

This work reveals that ideological alignment with foreign governments affects cross-border capital allocation by US institutional investors, implying that partisan perception is a global phenomenon and its economic effects transcend national borders.

Recent studies have shown that voters, whether members of households or sophisticated credit analysts, hold political perceptions that shape their views of the economy. Are things going well for the economy under a president from Party A? Your view is likely influenced by your affiliation with Party A or B.

However, what do we know about whether and how these voters make economic decisions based on their political perceptions? When it comes to investment, what are the economic implications of this partisan-perception phenomenon, especially regarding cross-border capital allocation? That is, do people project their domestic political perceptions on to foreign governments and, hence, make like-minded economic decisions?

This research is the first to provide answers to these and other questions relating to cross-border capital allocation by investigating whether cross-border investments by large institutional investors are shaped by an ideological alignment with elected foreign parties. The authors use two independent settings, syndicated corporate loans and equity mutual funds to analyze cross-border capital flows, including at the level of individual banks and mutual funds.

Among other results, the authors find that:

- Belief disagreement is a likely mechanism driving observed differences in capital allocation by US investors. This finding is supported by evidence of banks’ downward-revision of GDP growth forecasts when they experience an increase in ideological distance, relative to banks that experience a decrease in ideological distance.

- To put a number on it: When a bank experiences an increase in ideological distance after a foreign election, it reduces its lending volume by 22% and the number of loans by 10%.

Note: The figure plots the difference in the cumulative loan issuance volume between U.S. banks that experience an increase versus a decrease in ideological distance around a foreign election. The authors plot the coefficients $B_T$ from equation (3) for nine half-years around elections. The dependent variable is the logarithm of one plus the cumulative dollar loan issuance volume from $T = -4$ to $T$. The authors include election x time, investor x election, and investor x time fixed effects. The corresponding 95% confidence intervals are based on standard errors that are clustered at the investor x destination country level.
• Further, the authors document a decrease in the loan quantity provided by misaligned banks even within the same loan, a finding that allows them to rule out that the relative decline in loan quantity is driven by differences in borrower demand.

• In terms of loan pricing, the authors find a sizable, positive effect of ideological distance on loan spreads. An increase in ideological distance is associated with a 13.9% increase in loan spreads, which translates to approximately 30 basis points for the average loan in their sample.

• Partisan perception can affect the net supply of capital by foreign investors. Importantly, ideological alignment between countries can explain patterns in bilateral portfolio and foreign direct investment.

• Bottom line: Ideological alignment is a key—and omitted—factor in current models of international capital flows.

Regarding partisan perception’s effect on non-US investors, the evidence is mixed. Differences in data availability and reporting thresholds for political contributions across countries do not allow the authors to reach firm conclusions. Likewise, questions relating to the sources of cross-country differences in the influence of partisan perception on economic decisions would motivate interesting future research.