinson (2019). Democracy does cause growth. *Journal of Political Economy 127*(1), 47–100.

Acemoglu, D. and J. A. Robinson (2000). Why did the west extend the franchise? Democracy, inequality, and growth in historical perspective. *Quarterly Journal of Economics 115*(4), 1167–1199.

Ahern, K. R., D. Daminelli, and C. Fracassi (2015). Lost in translation? The effect of cultural values on mergers around the world. *Journal of Financial Economics 117*(1), 165–189.

Ahmad, M. F., E. de Bodt, and J. Harford (2021). International trade and the propagation of merger waves. *Review of Financial Studies 34*(10), 4876–4925.

Aidt, T. S. and R. Franck (2015). Democratization under the threat of revolution: Evidence from the Great Reform Act of 1832. *Econometrica 83*(2), 505–547.

Aidt, T. S. and P. S. Jensen (2014). Workers of the world, unite! Franchise extensions and the threat of revolution in Europe, 1820–1938. *European Economic Review 72*, 52–75.

Aidt, T. S. and G. Leon (2016). The democratic window of opportunity: Evidence from riots in Sub-Saharan Africa. *Journal of Conflict Resolution 60*(4), 694–717.

Albuquerque, R., L. Brandão-Marques, M. A. Ferreira, and P. Matos (2019). International corporate governance spillovers: Evidence from cross-border mergers and acquisitions. *Review of Financial Studies 32*(2), 738–770.

Alfaro, L., S. Kalemli-Ozcan, and V. Volosovych (2008). Why doesn't capital flow from rich to poor countries? An empirical investigation. *Review of Economics and Statistics 90*(2), 347–368.

Alimov, A. (2015). Labor market regulations and cross-border mergers and acquisitions. *Journal of International Business Studies 46*(8), 984–1009.

Angrist, J. D. and J.-S. Pischke (2009). *Mostly Harmless Econometrics: An Empiricist's Companion*. Princeton University Press.

Asiedu, E. and D. Lien (2011). Democracy, foreign direct investment and natural resources. *Journal of International Economics 84*(1), 99–111.

Boix, C., M. Miller, and S. Rosato (2013). A complete data set of political regimes, 1800–2007. *Comparative Political Studies 46*(12), 1523–1554.

Bonhomme, S. and E. Manresa (2015). Grouped patterns of heterogeneity in panel data. *Econometrica 83*(3), 1147–1184.

Bris, A., N. Brisley, and C. Cabolis (2008). Adopting better corporate governance: Evidence from cross-border mergers. *Journal of Corporate Finance 14*(3), 224–240.

Bris, A. and C. Cabolis (2008). The value of investor protection: Firm evidence from cross-border mergers. *Review of Financial Studies 21*(2), 605–648.

Buera, F. J., A. Monge-Naranjo, and G. E. Primiceri (2011). Learning the wealth of nations. *Econometrica 79*(1), 1–45.

Burchardi, K. B., T. Chaney, and T. A. Hassan (2019). Migrants, ancestors, and foreign investments. *Review of Economic Studies 86*(4), 1448–1486.

Bushman, R. M., J. D. Piotroski, and A. J. Smith (2004). What determines corporate transparency? *Journal of Accounting Research 42*(2), 207–252.

Cao, C., X. Li, and G. Liu (2019). Political uncertainty and cross-border acquisitions. *Review of Finance 23*(2), 439–470.

Carlson, J., T. Incerti, and P. Aronow (2021). Dyadic clustering in international relations. *Working Paper*.

Coffee, J. C. (1998). Future as history: The prospects for global convergence in corporate governance and its implications. *Northwestern University Law Review, 93*(3), 641–708.

Coppedge, M., J. Gerring, C. H. Knutsen, J. Krusell, J. Medzihorsky, J. Pernes, S.-E. Skaaning, N. Stepanova, J. Teorell, E. Tzelgov, et al. (2019). The methodology of "varieties of democracy"(v-dem). *Bulletin of Sociological Methodology/Bulletin de Méthodologie Sociologique 143*(1), 107–133.

Degryse, H., T. Lambert, and A. Schwienbacher (2018). The political economy of financial systems: Evidence from suffrage reforms in the last two centuries. *Economic Journal 128*(611), 1433–1475.

Delis, M. D., I. Hasan, and S. Ongena (2020). Democracy and credit. *Journal of Financial Economics 136*(2), 571–596.

Dinc, S. and I. Erel (2013). Economic nationalism in mergers and acquisitions. *Journal of Finance 68*(6), 2471–2514.

Djankov, S., R. La Porta, F. Lopez-de Silanes, and A. Shleifer (2008). The law and economics of self-dealing. *Journal of Financial Economics 88*(3), 430–465.

Drautzburg, T., J. Fernández-Villaverde, P. Guerrón-Quintana, et al. (2022). Politics and income distribution. *Economic Insights – Federal Reserve Bank of Philadelphia 7*(2), 11–18.

Duong, H. N., A. Goyal, V. Kallinterakis, and M. Veeraraghavan (2022). Democracy and the pricing of initial public offerings around the world. *Journal of Financial Economics 145*(1), 322–341.

Ellis, J., S. B. Moeller, F. P. Schlingemann, and R. M. Stulz (2011). Globalization, governance, and the returns to cross-border acquisitions. *NBER Working Paper No. 16676*.

Erel, I., R. C. Liao, and M. S. Weisbach (2012). Determinants of cross-border mergers and acquisitions. *Journal of Finance 67*(3), 1045–1082.

Ferreira, M. A., M. Massa, and P. Matos (2010). Shareholders at the gate? institutional investors and cross-border mergers and acquisitions. *Review of Financial Studies 23*(2), 601–644.

Frésard, L., U. Hege, and G. Phillips (2017). Extending industry specialization through cross-border acquisitions. *Review of Financial Studies 30*(5), 1539–1582.

Gao, Y., L. Zang, A. Roth, and P. Wang (2017). Does democracy cause innovation? An empirical test of the popper hypothesis. *Research Policy 46*(7), 1272–1283.

Giuliano, P., P. Mishra, and A. Spilimbergo (2013). Democracy and reforms: Evidence from a new dataset. *American Economic Journal: Macroeconomics 5*(4), 179–204.

Gomez, P.-Y. and H. Korine (2005). Democracy and the evolution of corporate governance. *Corporate Governance: An International Review 13*(6), 739–752.

Grosjean, P. and C. Senik (2011). Democracy, market liberalization, and political preferences. *Review of Economics and Statistics 93*(1), 365–381.

Guiso, L., P. Sapienza, and L. Zingales (2009). Cultural biases in economic exchange? *Quarterly Journal of Economics 124*(3), 1095–1131.

Gupta, N. and X. Yu (2007). Does money follow the flag? *Working Paper*.

Guriev, S. and E. Papaioannou (2022). The political economy of populism. *Journal of Economic Literature 60*(3), 753–832.

Hicks, D. L. (2013). War and the political zeitgeist: Evidence from the history of female suffrage. *European Journal of Political Economy 31*, 60–81.

Hijzen, A., H. Görg, and M. Manchin (2008). Cross-border mergers and acquisitions and the role of trade costs. *European Economic Review 52*(5), 849–866.

Huizinga, H. P. and J. Voget (2009). International taxation and the direction and volume of cross-border m&as. *Journal of Finance 64*(3), 1217–1249.

Huntington, S. P. (1993). *The Third Wave: Democratization in the Late Twentieth Century*, Volume 4. University of Oklahoma Press.

Igan, D., A. R. Lauwers, and D. Puy (2022). Capital flows and institutions. *CEPR Discussion Paper No. 17527*.

Jiang, W. (2017). Have instrumental variables brought us closer to the truth. *Review of Corporate Finance Studies 6*(2), 127–140.

Julio, B. and Y. Yook (2016). Policy uncertainty, irreversibility, and cross-border flows of capital. *Journal of International Economics 103*, 13–26.

Karolyi, G. A. and R. C. Liao (2017). State capitalism's global reach: Evidence from foreign acquisitions by state-owned companies. *Journal of Corporate Finance 42*, 367–391.

Karolyi, G. A. and A. G. Taboada (2015). Regulatory arbitrage and cross-border bank acquisitions. *Journal of Finance 70*(6), 2395–2450.

Kempf, E., M. Luo, L. Schäfer, and M. Tsoutsoura (2022). Political ideology and international capital allocation. *Working Paper*.

La Porta, R., F. Lopez-de Silanes, A. Shleifer, and R. Vishny (2000). Investor protection and corporate governance. *Journal of Financial Economics 58*(1-2), 3–27.

La Porta, R., F. Lopez-de Silanes, A. Shleifer, and R. W. Vishny (1998). Law and finance. *Journal of Political Economy 106*(6), 1113–1155.

Laeven, L. and A. Popov (2021). Carbon taxes and the geography of fossil lending. *CEPR Discussion Paper No. 16745*.

Lambert, T. and P. Volpin (2018). Endogenous political institutions and financial development. *Handbook of Finance and Development*, 477–500.

Leblang, D. (2010). Familiarity breeds investment: Diaspora networks and international investment. *American Political Science Review 104*(3), 584–600.

Lel, U. and D. P. Miller (2015). Does takeover activity cause managerial discipline? Evidence from international M&A laws. *Review of Financial Studies 28*(6), 1588–1622.

Levine, R., C. Lin, and B. Shen (2020). Cross-border acquisitions: Do labor regulations affect acquirer returns? *Journal of International Business Studies 51*(2), 194–217.

Li, Q. and A. Resnick (2003). Reversal of fortunes: Democratic institutions and foreign direct investment inflows to developing countries. *International Organization 57*(1), 175–211.

Li, T., D. Y. Tang, and F. Xie (2022). Climate laws and cross-border mergers and acquisitions. *Working Paper*.

Lizzeri, A. and N. Persico (2004). Why did the elites extend the suffrage? Democracy and the scope of government, with an application to Britain's "Age of Reform". *Quarterly Journal of Economics 119*(2), 707–765.

Llavador, H. and R. J. Oxoby (2005). Partisan competition, growth, and the franchise. *Quarterly Journal of Economics 120*(3), 1155–1189.

Madsen, J. B., P. A. Raschky, and A. Skali (2015). Does democracy drive income in the world, 1500–2000? *European Economic Review 78*, 175–195.

Martynova, M. and L. Renneboog (2008). Spillover of corporate governance standards in cross-border mergers and acquisitions. *Journal of Corporate Finance 14*(3), 200–223.

Miller, M. (2022). Who values democracy? *Working Paper*.

Mundlak, Y. (1978). On the pooling of time series and cross section data. *Econometrica*, 69–85.

North, D. C. (1990). *Institutions, Institutional Change and Economic Performance*. Cambridge University Press.

Olea, J. L. M. and C. Pflueger (2013). A robust test for weak instruments. *Journal of Business & Economic Statistics 31*(3), 358–369.

Pagano, M. and P. Volpin (2006). Shareholder protection, stock market development, and politics. *Journal of the European Economic Association 4*(2-3), 315–341.

Pagano, M. and P. F. Volpin (2005). The political economy of corporate governance. *American Economic Review 95*(4), 1005–1030.

Papaioannou, E. (2009). What drives international financial flows? politics, institutions and other determinants. *Journal of Development Economics 88*(2), 269–281.

Papaioannou, E. and G. Siourounis (2008). Democratisation and growth. *Economic Journal 118*(532), 1520–1551.

Perotti, E. and A. Schwienbacher (2009). The political origin of pension funding. *Journal of Financial Intermediation 18*(3), 384–404.

Perotti, E. C. and E.-L. Von Thadden (2006). The political economy of corporate control and labor rents. *Journal of Political Economy 114*(1), 145–175.

Persson, T. and G. Tabellini (2009). Democratic capital: The nexus of political and economic change. *American Economic Journal: Macroeconomics 1*(2), 88–126.

Przeworski, A., R. M. Alvarez, M. E. Alvarez, J. A. Cheibub, F. Limongi, F. P. L. Neto, et al. (2000). *Democracy and development: Political institutions and well-being in the world, 1950-1990*. Number 3. Cambridge University Press.

Rajan, R. G. and L. Zingales (2003). The great reversals: the politics of financial development in the twentieth century. *Journal of Financial Economics 69*(1), 5–50.

Rode, M. and J. D. Gwartney (2012). Does democratization facilitate economic liberalization? *European Journal of Political Economy 28*(4), 607–619.

Roe, M. J. (2006). *Political Determinants of Corporate Governance: Political Context, Corporate Impact*. Oxford University Press.

Rossi, S. and P. F. Volpin (2004). Cross-country determinants of mergers and acquisitions. *Journal of Financial Economics 74*(2), 277–304.

Starks, L. T. and K. D. Wei (2013). Cross-border mergers and differences in corporate governance. *International Review of Finance 13*(3), 265–297.

A Variable Definitions and Data Sources

In this appendix, we provide detailed definitions for all variables used in our analysis as well as their corresponding data sources.

A.1 Country-Pair-Level Variables

Cross-border ratio – The total number of majority cross-border mergers between acquirer countries j and target countries i in year t, as a percentage of the total number of (domestic and cross-border) mergers in target countries i in year t. Source: SDC.

$ value cross-border ratio – The total $ value of majority cross-border mergers between acquirer countries j and target countries i in year t, as a percentage of the total $ value of (domestic and cross-border) mergers in target countries i in year t. Source: SDC.

ln(1+$ value deals) – The logarithm of one plus the total $ amount of cross-border mergers between acquirer countries j and target countries i in year t. Source: SDC.

1(Cross-border deal) – A dummy variable equal to one if any cross-border deal occurs between acquirer countries j and target countries i in year t, and zero otherwise. Source: SDC.

ΔDemocracy – The difference between acquirer countries j and target countries i in the Polity2 index. The Polity2 index of institutional democracy is an additive 21-point scale, combining an "Autoc" score and an "Democ" score (-10 indicating full autocracy and +10 indicating a full democracy). The "democracy threshold" is generally set at +6. In the regressions, we divide this variable by 100. Source: Polity IV.

ΔCER – The difference between acquirer countries j and target countries i in the "XRCOMP" component of the "Democ" score of the Polity2 index. The XRCOMP component captures the competitiveness of executive recruitment. In the regressions, we divide this variable by 100. Source: Polity IV.

ΔOER – The difference between acquirer countries j and target countries i in the "XROPEN" component of the "Democ" score of the polity2 index. The XROPEN component captures the openness of executive recruitment. In the regressions, we divide this variable by 100. Source: Polity IV.

ΔEC – The difference between acquirer countries j and target countries i in the "XCONST" component of the "Democ" score of the Polity2 index. The XCONST component captures the constraint of chief executive. In the regressions, we divide this variable by 100. Source: Polity IV.

ΔCP – The difference between acquirer countries j and target countries i in the "PARCOMP" component of the "Democ" score of the Polity2 index. The PARCOMP component captures the competitiveness of political participation. In the regressions, we divide this variable by 100.

Source: Polity IV.

ΔDemoc – The difference between acquirer countries j and target countries i in the "Democ" score of the Polity2 index. The Democ score of institutional democracy is an additive eleven-point scale (0-10) derived from codings of the competitiveness of political participation (PARCOMP), the openness and competitiveness of executive recruitment (XRCOMP and XROPEN), and constraints on the chief executive (XCONST). In the regressions, we divide this variable by 100. Source: Polity IV.

ΔAutoc – The difference between acquirer countries j and target countries i in the "Autoc" score of the Polity2 index. The Autoc score of institutional autocracy is an additive eleven-point scale (0-10) derived from codings of the competitiveness of political participation (PARCOMP), the regulation of participation (PARREG), the openness and competitiveness of executive recruitment (XROPEN and XRCOMP), and constraints on the chief executive (XCONST). In the regressions, we divide this variable by 100. Source: Polity IV.

ΔRegional waves – Regional waves of democratization and transitions to nondemocracy, excluding information in the focal country. The jackknifed average of democracy in a region. The construction of this IV follows the procedure of Acemoglu et al. (2019). The different regions of the world considered are Africa, East Asia and the Pacific, Eastern Europe and Central Asia, Western Europe and other developed countries, Latin America and the Caribbean, the Middle East and the North of Africa, and South Asia. In our IV regressions, we take the the difference between acquirer countries j and target countries i of this variable. Sources: Polity IV and Acemoglu et al. (2019).

ΔDemocracy (Freedom House) – The difference between acquirer countries j and target countries i in the Freedom House index, which captures the degree of democracy and includes additional elements as compared to Polity2, such as the guarantee of civil liberties, rule of law, freedom of the press, and other political rights. We use a dummy variable equal to one if the Freedom House status of a country in a given year is "Free" or "Partially Free", and zero otherwise. Source: Freedom House.

ΔDemocracy (BMR) – The difference between acquirer countries j and target countries i in the BMR index, which captures free and fair elections as well as minimum threshold value of suffrage. We use a dummy variable equal to one if the Freedom House status of a country in a given year is "Free" or "Partially Free", and zero otherwise. Source: Boix et al. (2013).

ΔDemocracy (V-Dem) – The difference between acquirer countries j and target countries i in the V-Dem electoral democracy index, which is formed by taking the average of, on the one hand, the weighted average of the indices measuring freedom of association thick, clean elections, freedom of expression, elected officials, and suffrage and, on the other, the five-way multiplicative interaction between those indices. Source: Coppedge et al. (2019).

ΔDemocracy (ANRR) – The difference between acquirer countries j and target countries i in the dichotomous indicator of institutional democracy as identified by Acemoglu et al. (2019). Source: Acemoglu et al. (2019).

ΔGDP per capita – The difference between acquirer countries j and target countries i in the logarithm of annual GDP (in $) divided by the population. Source: WDI.

ΔGDP growth – The difference between acquirer countries j and target countries i in the annual real growth rate of the GDP. Source: WDI.

ΔInvestment profile – The difference between acquirer countries j and target countries i in year t in the investment profile index, which captures the government's attitude toward investment. The investment profile is determined by summing the three following components: (1) risk of expropriation or contract viability; (2) payment delays; and (3) repatriation of profits. Each component is scored on a scale from 0 (very high risk) to 4 (very low risk). In the regressions, we divide this variable by 100. Source: ICRG.

ΔInstitutional quality – The difference between acquirer countries j and target countries i in year t in the institutional quality index, which captures the institutional quality of a country. The institutional quality index is determined by summing the three following components: (1) corruption; (2) law and order; and (3) bureaucratic quality. A high score indicates countries with higher institutional quality and vice versa. In the regressions, we divide this variable by 100. Source: ICRG.

Bilateral trade – The maximum of bilateral import and export between country pairs, where bilateral import (export) is calculated as the value of imports (exports) by the target country from (to) the acquirer country as a percentage of total imports (exports) by the target country. Source: IMF.

Geographical distance – Logarithm of the geographical distance between capitals of the acquirer j and target i countries. The geographical distance is calculated following the great circle formula, which uses latitudes and longitudes of the most important city (in terms of population) or of its official capital. Source: CEPII.

Cultural distance – Cultural differences between acquirer j and target i countries based on the four culture dimensions identified by Geert Hofstede (individualism, uncertainty avoidance, power distance, and future orientation) using the Euclidean distance formula. We divide the Euclidean distance by 100. Source: Geert Hofstede's website.

Common language – A dummy variable equal to one if targets' and acquirers' primary language are the same, and zero otherwise. Source: World Factbook.

Same colony – A dummy variable equal to one if targets' and acquirers' were colonized by the

same nation, and zero otherwise. Source: World Factbook.

ΔStock market capitalization – The difference between acquirer countries j and target countries i in year t in their ratio of the total market capitalization of listed companies to GDP. Source: WDI.

ΔPrivate credit – The difference between acquirer countries j and target countries i in year t in their ratio of the private credit provided to the private sector to GDP. Source: WDI.

ΔExchange rate volatility – The annual average of the monthly standard deviation of the exchange rates of both acquirer and target countries' currency for the previous 36 months. Source: Worldscope.

ΔExchange rate growth – The average difference between acquirer countries j and target countries i in year t in the annual real bilateral $ exchange rate returns. Source: Worldscope.

Shareholder protection – Anti-Director Rights (ADR) index, which captures how strongly the legal system favors minority shareholders against managers and/or dominant shareholders. We use a dummy variable equal to one if the ADR index for the target country i is in the sample top tercile, and zero otherwise. Source: Djankov et al. (2008).

Accounting standards – Disclosure Quality index created by the Center for International Financial Analysis and Research to rate the quality of 1990 annual reports on their disclosure of accounting information. We use a dummy variable equal to one if the Disclosure Quality index for the target country i is in the sample top tercile, and zero otherwise. Source: La Porta et al. (1998).

M&A laws – A dummy variable equal to one if the target country i has in place an M&A law in a given year t, and zero otherwise. This variable is available for the period 1985–2002. Source: Lel and Miller (2015).

A.2 Deal-Level Variables

Target CAR – The cumulative abnormal returns of target firms calculated over a 3-day (or 7-day, depending on the specification) window around the announcement date. Abnormal returns are calculated using the market model relative to a local equity market index. The value weighted index for US firms is obtained from CRSP, while for other countries, local indices (proxies of market portfolio) are retrieved from Worldscope. The parameters of the market model are 200-days estimation period spread over (-236,-36). Sources: CRSP and Worldscope.

Acquirer CAR – The cumulative abnormal returns of acquiring firms calculated over a 3-day (or 7-day, depending on the specification) window around the announcement date. Abnormal returns are calculated using the market model relative to a local equity market index. The value weighted

index for US firms is obtained from CRSP, while for other countries, local indices (proxies of market portfolio) are retrieved from Worldscope. The parameters of the market model are 200-days estimation period spread over (-236,-36). Sources: CRSP and Worldscope.

Firm size – Logarithm of the book value of total assets of the acquirer in $M. Source: Worldscope.

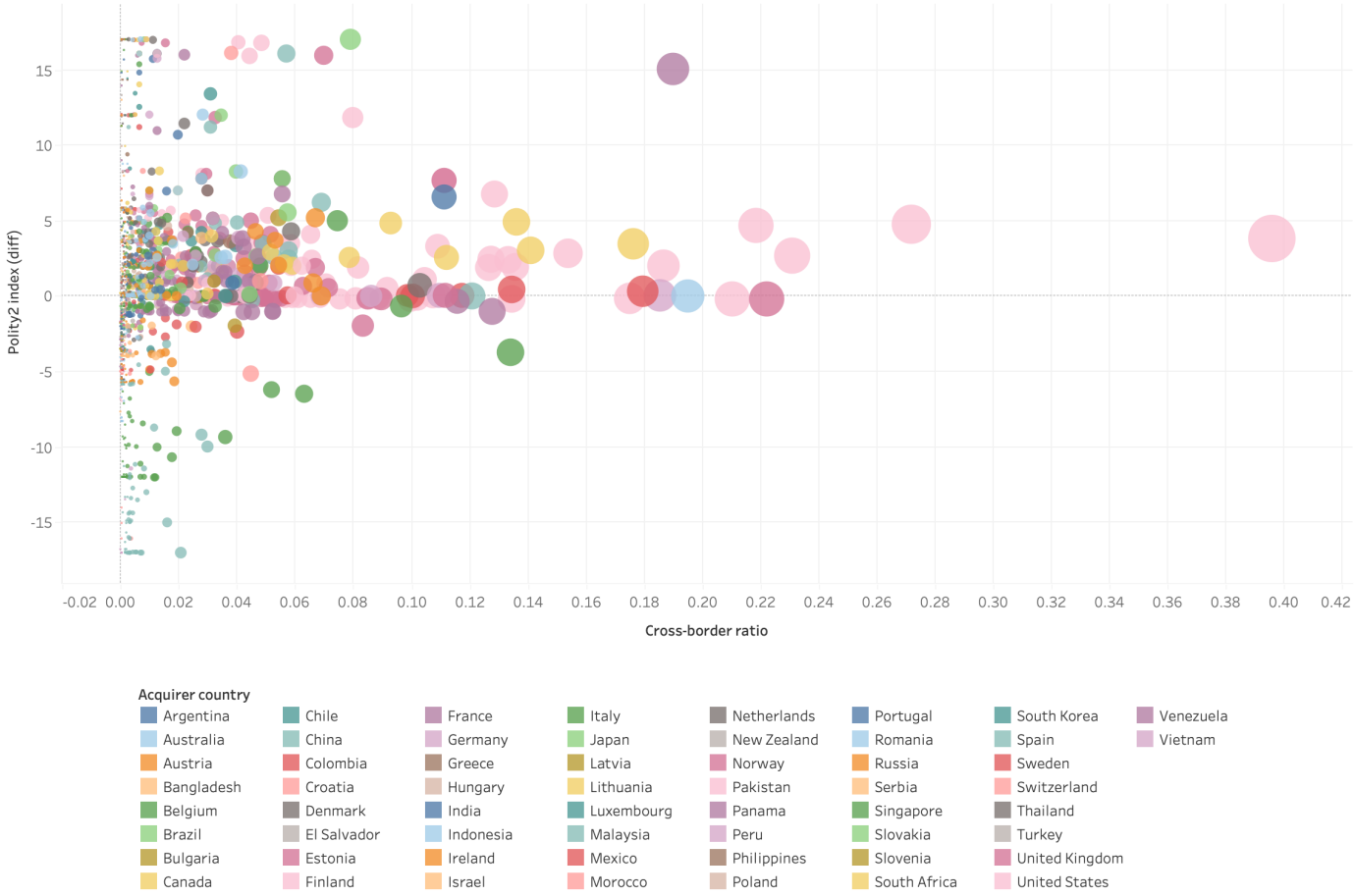
Financial acquirer – A dummy variable equal to one if the acquirer is a financial firm, and zero otherwise. Source: SDC.

Number of bidders – The number of bidders involved in the deal. Source: SDC.

Toehold – A dummy variable equal to one if acquirer owns nonzero percentage shares in the target firm before the announcement of the deal, and zero otherwise. Source: SDC.

Hostile – A dummy variable equal to one if deal attitude is classified as "hostile" by SDC, and zero otherwise. Source: SDC.

Figure 1: Differences in Democracy and Cross-Border Merger Flows: Visualization of Cross-Sectional Data



This figure shows the relation between the average differences in democracy (as captured by the Polity2 index) between acquirer and target countries, on the vertical axis, and their cross-border merger flows (as captured by Cross-border ratio), on the horizontal axis, for the whole sample comprising 58 countries. We refer to Appendix A for a full description of the variables and their corresponding sources.

Table 1: Cross-Border Merger Deals and Democracy around the World

This table describes on the left hand side all cross-border merger deals in our sample. The year represents the year in which the deal was announced. This table also describes on the right hand side the degree of democracy of our sample countries as captured by the Polity2 index.

	Cross-border mergers		Polity2 index			
Year	Numbers	Value [in $B]	Average	Minimum	Maximum	Standard deviation
1985	238	14.91	3.78	-8	10	7.20
1986	390	45.28	4.02	-8	10	7.06
1987	569	56.37	4.27	-8	10	6.99
1988	987	100.62	4.92	-8	10	6.56
1989	1,335	92.95	5.92	-8	10	5.69
1990	1,387	87.12	6.60	-8	10	5.23
1991	1,430	46.04	6.78	-8	10	5.03
1992	1,267	43.54	6.75	-7	10	5.00
1993	1,362	46.18	6.81	-7	10	4.86
1994	1,662	66.09	6.91	-7	10	4.80
1995	2,067	123.35	6.86	-7	10	4.89
1996	2,323	143.62	6.91	-7	10	4.89
1997	2,707	210.07	6.91	-7	10	4.87
1998	3,570	458.48	7.04	-7	10	4.73
1999	3,840	894.16	7.12	-7	10	4.57
2000	4,876	699.08	7.46	-7	10	4.40
2001	3,384	375.41	7.53	-7	10	4.40
2002	2,548	178.72	7.56	-7	10	4.35
2003	2,666	168.84	7.56	-7	10	4.35
2004	3,167	343.31	7.61	-7	10	4.35
2005	3,904	448.35	7.63	-7	10	4.36
2006	4,609	837.23	7.41	-7	10	4.65
2007	5,500	1,172.79	7.33	-7	10	4.59
2008	4,561	504.39	7.52	-7	10	4.40
2009	3,053	260.70	7.59	-7	10	4.25
2010	3,866	495.30	7.60	-7	10	4.24
2011	4,124	402.25	7.72	-7	10	4.11
2012	3,826	369.93	7.72	-7	10	4.11
2013	3,516	329.22	7.84	-7	10	3.90
2014	4,246	812.59	7.52	-7	10	4.26
2015	4,466	1,070.93	7.53	-7	10	4.27
2016	4,790	835.45	7.34	-7	10	4.47
2017	4,909	690.37	7.22	-7	10	4.65
2018	4,689	712.68	7.14	-7	10	4.89
Total	101,834	13,136.32	-	-	-	-

Table 2: Cross-Border Merger Deals and Democracy by Acquirer Countries, 1985-2018

This table reports on the left hand side descriptive statistics on all cross-border merger deals in our sample. The deals are listed by country of origin of the acquirer. This table also reports on the right hand side descriptive statistics on the degree of democracy for each of sample country, as captured by the Polity2 index and by years of transitions to and away from democracy.

	Cross-border mergers		Polity2 index		Democratization	
Country	Numbers	Value [in $B]	Minimum	Maximum	Transition years	Reversal years
Argentina	128	14.83	7	9	-	-
Australia	2,918	459.22	10	10	-	-
Austria	1,189	45.53	10	10	-	-
Bangladesh	2	0.08	-7	6	1991, 2009	2007
Belgium	1,773	278.20	8	10	-	-
Brazil	283	83.05	7	8	1985	-
Bulgaria	28	0.06	-7	9	1991	-
Canada	8,892	905.00	10	10		-
Chile	136	14.87	-6	10	1990	-
China	1,079	239.01	-7	-7	-	-
Colombia	127	21.09	7	9	-	-
Croatia	32	0.66	-5	9	2000	-
Denmark	1,640	80.49	10	10	-	-
El Salvador	4	0.56	6	8	-	-
Estonia	127	1.66	6	9	1992	-
Finland	1,517	102.76	10	10	-	-
France	5,945	970.67	8	9	-	-
Germany	6,127	1,071.21	10	10	-	-
Greece	183	11.26	8	10	-	-
Hungary	71	1.19	-7	10	1990	-
India	1,076	43.53	8	9	-	-
Indonesia	103	6.16	-7	9	1999	-
Ireland	1,885	194.44	10	10	-	-
Israel	608	149.49	6	6	-	-
Italy	1,625	168.29	10	10	-	-
Japan	2,272	457.88	10	10	-	-
Latvia	63	0.05	8	8	1993	-
Lithuania	76	0.61	10	10	1993	-
Luxembourg	1,033	142.98	10	10	-	-
Malaysia	593	24.50	3	7	-	-
Mexico	324	74.92	-3	8	1997	-
Morocco	6	0.00	-8	-4	-	-
Netherlands	4,287	800.63	10	10	-	-
New Zealand	500	33.26	10	10	-	-
Norway	1,461	87.18	10	10	-	-
Pakistan	9	0.10	-6	8	1988, 2008	1999
Panama	41	0.72	-8	9	1994	-
Peru	51	0.99	-3	9	1993	1992
Philippines	91	5.92	-6	8	1987	-
Poland	202	7.13	-7	10	1990	-
Portugal	226	11.10	10	10	-	-
Romania	28	0.60	-8	9	1990	-
Russia	281	45.50	3	6	1993	2004
Serbia	10	0.08	8	8	2000	-
Singapore	1,617	144.31	-2	-2	-	-
Slovakia	25	1.08	7	10	1993	-
Slovenia	42	0.59	10	10	1992	-
South Africa	417	50.68	4	9	1994	-
South Korea	463	57.78	-5	8	1988	–
Spain	1,640	340.58	10	10	-	-
Sweden	3,958	206.23	10	10	-	-
Switzerland	3,334	573.49	10	10	-	-
Thailand	139	13.29	-5	9	1992, 2008	1991, 2006
Turkey	122	7.34	-4	9		2016
United Kingdom	13,609	2,139.05	8	10	-	-
United States	27,368	3,043.31	8	10	-	-
Venezuela	27	0.75	-3	9	2013	2009, 2017
Vietnam	21	0.40	-7	-7	-	-
Total	101,834	13,136.34	-	-	-	-

Table 3: Descriptive Statistics

This table reports descriptive statistics for the variables used in country-pair level analysis (Panel A), and the deal-level analysis (Panels B and C). The variables preceded by Δ are computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources.

Panel A: Country-Pair Level Data

	Mean	Standard deviation	p25	p50	p75	Observations
Cross-border ratio	0.044	0.090	0.005	0.014	0.045	16,497
ΔDemocracy (Polity2)	0.003	0.047	0.000	0.000	0.010	16,497
ΔDemocracy (Freedom House)	0.049	0.445	0.000	0.000	0.000	11,398
ΔDemocracy (BMR)	0.011	0.367	0.000	0.000	0.000	16,393
ΔDemocracy (V-Dem)	0.024	0.250	-0.033	0.008	0.064	16,497
ΔDemocracy (ANRR)	0.006	0.362	0.000	0.000	0.000	16,497
ΔGDP per capita	0.309	1.310	-0.249	0.149	1.154	16,497
ΔGDP growth	-0.001	0.037	-0.020	-0.002	0.017	16,497
ΔInvestment profile	0.004	0.023	-0.008	0.001	0.016	16,497
ΔInstitutional quality	0.009	0.040	-0.014	0.006	0.037	16,497
Bilateral trade	0.057	0.086	0.010	0.026	0.067	16,497
Geographical distance	8.026	1.193	7.044	8.284	9.072	16,497
Cultural distance	1.244	0.713	0.625	1.131	1.775	16,497
Common language	0.117	0.321	0.000	0.000	0.000	16,497
Same colony	0.079	0.269	0.000	0.000	0.000	16,497
ΔStock market capitalization	0.124	0.768	-0.324	0.129	0.580	12,059
ΔPrivate credit	0.136	0.655	-0.321	0.143	0.612	11,769
ΔExchange rate volatility	0.039	0.154	0.000	0.001	0.003	15,428
ΔExchange rate growth	0.000	0.001	0.000	0.000	0.001	15,408
Shareholder protection	0.277	0.447	0.000	0.000	1.000	13,743
Accounting standards	0.295	0.456	0.000	0.000	1.000	12,550
M&A laws	0.495	0.500	0.000	0.000	1.000	6,107

Panel B: Target-Deal Level Data

	Mean	Standard deviation	p25	p50	p75	Observations
Target CAR (-1, +1)	0.202	0.205	0.020	0.156	0.327	2,068
Target CAR (-3, +3)	0.222	0.219	0.035	0.186	0.350	2,060
Firm Size	7.762	2.473	6.091	7.890	9.448	2,068
Financial acquirer	0.040	0.196	0.000	0.000	0.000	2,068
Number of bidders	1.144	0.402	1.000	1.000	1.000	2,068
Toehold	3.132	9.482	0.000	0.000	0.000	2,068
Hostile	0.048	0.214	0.000	0.000	0.000	2,068

Panel C: Acquirer-Deal Level Data

	Mean	Standard deviation	p25	p50	p75	Observations
Acquirer CAR (-1, +1)	0.008	0.045	-0.018	0.002	0.028	18,054
Acquirer CAR (-3, +3)	0.008	0.063	-0.028	0.002	0.040	16,812
Firm Size	6.877	2.468	5.254	6.847	8.449	18,054
Financial acquirer	0.044	0.206	0.000	0.000	0.000	18,054
Number of bidders	1.020	0.171	1.000	1.000	1.000	18,054
Toehold	0.634	4.543	0.000	0.000	0.000	18,054
Hostile	0.006	0.075	0.000	0.000	0.000	18,054

Table 4: Democratic Proximity and Cross-Border Merger Flows

This table reports estimates of the effect of the absolute difference in democracy between acquirer and target countries on cross-border merger ratio. We estimate the gravity model in equation (1) using Cross-border ratio as dependent variable. The variables preceded by Δ are computed as (the absolute) differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. p-values, reported in brackets, are based on heteroskedasticity-robust standard errors. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)
	Cross-border ratio	Cross-border ratio
|ΔDemocracy|	-0.012	-0.034
	(0.798)	(0.127)
	[0.635]	[0.026]
|ΔGDP per capita|	0.013***	0.002
	(0.000)	(0.151)
|ΔGDP growth|	0.032	-0.006
	(0.476)	(0.810)
|ΔInvestment profile|	-0.066	0.071*
	(0.444)	(0.073)
|ΔInstitutional quality|	0.226***	0.001
	(0.006)	(0.970)
Bilateral trade	0.389***	0.235***
	(0.000)	(0.000)
Geographical distance	-0.003**	-0.004***
	(0.029)	(0.001)
Cultural distance	-0.005**	-0.016***
	(0.013)	(0.000)
Common language	0.009	0.005
	(0.177)	(0.108)
Same colony	0.005	0.004
	(0.425)	(0.297)
Year FE	Yes	No
Acquirer country × year FE	No	Yes
Target country × year FE	No	Yes
Observations	16,497	16,497
Adjusted R^2	0.25	0.76

Table 5: Differences in Democracy and Cross-Border Merger Flows: Baseline Panel Estimates

This table reports estimates of the effect of differences in democracy between acquirer and target countries on cross-border merger ratio. We estimate the gravity model in equation (1) using Cross-border ratio as dependent variable. The variables preceded by Δ are computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)	(3)
	Cross-border ratio	Cross-border ratio	Cross-border ratio
Δ Democracy	0.131***	0.424***	0.474***
	(0.000)	(0.000)	(0.000)
Δ GDP per capita	0.010***	0.048***	0.052***
	(0.000)	(0.000)	(0.000)
Δ GDP growth	0.150***	0.124***	0.123***
	(0.000)	(0.000)	(0.000)
Δ Investment profile	0.014	-0.148***	-0.143***
	(0.816)	(0.003)	(0.006)
Δ Institutional quality	0.172***	0.356***	0.303**
	(0.003)	(0.002)	(0.012)
Bilateral trade	0.373***	0.234***	0.102
	(0.000)	(0.000)	(0.137)
Geographical distance	-0.001	-0.005***	
	(0.629)	(0.001)	
Cultural distance	-0.008***	-0.018***	
	(0.000)	(0.000)	
Common language	0.003	-0.003	
	(0.661)	(0.452)	
Same colony	0.006	0.008**	
	(0.369)	(0.039)	
Year FE	Yes	Yes	Yes
Acquirer country FE	No	Yes	No
Target country FE	No	Yes	No
Country pair FE	No	No	Yes
Observations	16,497	16,497	16,497
Adjusted R^2	0.27	0.58	0.58

Table 6: Differences in Democracy and Cross-Border Merger Flows: Sensitivity Tests

This table reports estimates of the effect of differences in democracy between acquirer and target countries on cross-border merger ratio. We estimate the gravity model in equation (1) using Cross-border ratio as dependent variable (unless specified otherwise). In Panel A, we impose sample restrictions either at the country level or at the sector level. In Panel B, we impose different sample selection criteria to compute the dependent variable Cross-border ratio. In Panel C, we use of alternative dependent variables and an alternative estimation technique. In columns 2 and 3 of Panel C, we control for the size of the M&A market in the target country by including the natural logarithm of the value of local and cross-border M&A deals in the target country. In Panel D, we include additional time-varying controls. In all specifications, we include the same set of controls as in column 3 of Table 5. The variables preceded by Δ are computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

Panel A: Subsamples

	(1)	(2)	(3)	(4)	(5)	(6)
	Cross-border ratio	Cross-border ratio	Cross-border ratio	Cross-border ratio	Cross-border ratio	Cross-border ratio
ΔDemocracy	0.448***	0.402***	0.507***	0.542***	0.458***	0.320***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Time-varying controls	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Country pair FE	Yes	Yes	Yes	Yes	Yes	Yes
Countries dropped	United States	United Kingdom	Canada	China, Singapore	Small countries	Western Europe
Observations	15,489	14,534	15,186	15,123	16,273	4,385
Adjusted R^2	0.59	0.60	0.58	0.59	0.56	0.60

Panel B: Alternative Definitions of Cross-Border Ratio

	(1) Cross-border ratio	(2) Cross-border ratio	(3) Cross-border ratio	(4) Cross-border ratio
ΔDemocracy	0.519***	0.597***	1.009***	0.583***
	(0.000)	(0.000)	(0.001)	(0.000)
Time-varying controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Country pair FE	Yes	Yes	Yes	Yes
Deals included	Completed deals	Deals with value reported	Larger than $50M	Financial firms excluded
Observations	16,230	9,872	5,725	14,518
Adjusted R^2	0.57	0.60	0.65	0.60

Panel C: Alternative Dependent Variables and Estimation Techniques

	(1) $value cross-border ratio	(2) ln(1+$value deals)	(3) 1(Cross-border deal)	(4) Cross-border ratio
ΔDemocracy	0.408***	2.956*	0.199***	0.132***
	(0.006)	(0.065)	(0.001)	(0.000)
Time-varying controls	Yes	Yes	Yes	Yes
Time-invariant controls	No	No	No	Yes
Year FE	Yes	Yes	Yes	Yes
Country pair FE	Yes	Yes	Yes	No
Estimator	Within	Within	Within	Tobit
Observations	16,367	16,367	37,141	16,497
Adjusted R^2	0.21	0.42	0.93	
Log pseudo likelihood				18,764.75

Panel D: Additional Controls

	(1) Cross-border ratio	(2) Cross-border ratio	(3) Cross-border ratio	(4) Cross-border ratio	(5) Cross-border ratio
ΔDemocracy	0.232***	0.253*	0.356***	0.404***	0.141*
	(0.001)	(0.099)	(0.001)	(0.001)	(0.077)
ΔStock market capitalization	-0.003				0.001
	(0.117)				(0.691)
ΔPrivate credit		-0.014***			-0.010**
		(0.001)			(0.019)
ΔExchange rate volatility			-0.012		0.024
			(0.361)		(0.509)
ΔExchange rate growth				1.098***	-0.349
				(0.002)	(0.527)
Time-varying controls	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Country pair FE	Yes	Yes	Yes	Yes	Yes
Observations	12,059	11,769	15,428	15,408	8,034
Adjusted R^2	0.62	0.63	0.60	0.60	0.68

Table 7: Differences in Democracy and Cross-Border Merger Flows: IV Estimates

This table reports IV estimates of the effect of differences in democracy between acquirer and target countries on cross-border merger ratio. In Panel A, we present 2SLS estimates instrumenting ΔDemocracy with ΔRegional waves. In Panel B, we present the corresponding first-stage estimates and the effective first-stage F-statistic as recommended by Olea and Pflueger (2013). In all specifications, we include the same set of controls as in Table 5. The variables preceded by Δ are computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

Panel A: 2SLS Estimates

	(1) Cross-border ratio	(2) Cross-border ratio	(3) Cross-border ratio
ΔDemocracy	0.224***	4.585***	5.382***
	(0.001)	(0.000)	(0.000)
Time-varying controls	Yes	Yes	Yes
Time-invariant controls	Yes	Yes	No
Year FE	Yes	Yes	Yes
Acquirer country FE	No	Yes	No
Target country FE	No	Yes	No
Country pair FE	No	No	Yes
Observations	16,497	16,497	16,497

Panel B: First-Stage Estimates

	(1) ΔDemocracy	(2) ΔDemocracy	(3) ΔDemocracy
ΔRegional waves	0.107***	0.029***	0.030***
	(0.000)	(0.000)	(0.000)
Time-varying controls	Yes	Yes	Yes
Time-invariant controls	Yes	Yes	No
Year FE	Yes	Yes	Yes
Acquirer country FE	No	Yes	No
Target country FE	No	Yes	No
Country pair FE	No	No	Yes
Observations	16,497	16,497	16,497
Adjusted R^2	0.49	0.91	0.92
Partial R^2	0.28	0.01	0.02
Effective first-stage F-statistic	301.31	20.79	16.28

Table 8: Differences in Democracy and Cross-Border Merger Flows: Democratic Transitions and Autocratic Reversals

This table reports estimates of the effect of differences in democracy between acquirer and target countries on cross-border merger ratio. We estimate a version of equation (1) using Cross-border ratio as dependent variable and the dichotomous measure, ΔDemocracy (ANRR), as independent variable of interest. In all specifications, we include the same set of controls as in Table 5. The sign Δ implies that the variable is computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)	(3)
	Cross-border ratio	Cross-border ratio	Cross-border ratio
ΔDemocracy (ANRR)	0.007*	0.025***	0.029***
	(0.053)	(0.000)	(0.000)
Time-varying controls	Yes	Yes	Yes
Time-invariant controls	Yes	Yes	No
Year FE	Yes	Yes	Yes
Acquirer country FE	No	Yes	No
Target country FE	No	Yes	No
Country pair FE	No	No	Yes
Observations	16,497	16,497	16,497
Adjusted R^2	0.27	0.57	0.58

Table 9: Differences in Democracy and Cross-Border Merger Flows: Between Estimates

This table reports between estimates of the effect of the differences in democracy between acquirer and target countries on cross-border merger ratio. We estimate the gravity model in equation (1) using Cross-border ratio as dependent variable. The variables preceded by Δ are computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values are reported in parentheses. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)	(3)
	Cross-border ratio	Cross-border ratio	Cross-border ratio
ΔDemocracy	0.321***	0.124**	0.137***
	(0.000)	(0.015)	(0.007)
ΔGDP per capita		0.018***	0.017***
		(0.000)	(0.000)
ΔGDP growth		0.242***	0.255***
		(0.006)	(0.004)
ΔInvestment profile		0.305*	0.298*
		(0.052)	(0.059)
ΔInstitutional quality		-0.075	-0.068
		(0.469)	(0.515)
Bilateral trade		0.436***	0.463***
		(0.000)	(0.000)
Geographical distance		-0.002	
		(0.312)	
Cultural distance		-0.009**	
		(0.010)	
Common language		0.037***	
		(0.000)	
Same colony		-0.003	
		(0.813)	
Year FE	Yes	Yes	Yes
Observations	16,497	16,497	16,497
Adjusted R^2	0.08	0.21	0.20

Table 10: Differences in Democracy and Cross-Border Merger Flows: 100-Percent Mergers

This table reports estimates of the effect of differences in democracy between acquirer and target countries on cross-border merger ratio. We estimate the gravity model in equation (1) using Cross-border ratio (with a different definition for each column) as dependent variable. In column 1, we define Cross-border ratio using as numerator the number of deals in which the acquirer stake after the deal is 100 percent (i.e., complete control deals). In column 2, we define Cross-border ratio using as the numerator the number of deals in which the acquirer stake after the deal is between 50 percent and 99.9 percent (i.e., majority deals). In column 3, we define Cross-border ratio using as numerator the number of deals in which the acquirer stake after the deal is less than 50 percent and as denominator the total number (domestic and cross-border) of minority and non-minority deals in the target country (i.e., minority deals). In all specifications, we include the same set of controls as in column 3 of Table 5. The sign Δ implies that the variable is computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)	(3)
	Cross-border ratio	Cross-border ratio	Cross-border ratio
ΔDemocracy	0.463***	-0.005	-0.000
	(0.000)	(0.588)	(0.984)
Time-varying controls	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Country pair FE	Yes	Yes	Yes
Types of deals	Complete control	Majority	Minority
Observations	16,497	16,497	16,497
Adjusted R^2	0.53	0.12	0.29

Table 11: Push and Pull Factors in Cross-Border Mergers

This table reports estimates of the effect of the degree of democracy in the acquirer and target countries on cross-border merger ratio. We estimate a version of equation (1) using Cross-border ratio as dependent variable. The independent variables of interest are the level of democracy in the acquirer and target countries, respectively. The level of democracy in the acquirer (target) country captures the push (pull) factor. In all specifications, we include the same set of controls as in Table 5. We refer to Appendix A for a full description of the variables and their corresponding sources. *p*-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)	(3)	(4)
	Cross-border ratio	Cross-border ratio	Cross-border ratio	Cross-border ratio
Acquirer democracy	0.018	0.168***		0.015
	(0.615)	(0.008)		(0.530)
Target democracy	-0.227***	-0.653***	-0.506***	
	(0.000)	(0.000)	(0.000)	
Time-varying controls	Yes	Yes	Yes	Yes
Time-invariant controls	Yes	No	Yes	Yes
Year FE	Yes	Yes	No	No
Acquirer country FE	No	No	No	Yes
Target country FE	No	No	Yes	No
Acquirer country × year FE	No	No	Yes	No
Target country × year FE	No	No	No	Yes
Country pair FE	No	Yes	No	No
Observations	16,497	16,497	16,497	16,497
Adjusted R^2	0.28	0.58	0.61	0.76

Table 12: Pull Factors in Cross-Border Mergers: Cross-Sectional Heterogeneity (Investor Protection)

This table reports estimates of the interacted effect of the degree of democracy and investor protection in the target country on cross-border merger ratio. We estimate a version of equation (1) using Cross-border ratio as dependent variable. The independent variables of interest are the level of democracy in the target country and its interaction with investor protection. The level of democracy in the target country captures the pull factor. In column 1, we interact the variable Target democracy with the time-invariant dummy variable Target shareholder protection, which means that the coefficient for the variable alone is subsumed by the target-country fixed effects. In column 2, we interact the variable Target democracy with the time-invariant dummy variable accounting standards, which means that the coefficient for the variable alone is subsumed by the target-country fixed effects. In column 3, we interact the variable Target democracy with the time-varying dummy variable Target M&A laws. In all specifications, we include acquirer country × year fixed effects, which subsumes the variable Acquirer democracy, and we also include the same set of controls as in Table 5. We refer to Appendix A for a full description of the variables and their corresponding sources. *p*-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)	(3)
	Cross-border ratio	Cross-border ratio	Cross-border ratio
Target democracy	-0.461***	-0.310**	-0.958***
	(0.001)	(0.023)	(0.001)
Target democracy × Shareholder protection	0.555**		
	(0.021)		
Target democracy × Accounting standards		0.239***	
		(0.002)	
Target democracy × M&A laws			1.269***
			(0.000)
M&A laws			-0.121***
			(0.000)
Time-varying controls	Yes	Yes	Yes
Time-invariant controls	Yes	Yes	Yes
Target country FE	Yes	Yes	Yes
Acquirer country × year FE	Yes	Yes	Yes
Observations	13,743	12,550	6,107
Adjusted R^2	0.57	0.56	0.61

Table 13: Stock Price Reactions to Merger Announcements

This table reports estimates of the effect of differences in democracy between acquirer and target countries on CARs for targets and acquirers over the periods $t = (1, +1)$ and $t = (3, +3)$ around the announcement day. We estimate the model in equation (2) using Target CAR as dependent variable in columns 1 and 2 and Acquirer CAR in columns 3 and 4. The variables preceded by Δ are computed as differences between the acquirer country j and the target country i. Industry fixed effects are based on SIC-2 industry codes. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	Target returns		Acquirer returns	
	(1)	(2)	(3)	(4)
	Target CAR (-1, +1)	Target CAR (-3, +3)	Acquirer CAR (-1, +1)	Acquirer CAR (-3, +3)
ΔDemocracy	7.524***	6.210**	-0.020	0.002
	(0.000)	(0.012)	(0.779)	(0.983)
ΔGDP per capita	-0.065	-0.038	-0.007	0.008
	(0.574)	(0.732)	(0.189)	(0.302)
ΔGDP growth	-0.175	-0.175	-0.001	-0.007
	(0.523)	(0.525)	(0.961)	(0.770)
ΔInvestment profile	-0.060	-0.069	-0.059**	-0.074*
	(0.902)	(0.884)	(0.031)	(0.070)
ΔInstitutions quality	-0.563	-1.047*	-0.012	-0.021
	(0.325)	(0.089)	(0.804)	(0.773)
Bilateral trade	-0.093	-0.167	-0.016	-0.011
	(0.637)	(0.388)	(0.291)	(0.632)
Firm size	0.010***	0.011***	-0.002***	-0.002***
	(0.000)	(0.000)	(0.000)	(0.000)
Financial acquirer	0.062*	0.047	0.001	0.002
	(0.064)	(0.206)	(0.663)	(0.417)
Number of bidders	-0.024**	-0.023**	-0.001	-0.003
	(0.022)	(0.032)	(0.766)	(0.211)
Toehold	-0.000	0.000	-0.000	-0.000
	(0.492)	(0.968)	(0.709)	(0.144)
Hostile	0.060***	0.070***	-0.009***	-0.014**
	(0.000)	(0.000)	(0.002)	(0.012)
Year FE	Yes	Yes	Yes	Yes
Country Pair FE	Yes	Yes	Yes	Yes
Acquirer Industry FE	Yes	Yes	Yes	Yes
Target Industry FE	Yes	Yes	Yes	Yes
Observations	2,068	2,060	18,054	16,812
Adjusted R^2	0.07	0.05	0.03	0.02

Table 14: Cross-Border Merger Flows, Investor Protection, and the Fundamental Role of Democracy

This table reports estimates of the effect of differences in investor protection between acquirer and target countries on cross-border merger ratio by isolating the effect due to the fundamental role of democratic institutions. In Panel A, we rely on a two-step approach. In the first step, we estimate the following model: $\Delta\text{Investor protection}_{i,j,[t]} = \alpha_0 + \alpha_i + \alpha_j + [\alpha_t] + \beta\Delta\text{Democracy}_{j-i,[t]} + \varepsilon_{i,j,[t]}$, where $\Delta\text{Investor protection}_{i,j,[t]}$ is one of the measures of investor protection, namely ΔShareholder protection, ΔAccounting standards, ΔM&A laws. α_0 is a constant term. The other parameters and variables are the same as in equation (1). The model is cross-sectional (i.e., no time dimension t) when estimating the effect on ΔShareholder protection and ΔAccounting standards. For the former variable we use the year 2008 and the latter variable the year 1990, that is, the year for which these indices are constructed. The model is, however, in panel when estimating the effect on ΔM&A laws and thus includes year fixed effects. In the second step, we estimate the gravity model in equation (1) using Cross-border ratio as dependent variable and the predicted and residual values calculated in the first step. Therefore, the predicted value of the investor protection variable captures the fundamental effect of democracy, while the residual value captures the effect of investor protection that is not explained by democracy. In all specifications, we include the same set of controls as in Table 5. In Panel B, we report descriptive statistics for the predicted and residual values of the investor protection variables. The variables preceded by Δ are computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

Panel A: Panel A: Estimates from the Two-Step Procedure

	(1)	(2)	(3)
	Cross-border ratio	Cross-border ratio	Cross-border ratio
ΔShareholder protection (predicted)	0.479***		
	(0.000)		
ΔShareholder protection (residual)	-0.225		
	(0.417)		
ΔAccounting standards (predicted)		0.102***	
		(0.000)	
ΔAccounting standards (residual)		0.118***	
		(0.000)	
ΔM&A laws (predicted)			0.726***
			(0.002)
ΔM&A laws (residual)			0.016***
			(0.003)
Time-varying variables	Yes	Yes	Yes
Time-invariant variables	Yes	Yes	No
Year FE	Yes	Yes	Yes
Country pair FE	No	No	Yes
Observations	12,649	10,716	6,103
Adjusted R^2	0.39	0.41	0.57

Panel B: Descriptive statistics

	Mean	SD	Median
ΔShareholder protection (predicted)	0.000	0.014	0.000
ΔShareholder protection (residual)	-0.000	0.006	0.000
ΔAccounting standards (predicted)	0.073	0.156	0.060
ΔAccounting standards (residual)	-0.051	0.113	-0.000
ΔM&A laws (predicted)	0.072	0.051	0.068
ΔM&A laws (residual)	0.000	0.291	-0.005

Internet Appendix to

"Does Democracy Shape International Merger Activity?"

This internet appendix presents additional statistics and results to accompany the paper "Does Democracy Shape International Merger Activity?". The content is as follows:

- Table IA1 reports estimates of the main specification in Table 5 including further controls for national cultural values retrieved from the World Values Survey.
- Table IA2 reports the correlation matrix for the main variables used in the country-pair analysis.
- Table IA3 reports estimates of specifications similar than in Table 4 using alternative dependent variables.
- Table IA4 reports in columns 1-3 estimates of the main specification in Table 5 using alternative clustering of standard errors. The estimates reported in column 4 use dyadic clustering robust standard errors. Therefore, we rely on a slightly different model including year fixed effects and acquirer and target countries fixed effects. This is because our data set is dyadic (the level of observation of the data is the country-pair). In column 4, we calculate standard errors accounting for the correlations between repeated observations of dyads as well as country of origin and country of destination fixed effects, as recommended by recent literature in international economics and political science (Carlson et al., 2021).
- Table IA5 reports estimates of the main specification in Table 5 for two different sample periods: 1985-2006 and 2007-2018.
- Table IA6 reports estimates of the main specification in Table 5 including gravity controls in absolute value as in Table 4.
- Table IA7 reports estimates of the main specification in Table 5 using the Freedom House, BMR, and V-Dem indices as alternative measures of democracy.
- Table IA8 reports estimates of the main specification in Table 5 using each component of the Polity2 index as independent variable of interest.
- Table IA9 reports estimates of the main specification in Table 5 without considering acquirer (target) firms from developed (developing) countries.
- Table IA10 reports IV estimates of specifications similar than in Table 7 including further controls capturing regional trends.
- Table IA11 reports OLS estimates of the effect of several cross-country determinants (including democracy) on investor protection.

- Table IA12 reports estimates of the main specification similar in Table 5 using alternative dependent variables based on the method of payment.
- Table IA13 reports IV estimates for all specifications in Table 11.
- Table IA14 reports estimates of the same specifications than in Table 13 restricting the sample to 100-percent deals only.
- Table IA15 reports estimates of the specification in Table 12 focusing instead on employment protection laws and environmental laws.
- Table IA16 reports estimates of the main specification in Tables 5 and 11 focusing on sample deals for which the target firm is not in a natural-resource exporting country.

Table IA1: Differences in Democracy and Cross-Border Merger Flows: Trust, Hierarchy, and Individualism (World Values Survey)

This table reports estimates of the effect of differences in democracy between acquirer and target countries on cross-border merger ratio. We estimate the gravity model in equation (1) using Cross-border ratio as dependent variable and further controlling for national cultural values. The variable Trust is defined as the average answer to the following question: "Generally speaking, would you say that (1) most people can be trusted (2) need to be very careful" (source: World Values Survey, Question V25). The variable Hierarchy is defined as the average answer to the following question: "People have different ideas about following instructions at work. Some say that one should follow one's superior's instructions even when one does not fully agree with them. Others say that one should follow one's superior's instructions only when one is convinced that they are right. With which of these two opinions do you agree? (1) Should follow instructions; (2) must be convinced first; (3) depends" (source: World Values Survey, Question V105). The variable Individualism is defined as the average answer to the following question: "Incomes should be more equal or We need larger income differences as incentives for individual effort" (source: World Values Survey, Question V141). The variables preceded by Δ are computed as differences between the acquirer country j and the target country i. In all specifications, we include the same set of controls as in column 3 of Table 5. We refer to Appendix A for a full description of the other variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)	(3)	(4)
	Cross-border ratio	Cross-border ratio	Cross-border ratio	Cross-border ratio
ΔDemocracy	0.399***	0.555***	0.465***	0.537***
	(0.000)	(0.001)	(0.000)	(0.001)
ΔTrust	-0.028***			-0.065***
	(0.008)			(0.003)
ΔHierarchy		-0.008		-0.015
		(0.728)		(0.514)
ΔIndividualism			-0.048***	-0.059***
			(0.000)	(0.000)
Time-varying controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Country Pair FE	Yes	Yes	Yes	Yes
Observations	11,951	6,403	12,150	6,402
Adjusted R^2	0.58	0.57	0.57	0.57

Table IA2: Correlation Matrix

This table reports correlations between the main variables used in the country-pair level analysis.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
(1) Cross-border ratio	1.000										
(2) ΔDemocracy	0.156	1.000									
(3) ΔGDP per capita	0.243	0.455	1.000								
(4) ΔGDP growth	-0.053	-0.404	-0.376	1.000							
(5) ΔInvestment profile	0.181	0.337	0.590	-0.163	1.000						
(6) ΔInstitutional quality	0.224	0.405	0.785	-0.248	0.668	1.000					
(7) Bilateral trade	0.403	0.028	0.088	-0.046	0.081	0.059	1.000				
(8) Geographical distance	-0.068	0.012	0.040	-0.003	0.045	0.047	-0.250	1.000			
(9) Cultural distance	-0.094	-0.010	-0.012	-0.024	-0.035	-0.035	-0.060	-0.287	1.000		
(10) Common language	0.072	-0.023	-0.060	0.018	-0.029	-0.061	0.117	0.102	-0.245	1.000	
(11) Same colony	0.055	0.014	-0.016	-0.002	-0.004	-0.023	0.032	0.061	-0.174	0.314	1.000

Table IA3: Democratic Proximity and Cross-Border Merger Flows: Alternative Dependent Variables

This table reports estimates of the effect of the absolute difference in democracy between acquirer and target countries on cross-border merger ratio. We estimate the gravity model in equation (1) using alternative dependent variables (as specified in each column label) to Cross-border ratio. In all specifications, we include the same set of controls as in Table 4. In columns 3 to 6, we additionally control for the size of the M&A market in the target country by including the natural logarithm of the value of local and cross-border M&A deals in the target country. The variables preceded by Δ are computed as (the absolute) differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. p-values, reported in brackets, are based on heteroskedasticity-robust standard errors. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)	(3)	(4)	(5)	(6)
	$value cross-border ratio	$value cross-border ratio	ln(1+$value deals)	ln(1+$value deals)	1(Cross-border deal)	1(Cross-border deal)
|ΔDemocracy|	-0.042	-0.198***	-0.680	-4.897*	-0.109**	-0.063
	(0.368)	(0.001)	(0.515)	(0.095)	(0.027)	(0.454)
	[0.222]	[0.001]	[0.217]	[0.000]	[0.000]	[0.122]
Time-varying controls (absolute value)	Yes	Yes	Yes	Yes	Yes	Yes
Time-invariant controls	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	No	Yes	No	Yes	No
Acquirer country × year FE	No	Yes	No	Yes	No	Yes
Target country × year FE	No	Yes	No	Yes	No	Yes
Observations	16,367	16,367	16,367	16,367	37,141	37,141
Adjusted R^2	0.06	0.17	0.24	0.35	0.89	0.94

Table IA4: Differences in Democracy and Cross-Border Merger Flows: Alternative Treatments of Standard Errors

This table reports the estimates of the effect of the differences in democracy between acquirer and target countries on cross-border merger ratio. We estimate the gravity model in equation (1) using Cross-border ratio as dependent variable. Specifications in columns 1 to 3 are the same than the one of column 3 in Table 5. The specification in column 4 relies on a slightly different model including year fixed effects and acquirer and target countries fixed effects. This is because our data set is dyadic (the level of observation of the data is the country-pair). We calculate dyadic clustering robust standard errors, which account for the correlations between repeated observations of dyads as well as country of origin and country of destination fixed effects, as recommended by recent literature in international economics and political science (Carlson et al., 2021). The sign Δ implies that the variable is computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. t-statistics, reported in brackets, are based on standard errors that are subject to alternative treatments as indicated at the bottom of the table. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)	(3)	(4)
	Cross-border ratio	Cross-border ratio	Cross-border ratio	Cross-border ratio
ΔDemocracy	0.474***	0.474***	0.474**	0.424***
	[5.269]	[2.997]	[2.646]	[2.99]
Time-varying controls	Yes	Yes	Yes	Yes
Time-invariant controls	No	No	No	Yes
Year FE	Yes	Yes	Yes	Yes
Country pair FE	Yes	Yes	Yes	No
Acquirer country FE	No	No	No	Yes
Target country FE	No	No	No	Yes
Cluster of s.e.	No cluster, robust	Acquirer country, target country	Acquirer country, target country, and year	Dyadic clustering robust
Observations	16,497	16,497	16,497	16,497
Adjusted R^2	0.58	0.58	0.58	0.58

Table IA5: Differences in Democracy and Cross-Border Merger Flows: Subperiods

This table reports estimates of the effect of differences in democracy between acquirer and target countries on cross-border merger ratio for different subperiods. We estimate the gravity model in equation (1) using Cross-border ratio as dependent variable. In column 1, the period is from 1985 to 2005. In column 2, the period is from 2007 to 2018. In all specifications, we include the same set of controls as in column 3 of Table 5. The sign Δ implies that the variable is computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)
	Cross-border ratio	Cross-border ratio
Δ Democracy	0.643***	0.065*
	(0.003)	(0.053)
Time-varying controls	Yes	Yes
Year FE	Yes	Yes
Country pair FE	Yes	Yes
Subperiods	1985-2006	2007-2018
Observations	8,707	7,790
Adjusted R^2	0.58	0.76

Table IA6: Differences in Democracy and Cross-Border Merger Flows: Controls in Absolute Value

This table reports estimates of the effect of differences in democracy between acquirer and target countries on cross-border merger ratio. We estimate the gravity model in equation (1) using Cross-border ratio as dependent variable. All columns report the same specifications as in Table 5 with the further inclusion of the time-varying controls taken in absolute value. The variables preceded by Δ are computed as (the absolute) differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)	(3)
	Cross-border ratio	Cross-border ratio	Cross-border ratio
ΔDemocracy	0.127***	0.423***	0.460***
	(0.000)	(0.000)	(0.000)
ΔGDP per capita	0.009***	0.048***	0.047***
	(0.000)	(0.000)	(0.000)
ΔGDP growth	0.138***	0.121***	0.116***
	(0.000)	(0.000)	(0.000)
ΔInvestment profile	0.040	-0.139***	-0.136***
	(0.450)	(0.002)	(0.002)
ΔInstitutional quality	0.139***	0.328***	0.200**
	(0.006)	(0.002)	(0.040)
Bilateral trade	0.369***	0.230***	0.133**
	(0.000)	(0.000)	(0.047)
|ΔGDP per capita|	0.010***	0.006***	0.036***
	(0.000)	(0.000)	(0.000)
|ΔGDP growth|	0.022	0.035	0.017
	(0.592)	(0.295)	(0.661)
|ΔInvestment profile|	-0.058	-0.086	-0.100
	(0.429)	(0.165)	(0.154)
|ΔInstitutional quality|	0.112*	0.114**	0.437***
	(0.093)	(0.021)	(0.000)
Time-invariant controls	Yes	Yes	No
Year FE	Yes	Yes	Yes
Acquirer country FE	No	Yes	No
Target country FE	No	Yes	No
Country pair FE	No	No	Yes
Observations	16497	16497	16497
Adjusted R^2	0.29	0.58	0.59

Table IA7: Differences in Democracy and Cross-Border Merger Flows: Alternative Measures of Democracy

This table reports estimates of the effect of differences in democracy between acquirer and target countries on cross-border merger ratio. We estimate the gravity model in equation (1) using Cross-border ratio as dependent variable. In this table, we rely on alternative measures of democracy. In column 1, we use the Freedom House index. In column 2, we use the BMR index. In column 3, we use the V-Dem index. In all specifications, we include the same set of controls as in column 3 of Table 5. The variables preceded by Δ are computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)	(3)
	Cross-border ratio	Cross-border ratio	Cross-border ratio
ΔDemocracy (Freedom House)	0.016**		
	(0.014)		
ΔDemocracy (BMR)		0.014**	
		(0.025)	
ΔDemocracy (V-Dem)			0.078***
			(0.000)
Time-varying controls	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Country pair FE	Yes	Yes	Yes
Observations	11,398	16,393	16,497
Adjusted R^2	0.58	0.59	0.58

Table IA8: Differences in Democracy and Cross-Border Merger Flows: Components of the Polity2 Index

This table reports estimates of the effect of differences in democracy (using each component of the Polity2 index) between acquirer and target countries on cross-border merger ratio. We estimate the gravity model in equation (1) using Cross-border ratio as dependent variable. In columns 1 to 4, we use the different components of the Polity2 index of democracy. In column 5, we use the democracy part of the Polity 2 index, while in column 6 we use the autocracy part of the Polity2 index. In all specifications, we include the same set of controls as in column 3 of Table 5. The variables preceded by Δ are computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1) Cross-border ratio	(2) Cross-border ratio	(3) Cross-border ratio	(4) Cross-border ratio	(5) Cross-border ratio	(6) Cross-border ratio
ΔCER	1.470***					
	(0.000)					
ΔOER		0.083				
		(0.659)				
ΔEC			0.983***			
			(0.002)			
ΔCP				1.147***		
				(0.000)		
ΔDemoc					0.540***	
					(0.000)	
ΔAutoc						-1.295***
						(0.000)
Time-varying controls	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Country pair FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	16,472	16,472	16,472	16,472	16,497	16,472
Adjusted R^2	0.58	0.58	0.58	0.58	0.58	0.58

Table IA9: Differences in Democracy and Cross-Border Merger Flows: Developed and Developing Countries

This table reports estimates of the effect of differences in democracy between acquirer and target countries on cross-border merger ratio excluding from the sample acquirer firms (target firms) from developed (developing) countries. We estimate the gravity model in equation (1) using Cross-border ratio as dependent variable. In column 1, acquirer firms from developed countries are excluded. Developed countries are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Ireland, Israel, Italy, Japan, Luxembourg, Netherlands, New Zealand, Norway, Portugal, Spain, Sweden, Switzerland, United Kingdom, and the United States. In column 1, target firms from developing countries are excluded. Developing countries are Argentina, Bangladesh, Brazil, Bulgaria, Chile, China, Colombia, Croatia, El Salvador, Estonia, Hungary, India, Indonesia, Latvia, Lithuania, Malaysia, Mexico, Morocco, Pakistan, Panama, Peru, Philippines, Poland, Romania, Russia, Serbia, Singapore, Slovakia, Slovenia, South Africa, South Korea, Thailand, Turkey, Venezuela, and Vietnam. To classify a country as developed or developing, we follow the definition provided by the United Nations (www.un.org). In all specifications, we include the same set of controls as in column 3 of Table 5. The sign Δ implies that the variable is computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1) Cross-border ratio	(2) Cross-border ratio
ΔDemocracy	0.139**	0.196***
	(0.042)	(0.000)
Time-varying controls	Yes	Yes
Year FE	Yes	Yes
Country pair FE	Yes	Yes
Countries dropped	Acquirers from developed countries	Targets from developing countries
Observations	3,542	10,362
Adjusted R^2	0.61	0.65

Table IA10: Differences in Democracy and Cross-Border Merger Flows: IV Estimates with Additional Controls for Regional Trends

This table reports IV estimates of the effect of differences in democracy between acquirer and target countries on cross-border merger ratio. In Panel A, we present 2SLS estimates instrumenting ΔDemocracy with ΔRegional waves. In Panel B, we present the corresponding first-stage estimates and the effective first-stage F-statistic as recommended by Olea and Pflueger (2013). In all specifications, we include the same set of controls as in Table 5. In some specifications, we include an additional set of regional controls consisting in the differences between the acquirer country's region and the target country's region in the jackknifed averages of imports to GDP, of exports to GDP, of GDP per capita, and of GDP growth. The variables preceded by Δ are computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

Panel A: 2SLS Estimates

	(1) Cross-border ratio	(2) Cross-border ratio	(3) Cross-border ratio	(4) Cross-border ratio
ΔDemocracy	0.312***	0.369***	3.717**	6.808***
	(0.003)	(0.000)	(0.015)	(0.005)
Time-varying controls	Yes	Yes	Yes	Yes
Time-invariant controls	Yes	Yes	Yes	No
Regional controls	No	No	No	Yes
Year FE	No	No	No	Yes
Country pair FE	No	No	No	Yes
Acquirer country's regional trends	Yes	No	Yes	No
Target country's regional trends	No	Yes	Yes	No
Observations	16,497	16,497	16,497	16,497

Panel B: First-Stage Estimates

	(1) ΔDemocracy	(2) ΔDemocracy	(3) ΔDemocracy	(4) ΔDemocracy
ΔRegional waves	0.093***	0.106***	0.036***	0.019***
	(0.000)	(0.000)	(0.001)	(0.005)
Time-varying controls	Yes	Yes	Yes	Yes
Time-invariant controls	Yes	Yes	Yes	No
Regional controls	No	No	No	Yes
Year FE	No	No	No	Yes
Country pair FE	No	No	No	Yes
Acquirer country's regional trends	Yes	No	Yes	No
Target country's regional trends	No	Yes	Yes	No
Observations	16,497	16,497	16,497	16,497
Adjusted R^2	0.52	0.55	0.61	0.92
Partial R^2	0.18	0.23	0.01	0.01
Effective first-stage F-statistic	154.47	181.67	10.09	8.05

Table IA11: Democracy and Investor Protection: Cross-Sectional Analysis

This table reports OLS estimates of the effect of several cross-country determinants (including democracy) on investor protection. We use one of our proxies (as specified in the column label) for investor protection as dependent variable. All independent variables are averaged over our sample period. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values,reported in parentheses, are based on standard errors that are adjusted for heteroskedasticity using Huber-White correction. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1) Shareholder protection	(2) Shareholder protection	(3) Accounting standards	(4) Accounting standards	(5) M&A laws	(6) M&A laws
Democracy (Polity 2)	0.099**	0.097*	1.625*	1.675***	0.057***	0.055**
	(0.029)	(0.093)	(0.067)	(0.000)	(0.000)	(0.010)
GDP growth	32.405***	28.999**	14.322	144.086	5.387	2.146
	(0.003)	(0.043)	(0.928)	(0.222)	(0.306)	(0.693)
English legal origin	0.758**	0.175	13.785***	-4.359	0.298**	0.360
	(0.016)	(0.617)	(0.000)	(0.363)	(0.037)	(0.188)
French legal origin		-0.809*		-20.719***		0.261
		(0.059)		(0.001)		(0.375)
German legal origin		-0.296		-16.109***		0.310
		(0.525)		(0.002)		(0.298)
GDP per capita		0.022		5.518**		-0.256**
		(0.934)		(0.019)		(0.020)
Trade to GDP		0.132		5.879**		0.254*
		(0.681)		(0.029)		(0.069)
Investment profile		0.126		5.577***		0.113
		(0.602)		(0.001)		(0.132)
Institutional quality		-0.096		-3.661***		0.066
		(0.411)		(0.000)		(0.182)
Constant	1.582**	2.022	44.586***	-5.377	-0.151	0.394
	(0.013)	(0.394)	(0.000)	(0.804)	(0.418)	(0.655)
Observations	44	44	36	36	44	44
Adjusted R^2	0.30	0.23	0.32	0.70	0.18	0.36

Table IA12: Differences in Democracy and Cross-Border Merger Flows: Method of Payment

This table reports estimates of the effect of differences in democracy between acquirer and target countries on cross-border merger ratio. We estimate the gravity model in equation (1) using Cross-border ratio (with a different definition for both columns) as dependent variable. In column 1, we define Cross-border ratio using as the numerator the number of deals between the two countries that are paid in cash. In column 2, we define Cross-border ratio using as the numerator the number of deals between the two countries that are paid in stock or a combination of cash and stock. In all specifications, we include the same set of controls as in column 3 of Table 5. The sign Δ implies that the variable is computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)
	Cross-border ratio	Cross-border ratio
ΔDemocracy	0.022	0.452***
	(0.377)	(0.000)
Time-varying controls	Yes	Yes
Year FE	Yes	Yes
Country Pair FE	Yes	Yes
Method of payment	Cash only	Stock, or cash and stock
Observations	16,497	16,497
Adjusted R^2	0.19	0.53

Table IA13: Push and Pull Factors in Cross-Border Mergers: IV Estimates

This table reports IV estimates of the effect of the degree of democracy in the acquirer and target countries on cross-border merger ratio. In Panel A, we present 2SLS estimates instrumenting Acquirer democracy (Target democracy) with Acquirer regional wages (Target regional waves). The level of democracy in the acquirer (target) country captures the push (pull) factor. In Panel B, we present the corresponding first-stage estimates and the first-stage F-statistic as recommended by Angrist and Pischke (2009) in columns 1 and 2, and the effective F-statistic as recommended by Olea and Pflueger (2013) in columns 3 and 4. In columns 1 and 2, there are two endogenous regressors and two instruments, and in columns 3 and 4 one endogenous regressor and one instrument. In all specifications, we include the same set of controls as in Table 11. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

Panel A: 2SLS Estimates

	(1)	(2)	(3)	(4)
	Cross-border ratio	Cross-border ratio	Cross-border ratio	Cross-border ratio
Acquirer democracy	0.004	-1.704		0.453
	(0.942)	(0.395)		(0.148)
Target democracy	-0.443***	-8.232***	-5.530***	
	(0.000)	(0.000)	(0.000)	
Time Variant Controls	Yes	Yes	Yes	Yes
Time Invariant Controls	Yes	No	Yes	Yes
Year FE	Yes	Yes	No	No
Acquirer country FE	No	No	No	Yes
Target country FE	No	No	Yes	No
Acquirer country × year FE	No	No	Yes	No
Target country × year FE	No	No	No	Yes
Country-pair FE	No	Yes	No	No
Observations	16,497	16,497	16,497	16,497

Panel B: First-Stage Estimates

	(1)	(2)	(3)	(4)
	Acquirer democracy	Acquirer democracy		Acquirer democracy
Acquirer regional waves	0.125***	0.024***		0.026***
	(0.000)	(0.005)		(0.005)
Target regional waves	0.004	-0.000		
	(0.210)	(0.951)		
Time-varying controls	Yes	Yes		Yes
Time-invariant controls	Yes	No		Yes
Year FE	Yes	Yes		No
Acquirer country FE	No	No		Yes
Target country FE	No	No		No
Acquirer country × year FE	No	No		No
Target country × year FE	No	No		Yes
Country pair FE	No	Yes		No
Observations	16,497	16,497		16,497
Angrist-Pischke F-statistic	396.40	9.03		
Effective first-stage F-statistic				8.00
	Target democracy	Target democracy	Target democracy	
Acquirer regional waves	0.014***	-0.006		
	(0.010)	(0.179)		
Target regional waves	0.107***	0.029***	0.031***	
	(0.000)	(0.000)	(0.000)	
Time-varying controls	Yes	Yes	Yes	
Time-invariant controls	Yes	No	Yes	
Year FE	Yes	Yes	No	
Acquirer country FE	No	No	No	
Target country FE	No	No	Yes	
Acquirer country × year FE	No	No	Yes	
Target country × year FE	No	No	No	
Country pair FE	No	Yes	No	
Observations	16,497	16,497	16,497	
Angrist-Pischke F-statistic	259.44	16.47		
Effective first-stage F-statistic			20.17	

Table IA14: Stock Price Reactions to Merger Announcements: 100-Percent Mergers

This table reports estimates of the effect of differences in democracy between acquirer and target countries on CARs for targets and acquirers over the periods $t = (1, +1)$ and $t = (3, +3)$ around the announcement day. We keep in the sample those deals that involve complete control of the target (i.e., acquisition of 100 percent of the target). We estimate the model in equation (2) using Target CAR as dependent variable in columns 1 and 2 and Acquirer CAR in columns 3 and 4. The sign Δ implies that the variable is computed as differences between the acquirer country j and the target country i. Industry fixed effects are based on SIC-2 industry codes. In all specifications, we include the same set of controls at the country-pair and deal levels as in Table 13. We refer to Appendix A for a full description of the variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	Target returns		Acquirer returns	
	(1)	(2)	(3)	(4)
	Target CAR (-1, +1)	Target CAR (-3, +3)	Acquirer CAR (-1, +1)	Acquirer CAR (-3, +3)
ΔDemocracy	14.863***	9.865***	0.009	0.072
	(0.000)	(0.006)	(0.901)	(0.472)
Time-varying controls	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Acquirer industry FE	Yes	Yes	Yes	Yes
Target industry FE	Yes	Yes	Yes	Yes
Country pair FE	Yes	Yes	Yes	Yes
Observations	1,402	1,396	16,795	15,608
Adjusted R^2	0.07	0.05	0.03	0.02

Table IA15: Pull Factors in Cross-Border Mergers: Cross-Sectional Heterogeneity (Labor Protection Laws and Environmental Laws)

This table reports estimates of the interacted effect of the degree of democracy and labor protection laws (environmental laws) in the target country on cross-border merger ratio. We estimate a version of equation (1) using Cross-border ratio as dependent variable. The independent variables of interest are the level of democracy in the target country and its interaction with labor protection laws (column 1) or with environmental laws (column 2). The level of democracy in the target country captures the pull factor. In column 1, we interact the variable Target democracy with the time-varying dummy variable Labor protection laws. The variable Labor protection laws is defined based on a time-varying index, between 0 and 6, measuring the strictness of regulations that an employer must follow in order to dismiss a worker with a regular contract. We use a dummy variable equal to one if this 0-6 index for the target country i is in the sample top tercile, and zero otherwise (source: OECD). In column 1, the period covered is from 1985 to 2018 (we backfill the data until 2018). In column 2, we interact the variable Target democracy with the time-varying dummy variable Environmental laws. The variable Environmental laws takes the value of one the target country has a carbon tax or an emission trading system in place, and zero otherwise (source: Laeven and Popov, 2021). This dummy variable is available for the period 1990–2018. In all specifications, we include acquirer country × year fixed effects, which subsumes the variable Acquirer democracy, and we also include the same set of controls as in Table 5. We refer to Appendix A for a full description of the other variables and their corresponding sources. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1)	(2)
	Cross-border ratio	Cross-border ratio
Target democracy	-0.529**	-0.204***
	(0.012)	(0.006)
Target democracy × Labor protection laws	0.366*	
	(0.090)	
Labor protection laws	-0.027	
	(0.214)	
Target democracy × Environmental laws		0.142
		(0.432)
Environmental laws		-0.011
		(0.538)
Time-varying controls	Yes	Yes
Time-invariant controls	Yes	Yes
Target country FE	Yes	Yes
Acquirer country × year FE	Yes	Yes
Observations	13,879	15,711
Adjusted R^2	0.59	0.63

Table IA16: Democracy and Cross-Border Merger Flows: Natural Resources

This table reports estimates of the effect of democracy on cross-border merger ratio. We estimate the gravity model in equation (1) using Cross-border ratio as dependent variable. In column 1, we use ΔDemocracy as independent variable of interest, while in column 2 we use Target democracy. In column 1, we include the same set of controls as in column 3 of Table 5, while in column 2 we include the same set of controls as in column 3 of Table 11. The sign Δ implies that variable is computed as differences between the acquirer country j and the target country i. We refer to Appendix A for a full description of the variables and their corresponding sources. The sample is restricted to deals for which the target firm is not in a natural-resource exporting country as defined in Asiedu and Lien (2011)—that is, natural-resource exporting are those countries for which the share of fuel and minerals in total merchandise exports is above their sample median. p-values, reported in parentheses, are based on standard errors that are clustered at the country-pair level. ***, **, and * indicate statistical significance at 1-percent, 5-percent, and 10-percent levels, respectively.

	(1) Cross-border ratio	(2) Cross-border Ratio
ΔDemocracy	0.289***	
	(0.003)	
Target democracy		-0.317**
		(0.023)
Time-varying controls	Yes	Yes
Time-invariant controls	No	Yes
Year FE	Yes	No
Country pair FE	Yes	No
Target country FE	No	Yes
Acquirer country × year FE	No	Yes
Observations	13,968	13,968
Adjusted R^2	0.62	0.63