Does Political Partisanship Cross Borders? Evidence from International Capital Flows

Larissa Schäfer
Frankfurt School & CEPR
joint with Elisabeth Kempf (Booth), Mancy Luo (ERM), Margarita Tsoutsoura (Cornell)

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Motivation

- Growing partisan divide in the U.S. (e.g., Iyengar et al. (2012); Mason (2013, 2015); Boxell et al. (2017)).

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- Partisan perception has been shown to affect **economic behavior of U.S. individuals in the U.S.**
  - Households: Consumption and portfolio choice (McGrath (2017), Mian et al. (2017), Meeuwis et al. (2020)).
  - Professionals: Credit rating analysts, loan officers, judges, executives (Kempf & Tsoutsoura (2020), Dagostino et al. (2021), Gormley et al. (2020), Rice (2020), Fos et al (2021)).

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- **No evidence on effects of partisan perception outside U.S.**

This paper

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- Settings: **syndicated loan market and equity mutual funds**
  1. Large part of cross-border lending and equity investments.
  2. Capital flows at individual investor level.
  3. We examine capital allocation by partisan investors in the **same destination country** around the **same foreign election.**

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     - U.S. banks charge higher spreads but do not face more defaults.
  2. U.S. equity mutual funds **decrease portfolio allocation** when their **distance increases.**
     - U.S. funds experience no significant differences in performance.
  3. Similar effects for non-U.S. investors and FDI flows.

Contribution

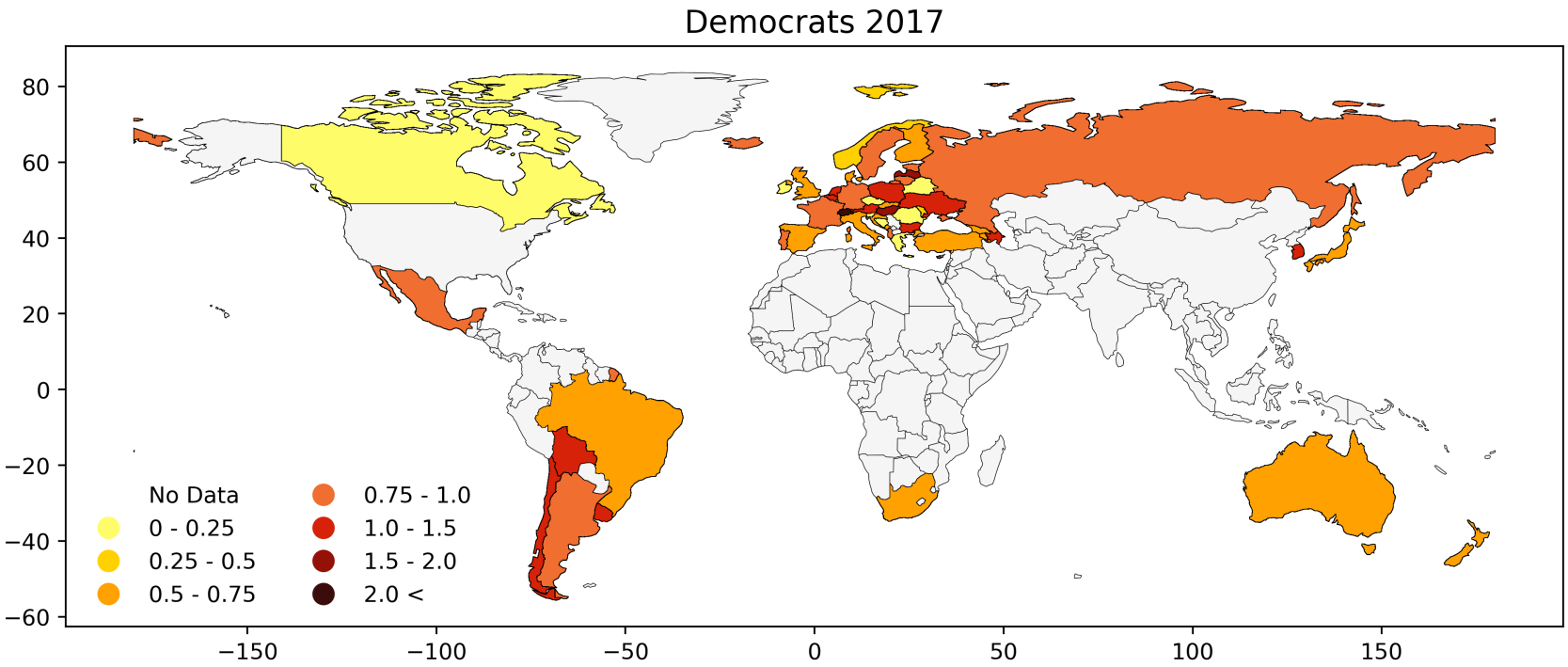
- Response of partisan investors to domestic political events (Bonparte et al. (2017), Meeuwis et al. (2018), Kempf & Tsousoura (2020), Dagostino et al. (2021)).
- Political affiliation and investor behavior (Hong & Kostovetsky (2012), Kaustia & Torstila (2011), Jiang et al. (2016), Hutton et al. (2014)).
- Determinants of cross-border capital flows (Mian (2006), Guiso et al. (2009), Hwang (2011), Ahern et al. (2015), Botazzi et al. (2016), Giannetti & Laeven (2012), Giannetti & Yafeh (2012)).
- **First to show how partisan perception affects cross-border flows.**

Political Ideology Data

- **U.S. banks:** Party affiliations based on political contributions from political action committee (PAC).
- **U.S. fund managers:** U.S. voter registration records.
- Ideological score from Manifesto Project to measure policy positions for political parties on left-right scales.
- Difference between ideological score of party of investor i and the party in power in country c at time t:

$$Distance_{ict} = |Ideology_{it} - Ideology_{ct}|$$

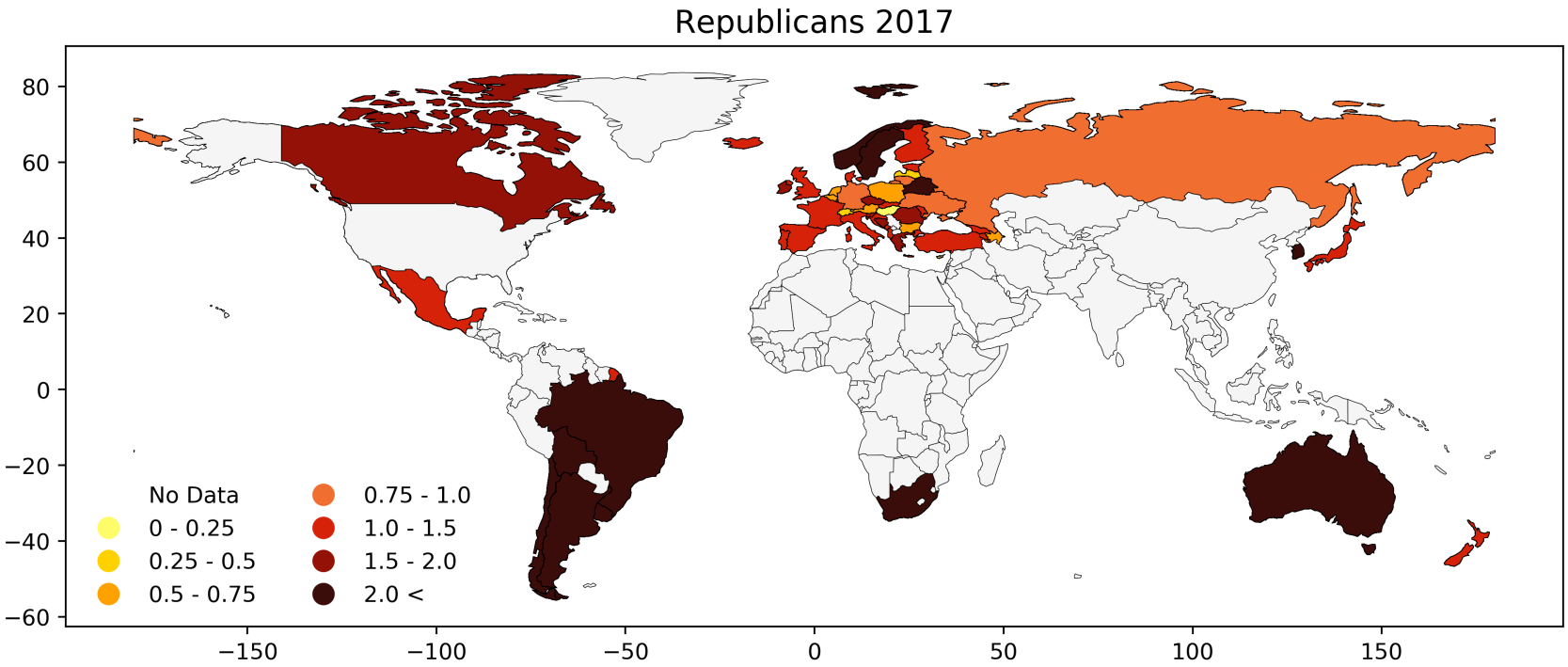
Distance of U.S. Investors to Foreign Governments



Democratic Investors in 2017

2007

Distance of U.S. Investors to Foreign Governments



Republican Investors in 2017

2007

International Investment Data

- Thomson Reuters' Dealscan database for syndicated loans between 2000 and 2018.
  - Focus on 20,588 cross-border deals to 4,816 non-financial borrowers from 46 foreign destination countries by 28 U.S. banks.
  - 80% of all cross-border lending by U.S. banks.

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  - 80% of all cross-border lending by U.S. banks.
- Factset International Ownership database combined with Morningstar Direct on all open-ended mutual funds ("OEF") between 2000 and 2018.
  - Focus on 385 U.S. international funds with 204 fund managers investing in 24 foreign destination countries.
  - 34% TNA of all U.S. international equity OEF funds.

What do we expect?

- Ideologically closer investors have more positive expectations wrt. profitability of investment projects.
- Ideologically closer (distant) banks may underestimate (overestimate) likelihood of borrower's default.
- As a result, **distant banks** will **lend less** relative to close banks.
- **Distant banks** will charge **higher spreads** relative to close banks but not experience **more defaults**.

Identification Challenges

- How to identify the effect of ideological distance on investments?

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  1. Ideological distance likely correlates with other bilateral measures of proximity (e.g., language, culture, religion).

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  3. Expected investment returns may be influenced by political elections.

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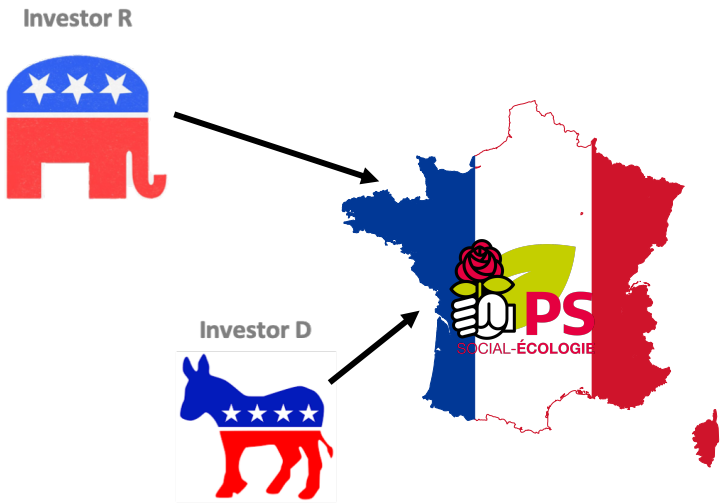
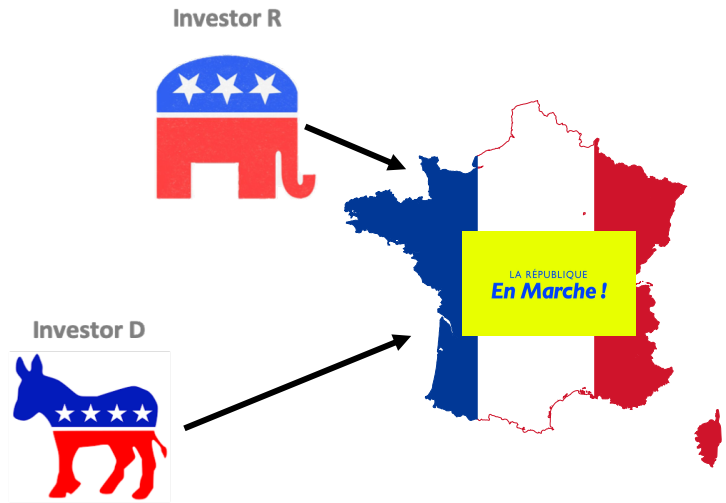
  1. Ideological distance likely correlates with other bilateral measures of proximity (e.g., language, culture, religion).
  2. Ideological distance may affect degree of government collaboration.
  3. Expected investment returns may be influenced by political elections.
- We examine capital allocation by partisan investors in the **same destination country** around the **same foreign election** at the **same point in time.**

Identification Strategy



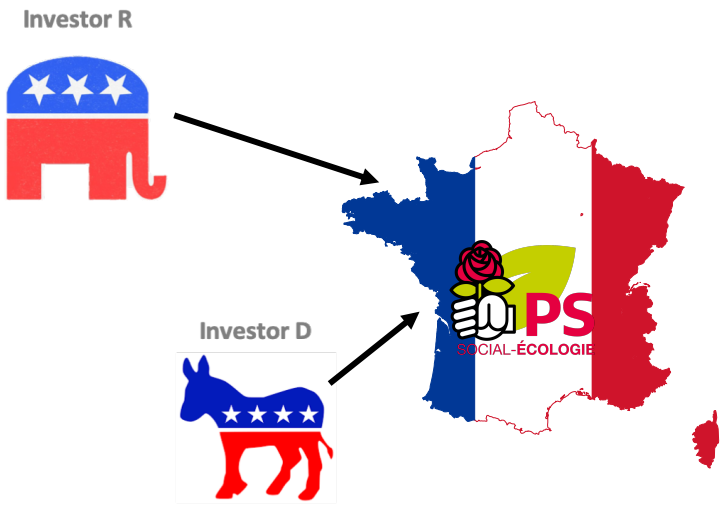
Pre-election period



Post-election period

- Bank R (Republican) and D (Democrat) from the U.S. are extending loans to French firms around the election in 2017.

Identification Strategy



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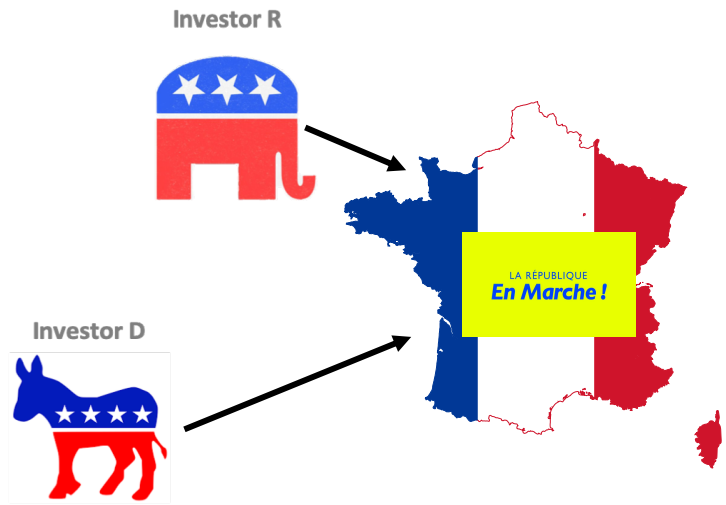
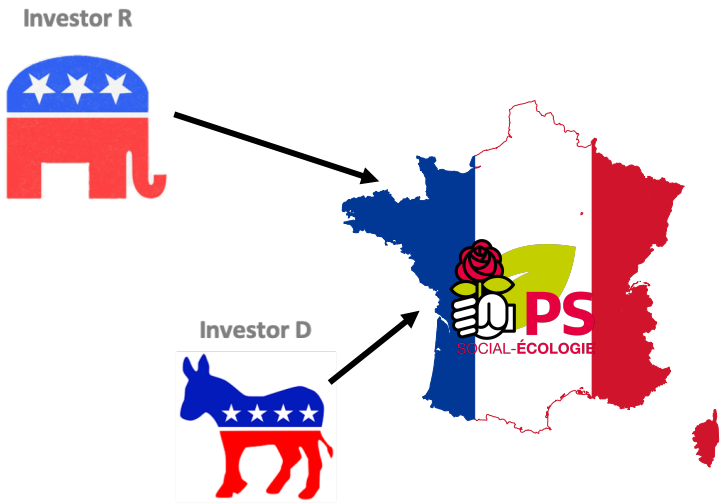


Post-election period

- Before the election, Bank D is ideologically closer to ruling left-wing party.

Identification Strategy



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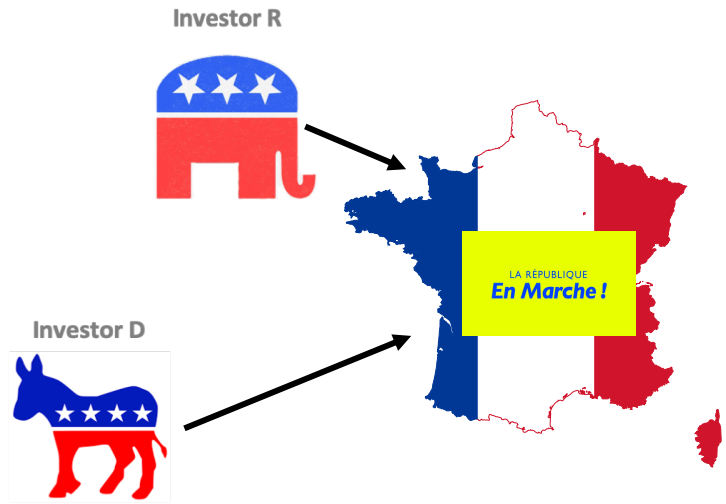


Post-election period

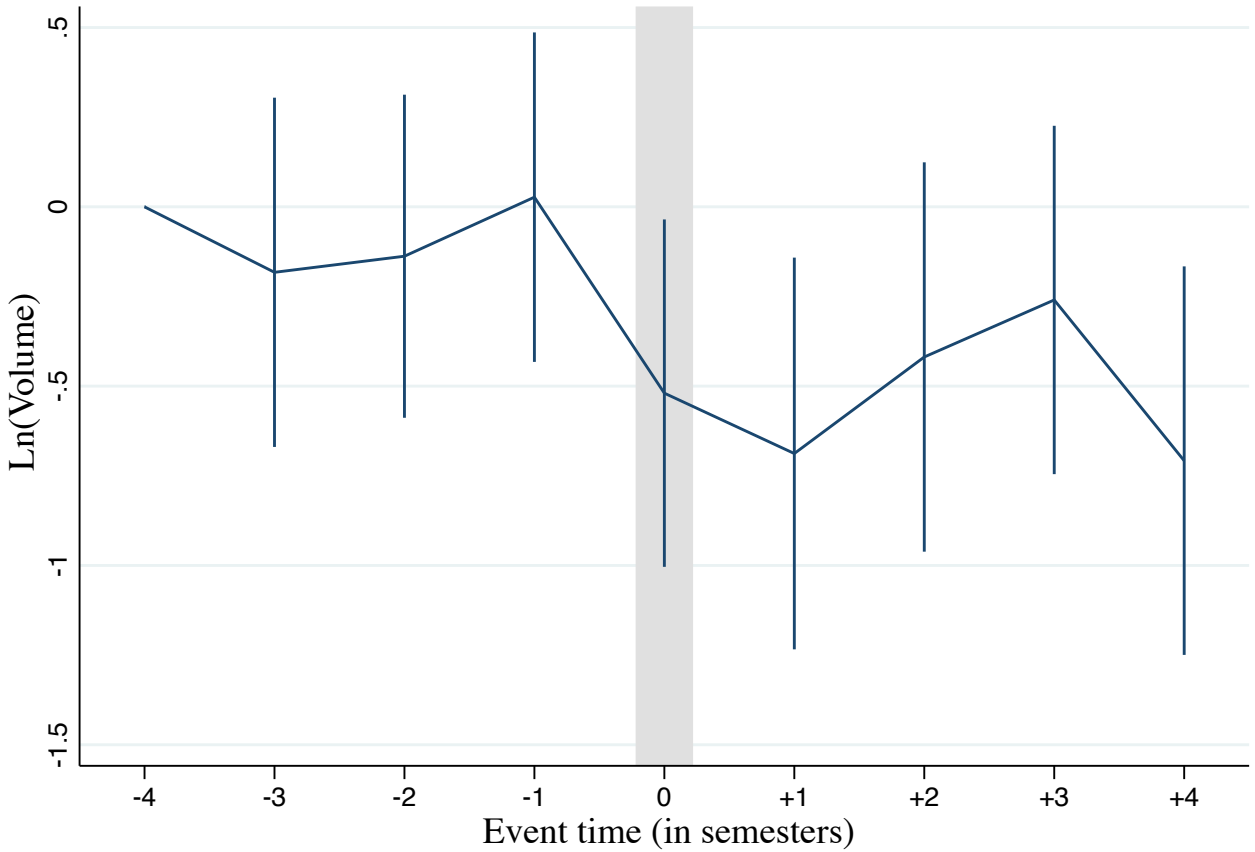
- After the election, Bank D is ideologically more distant from overtaking center-right party.

Ideological Distance and International Investments

$$Investment_{iect} = \beta_1 Distance\ Increase_{iec} \times Post_{ect} + \alpha_{ect} + \alpha_{iec} + \lambda' X_{i,t-1} + \epsilon_{iect}$$

- $Investment_{iect}$: investment by investor i to destination country c in half year t around election e ($\tau = [-4, +4]$).
- $Distance\ Increase_{iec}$: equal to 1 if ideological distance between investor i and destination country c increases after election e.
- $Post_{ect}$: equal to 1 if half year t falls in post-election period ($\tau = [0, +4]$).
- α_{ect}: election $\times$ half year fixed effects.
- α_{iec}: investor $\times$ election fixed effects.

U.S. Banks: Drop in Lending after Election



- **Drop in lending** volume when banks' ideological **distance increases**.

number

U.S. Banks: Drop in Lending after Election

$$Ln(Volume)_{iect} = \beta_1 Distance\ Increase_{iec} \times Post_{ect} + \alpha_{ect} + \alpha_{iec} + \lambda' X_{i,t-1} + \epsilon_{iect}$$

	(1)	(2)	(3)
Post × Distance Increase	-0.335	-0.383	-0.375
	(-2.48)	(-3.51)	(-3.43)
Economic Effect (%)	-28.48	-31.83	-31.25
Bank Controls	No	No	Yes
Election × Time FE	Yes	Yes	Yes
Bank × Election FE	No	Yes	Yes
R^2	0.181	0.773	0.773
N (Bank - Dest. Country - Time)	17,793	17,759	17,754

- Banks **reduce lending volume by 32%** when their **distance increases.**

number | summary stats | robust | firm

U.S. Banks: Stronger Effects for Close Elections

$$Ln(Volume)_{iect} = \beta_1 Distance\ Increase_{iec} \times Post_{ect} + \alpha_{ect} + \alpha_{iec} + \lambda' X_{i,t-1} + \epsilon_{iect}$$

	Close	Non-Close
	(1)	(2)
Post × Distance Increase	-0.625	-0.268
	(-4.90)	(-1.79)
Difference test p-value	0.066	
Economic Effect (%)	-46.47	-23.53
Bank Controls	No	No
Election × Time FE	Yes	Yes
Bank × Election FE	Yes	Yes
R^2	0.762	0.779
N (Bank - Dest. Country - Time)	6,290	11,469

elections

U.S. Banks: Higher Loan Spreads after Election

$$Ln(Spread)_{ikect} = \beta_1 Distance\ Increase_{iec} \times Post_{ect} + \alpha_{ect} + \alpha_{iec} + \lambda' X_{ik,t-1} + \epsilon_{ikect}$$

	Loan Spread		
	(1)	(2)	(3)
Post × Distance Increase	0.072	0.071	0.067
	(1.51)	(1.50)	(1.43)
Firm Controls	Yes	Yes	Yes
Bank Controls	No	Yes	Yes
Loan Controls	No	No	Yes
Rating Scale FE	Yes	Yes	Yes
Firm Cluster × Election × Time FE	Yes	Yes	Yes
Bank × Election FE	Yes	Yes	Yes
R^2	0.953	0.953	0.955
N (Bank - Firm - Loan - Time)	21,385	21,385	21,385

- Banks **charge 14 bps higher spreads** but effect is statistically insignificant.

summary stats | relationship

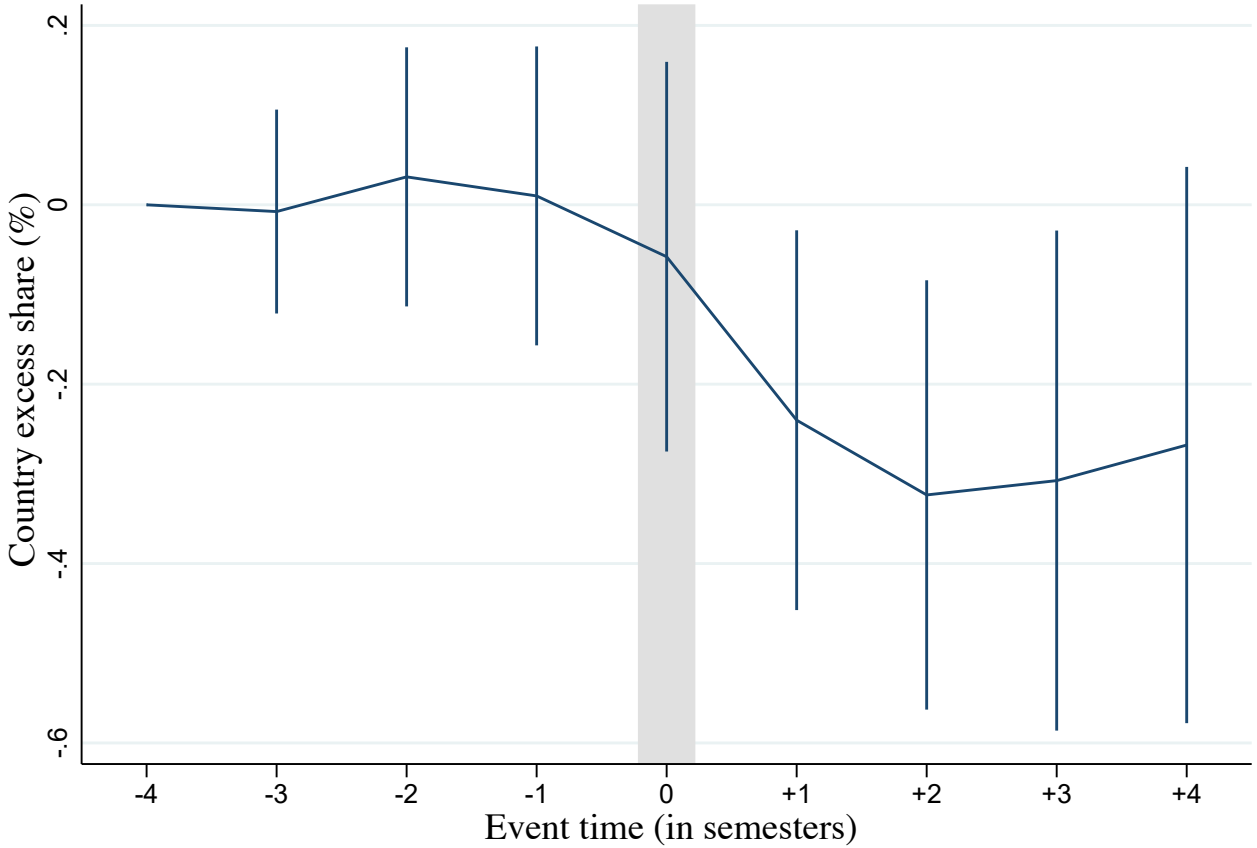
U.S. Banks: Not more Defaults after Election

$$Default_{ikect} = \beta_1 Distance\ Increase_{iec} \times Post_{ect} + \alpha_{ect} + \alpha_{iec} + \lambda' X_{ik,t-1} + \epsilon_{ikect}$$

	Default		
	(1)	(2)	(3)
Post × Distance Increase	0.002	0.003	0.003
	(0.57)	(0.96)	(0.90)
Firm Controls	Yes	Yes	Yes
Bank Controls	No	Yes	Yes
Loan Controls	No	No	Yes
Rating Scale FE	Yes	Yes	Yes
Firm Cluster × Election × Time FE	Yes	Yes	Yes
Bank × Election FE	Yes	Yes	Yes
R^2	0.947	0.947	0.948
N (Bank - Firm - Loan - Time)	14,478	14,478	14,478

- Banks do **not face more defaults.** downgrades

U.S. Funds: Reduction in Portfolio Share after Election



P-value (post-pre) = 0.01

- Funds **reduce** excess portfolio share when their **distance increases.**

U.S. Funds: Reduction in Portfolio Share after Election

$$ExcessWeight_{iect} = \beta_1 Distance\ Increase_{iec} \times Post_{ect} + \alpha_{ect} + \alpha_{iec} + \lambda' X_{i,t-1} + \epsilon_{iect}$$

	Excess Weight		
	(1)	(2)	(3)
Post × Distance Increase	-0.226	-0.232	-0.242
	(-2.62)	(-2.81)	(-2.59)
Economic Effect (%)	-4.77	-4.90	-5.12
Fund Controls	No	No	Yes
Election × Time FE	Yes	Yes	Yes
Fund × Election FE	No	Yes	Yes
R^2	0.042	0.825	0.824
N (Fund - Dest. Country - Time)	52,547	52,543	44,421

- Funds **reduce excess weight** by around **5%** relative to average weight.

summary stats | stocks | managers

U.S. Funds: No Effect on Fund Performance

$$Return_{iect} = \beta_1 Distance\ Increase_{iec} \times Post_{ect} + \alpha_{ect} + \alpha_{iec} + \lambda' X_{i,t-1} + \epsilon_{iect}$$

	Benchmark-adjusted returns			Value added		
	(1)	(2)	(3)	(4)	(5)	(6)
	Market	ETF	Local	Market	ETF	Local
Post × Distance Increase	-0.047	-0.023	-0.116	-0.191	-0.381	-0.518
	(-0.15)	(-0.07)	(-0.36)	(-0.20)	(-0.35)	(-0.52)
Fund Controls	No	No	No	No	No	No
Election × Time FE	Yes	Yes	Yes	Yes	Yes	Yes
Fund × Election FE	Yes	Yes	Yes	Yes	Yes	Yes
R^2	0.249	0.244	0.252	0.140	0.134	0.150
N (Fund - Dest. C.- Time)	41,080	39,720	40,610	41,080	39,720	40,610

- **No significant differences** in fund performance.

Similar Effects for Non-U.S. Investors

$$Investment_{ihect} = \beta_1 Distance\ Increase_{ihec} \times Post_{ect} + \alpha_{ect} + \alpha_{hec} + \alpha_{ht} + \epsilon_{ihect}$$

	Volume			Excess Weight		
	(1)	(2)	(3)	(4)	(5)	(6)
Post × Distance Increase	-0.615	-0.190	-0.107	-1.065	-0.928	-0.959
	(-2.00)	(-0.78)	(-0.40)	(-2.68)	(-2.45)	(-2.56)
Economic Effect (%)	-45.93	-17.34	-10.17	-17.46	-15.21	-15.73
Investor Controls	No	No	No	No	No	No
Election × Time FE	Yes	Yes	Yes	Yes	Yes	Yes
Home Country × Elect. FE	No	Yes	Yes	No	Yes	Yes
Home Country × Time FE	No	No	Yes	No	No	Yes
R^2	0.388	0.478	0.482	0.070	0.172	0.173
N (Inv. - Dest. C.- Time)	8,346	8,339	8,339	8,810	8,810	8,810

- Non-U.S. investors **reduce investments** when their **distance increases.**

countries

Effects on Aggregate Level

$$FDI_{hct} = \alpha_{hc} + \alpha_{ht} + \alpha_{ct} + \beta Distance_{hct} + \epsilon_{hct}$$

	FDI flow			
	(1)	(2)	(3)	(4)
Distance	-0.013	-0.015	-0.017	-0.016
	(-1.70)	(-2.51)	(-2.20)	(-2.38)
Home × Destination Country FE	Yes	Yes	Yes	Yes
Destination Country × Year FE	Yes	Yes	Yes	Yes
Home Country × Year FE	No	Yes	No	Yes
Exclude U.S.	No	No	Yes	Yes
R^2	0.499	0.526	0.505	0.532
N (Country - Dest. Country - Time)	12,528	12,528	11,710	11,710

- A one-standard-deviation **larger distance** is associated with a **0.86 pp. lower** FDI flows.

Conclusion

- Partisan perception transcends national borders.
  - Evidence from both syndicated loans and equity mutual funds.
- Economic effects of partisan perception not limited to the U.S.
- Important role of partisan perception in shaping the flow of international capital.