

Upfront

The Price of Going Left: In new democracies, right-leaning elections attract foreign investors

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A few decades ago, developing countries were either one-party socialist states, absolute monarchies, or military juntas, and so were not privy to the planned chaos of elections. But with the spread of democracy, these countries now regularly enjoy the drama and disruption of voting. Multinational corporations (MNCs) not only watch these elections closely, but also plan their foreign investments according to the elections' projected outcomes, finds Paul Vaaler, a professor of international business at the University of Minnesota's Carlson School of Management. He finds that when the political leadership of developing countries seems poised to shift from left to right, MNCs announce more project investments. But when an election seems likely to go to the left, foreign-domiciled MNCs announce fewer investments.

"MNCs don't vote at the ballot box, but they do vote with their dollars," says Vaaler, summarizing a study he published in the February 2008 *Academy of Management Journal*. He clarifies, however, that his study does not show that MNCs shape elections. Rather, they respond to them.

Vaaler says his study is the first to examine how elections in developing countries influence foreign corporate investment. Traditionally, right-wing policies are more investor-friendly because they favor less inflation, lower taxes, and fixed asset values—all of which fatten investors' returns, albeit often at the expense of employment. In contrast, left-wing policies protect employment even if it means increasing inflation, raising taxes, and devaluing assets.

In developing countries, however, relying on pat left/right distinctions can lead MNCs astray, says Vaaler. He points to the case of Brazil's President Luiz Inácio Lula da Silva, from the Partido dos Trabalhadores (Workers' Party). As da Silva's election became likely, lending from foreign banks to Brazil dried up. "They all presumed that this left-winger was going to put the country in default," says Vaaler. "But the result was quite different." Since da Silva took power in 2002, Brazil's economy has grown dramatically.

Because party affiliations do not necessarily predict policymaking, Vaaler recommends that MNCs carefully appraise the political candidates in the nations in which they want to invest. "A good strategic manager looks beyond labels at actual platforms," he says.

For their part, political candidates who seek foreign investment must work hard to communicate their actual stances. "Both incumbents and challengers should send representatives to Wall Street to talk about how they are going to promote good governance and reduce inflation," he says. "They ignore foreign investment constituency at their peril, because investors will look at clichés and act. And when they act, it's worth billions of dollars."

Indeed, since the mid-1960s, the value of announced project investments in countries outside the Organisation for Economic Co-operation and Development has topped \$1.6 trillion. These investments usually go toward construction, transportation, energy, telecommunications, and water.

To explore how elections shape foreign corporate investment, Vaaler studied 18 developing countries with competitive presidential elections, such as Bulgaria, Ecuador, and Indonesia. Because these countries are new to democracy, how elections affect foreign investment is a new issue, says Vaaler: "I'm capturing this dynamic as it unfolds." —A.C.



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