

EXPORTING IDEOLOGY: THE RIGHT AND LEFT OF FOREIGN INFLUENCE*

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Abstract

We present an economic rationale to explain why countries resort to foreign influence to export their ideology to other nations. Our model incorporates two fundamental elements: redistribution of tax burden between capital owners and workers, and international capital mobility. The model highlights the role of ideology in shaping both the taxes implemented by governments and the cross-border externalities of these policy choices. Pro-capital governments want to maximize returns to capital. Hence, they set lower capital taxes than pro-labor governments and benefit from other countries setting low capital taxes. In contrast, pro-labor governments' efforts to shift the tax burden onto domestic capital owners are facilitated by higher capital taxes abroad. These cross-border externalities create strong incentives to engage in foreign influence activities. We solve for a political equilibrium in which incumbent governments have the option to meddle in elections in other countries. In equilibrium, pro-capital parties exert influence aimed at promoting pro-capital parties and policies worldwide, while pro-labor governments carry out foreign influence activities aimed at boosting pro-labor parties and policies in other countries.

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1 Introduction

In the realm of international politics, the influence of governments often extends beyond their own borders, as they engage in activities that are aimed at shaping political outcomes in other countries. While these activities were a hallmark of Cold War international politics (see Gaddis, 1987), their frequency has barely abated in the decades since. Bubeck and Marinov (2019) document that, in the period from 1946 to 2012, 65% of competitive elections were subject to some form of foreign intervention. Remarkably, in the last decade covered by their dataset (2002-2012), foreign intervention is documented in about two-thirds of elections, in line with the average for the entire post WWII period.¹ This is therefore a pervasive phenomenon that cannot be solely attributed to the grand geopolitical tensions of the Cold War struggle.

A notable aspect of foreign influence is that it often features a clear partisan ideological dimension. Incumbents typically try to promote and support foreign parties or candidates abroad that share their position in the ideological spectrum. This pattern is particularly evident in the perennial tug of war between the right and the left in most of Latin America over the last few decades. For example, it is widely documented that Hugo Chávez, the former President of Venezuela, had a significant impact on foreign elections during his time in office, intervening in favor of left-wing politicians such as Evo Morales in Bolivia, Rafael Correa in Ecuador, or Cristina Fernández de Kirchner in Argentina, all of whom went on to win presidential elections in their respective countries.² Similarly, it is contended that, in the spread of Washington Consensus policies throughout Latin America, there was an element of foreign influence exerted by the United States through its clout over multilateral financial agencies.³ Why do incumbent parties seek to ‘export’ their ideology to foreign nations? More specifically, why do right-leaning, pro-capital incumbents prefer to have right-leaning, pro-capital governments in neighboring countries, and why are the policies implemented by

¹Bubeck and Marinov (2019) develop a distinction between process interventions (e.g., assignment of election observers) and candidate interventions (e.g., public statements in favor of a specific candidate). As the former also change the odds of victory, the study shows they are wielded strategically by interveners. If nonetheless one restricts attention to candidate interventions, such interventions are documented for 33% of elections over the entire period, a significant lower bound.

²See, for instance, “Chávez builds his sphere of influence” NBC News, February 23, 2007.

³In an assessment of Washington Consensus policies, Goldfajn et al. (2021) write “Across Latin America, several political groups opposed the Washington Consensus policies, for two main reasons: some saw them as imposed by the United States in an effort to increase its control over Latin American countries and promote the interests of international companies; while others considered that these policies had already been tried in the 1980s and had failed to stabilize the economy, entailing a high economic cost.” Similarly, Rodrik (2006) describes that “...the reform agenda eventually came to be perceived, at least by its critics, as an overtly ideological effort to impose “neoliberalism” and “economic fundamentalism” on developing nations.”

left-leaning pro-worker governments particularly desirable to other left-leaning pro-worker governments?

One explanation for this alignment may stem from grand strategic forces. Indeed, the main struggle of the Cold War was cast in terms of geopolitical blocks, which were partly defined by the participants' national political and economic organization and which were largely economically decoupled. Influencing activities expended to ensure that third countries would join or remain in each block would therefore naturally generate ideological alignment. As the evidence shows, however, this preference for ideological affinity has continued in a post Cold War world in which geopolitical block dynamics are greatly attenuated giving way to global economic interdependence

In this paper we advance a theoretically novel driver for these ideological patterns of foreign influence. Our approach is grounded on domestic politics and economic spillovers. We contend that there is a very natural reason why left-wing governments prefer to be surrounded by left-wing governments, while right-wing governments may try to block the emergence of such left-wing governments. Our argument is based on two elements: *redistribution* and *international capital mobility*. We show how these two elements interact to generate incentives for ideological affinity in a formal model.

Our starting point in Section 3 is a standard model of tax competition in which income is generated in part by capital, a factor that is internationally mobile (see Wilson, 1986, 1991; Zodrow and Mieszkowski, 1986). We add to this framework an explicit consideration of labor as a factor of production that is immobile and taxable. This implies that, in our model, the provision of public goods can always be funded with tax revenue.⁴ The tension is therefore not located on deciding which level of public goods to provide, but on deciding how to pay for them. In other words, we focus on an eminently political question: how should the tax burden be distributed between suppliers of labor (i.e., workers) and suppliers of capital (i.e., capitalists)?

We introduce ideology in Section 4 as the way different political parties answer this question. Pro-capital parties prefer to minimize capital taxes, while pro-labor parties prefer capital to pay for a larger share of public expenditure. While the choice of capital and labor taxes is in essence an internal political struggle of each country, capital mobility generates policy externalities across borders. Importantly, in Section 5 we formally show that the sign of these externalities interacts with ideology. The main novel result of our model is that capitalists benefit from foreign countries setting low capital taxes, because such taxes

⁴By assuming that most of the tax base is mobile, the literature on tax competition has focused on a “race-to-the-bottom” in taxation, which induces underprovision of public goods. We emphasize instead the determination of the *relative* tax burden between mobile and immobile factors of production.

anywhere in the world reduce the returns to capital *globally*. In contrast, workers benefit from other countries' high capital taxes. This is because workers want capitalists to pay a higher share of taxes but are *fearful of capital flight*. High capital taxation abroad reduces outward capital flows, thus allowing pro-labor governments to increase capital taxes in their own countries. In other words, domestic redistribution is more effective when foreign countries tax capital at a higher rate. Therefore, the combination of redistributive incentives and capital mobility results in ideological affinity: pro-capital governments benefit from other countries being ruled by pro-capital governments, while pro-labor governments benefit from other countries being ruled by pro-labor governments.

Having developed these insights and a baseline model of electoral competition (see Section 6), we next allow countries to engage in foreign influence activities. Following the approach in [Antràs and Padró i Miquel \(2011\)](#) and [Bubeck and Marinov \(2017\)](#), we model foreign influence in Section 7 as involving costly actions (by a government's incumbent) that probabilistically affect the election outcome in other countries. In the (subgame-perfect) equilibrium of our political game, parties running for election in a given country (Home) can only credibly commit to implementing their own preferred policies. Hence, foreign incumbents have an incentive to carry out foreign influence efforts aimed at boosting the chances of winning for the party with which they are politically aligned. More specifically, we show that sufficiently pro-capital Foreign incumbents take actions to increase the likelihood that the election at Home is won by a pro-capital party, while a sufficiently pro-labor Foreign incumbent would instead take actions to increase the likelihood that the election at Home is won by a pro-labor party.

We therefore propose an incentive for ideological affinity which is independent of any desire for ideological hegemony or altruism. Indeed, incumbents in this model do not exert foreign influence because they believe their ideology is superior and hence other countries would be better off if they adopted it. Instead, in the model incumbents care exclusively about the welfare of their domestic constituents. Nonetheless, they exert foreign influence to obtain ideological affinity because policies in foreign countries with ideologically aligned governments produce favorable economic spillovers for their constituents at home.

An exploration of the consequences of Chávez's influence in the Western Hemisphere provides a clear illustration of the economic policy dimension of these activities. Between 1999 and 2009, Venezuela exported petroleum at subsidized rates, extended concessionary loans and invested in countries governed by friendly governments. [Romero and Curiel \(2009\)](#) estimate the cost of these policies to be about \$45 billion. The promise of such largesse is one of the ways in which he helped elect left-wing governments from Bolivia to Nicaragua. These governments proceeded to change policies to terms less favorable to capitalists. For

example, Evo Morales of Bolivia imposed royalty payments on extractive industries, Ollanta Humala of Peru introduced new levies on mining and increased the minimum wage, and Ecuador's Rafael Correa increased the corporate income tax multiple times and robustly renegotiated contracts with oil companies (see [Caselli, 2013](#); [Anria and Huber, 2018](#)). This general hardening of conditions for capital in the region was no doubt beneficial to Chávez as he was pursuing his own renegotiations with private foreign investors (see [Shifter, 2006](#)).

Beyond this particular example, [Bubeck and Marinov \(2019\)](#) provide systematic evidence which is also consistent with the importance of the economic dimension in foreign influence. Their original dataset compiles the kind of differences in domestic party platforms that elicit potential intervention from foreign powers: for example, differences in anti-Americanism between incumbent and challenger in a given election should induce intervention from the United States in favor of the candidate with favorable views. Even though the focus of this work is on geopolitical issues, the data implies that a full 39% of the domestic platform disagreements which motivate foreign intervention are economic in nature, with the narrower category of investment and trade alone appearing in 11% of cases. By comparison, party positions related to geopolitical spheres of influence or to military issues are relevant in 25% and 26% of the cases of potential foreign influence, respectively. Clearly, cross-country spillovers caused by economic policies are at least as important as a cause of foreign concern as geopolitical concerns. Our model rationalizes why foreign influence appears to promote partisan alignment when domestic economic policies such taxation and redistribution are the paramount concern of policy makers.

With the goals of probing the generality of our arguments and of delineating a number of empirical predictions, in [Section 8](#) we extend our model in several directions. First, we demonstrate that any policy that reduces or increases returns to capital causes international externalities and therefore can motivate foreign influence in the manner we have described. Expropriation or nationalization of private enterprises is the most blatant form of reducing returns to capital, and if the original capital owners are foreign, the international dimension of such policies is obvious. Facing such actions or threats from domestic governments, foreign, pro-capital incumbents would be interested in changing the political scenario. Our argument thus naturally extends to influence activities aimed to effect non-democratic regime change, and our model predicts that when it comes to interventions to prevent (or roll-back) nationalizations, the foreign sponsors of such operations are more likely to be pro-capital governments. This is consistent with the CIA interventions in Iran in 1953, Guatemala in 1954 and Chile in 1973 all taking place under Republican administrations.

In our second extension, we consider a multilateral world in which incumbents in multiple countries attempt to affect the electoral outcome in a given country, and we explore the

differential incentives that the various incumbents might have in shaping that election. Third, we study an environment in which elections occur in a staggered manner across the two countries. Our main result of this extension is that incumbents have an additional incentive to boost the electoral prospects of ideologically-aligned parties: by increasing the chance of having an aligned government in the other country, they increase the chance of favorable future foreign influence in their own reelection bid. Finally, we allow parties to credibly commit to policy platforms in advance of the election. With commitment, foreign influence not only affects who wins an election but also the policy platforms. More specifically, if the foreign incumbent is pro-capital, the pro-labor party at home ‘tilts to the right’, announcing lower capital taxes than it would implement without commitment. The purpose of this shift is to reduce the influencing motive of the foreign government. The opposite is true when the foreign incumbent is pro-labor.

2 Literature Review

We view our work as contributing to several literatures in both political science and economics.

Foreign Influence We add to the formal literature studying biased electoral contests, a burgeoning area of research with multiple recent advances.⁵ In particular, we directly contribute to a literature at the intersection of economics and political science studying foreign influence on domestic politics.⁶ This literature has been comprehensively reviewed in [Aidt et al. \(2021\)](#). These authors distinguish three types of intervention strategies: (i) negotiated bilateral agreements, (ii) strategically chosen rewards or sanctions and (iii) institutional interventions in which the foreign power seeks to change internal policy making in the target country. Our modeling of foreign influence pertains to the latter type of intervention. [Antràs and Padró i Miquel \(2011\)](#) shows that *the possibility* of foreign influence leads to policies that end up maximizing a weighted sum of domestic and foreign welfare, and may thus increase aggregate world welfare when there are no other means of alleviating the externalities that arise from cross-border effects of policies (see also [Aidt and Hwang, 2014](#)). In that prior work, however, we altogether ignored the role of ideology both in the foreign power and in the target country. As a result, foreign influence only worked as a

⁵See for instance [Little \(2012\)](#), [Rundlett and Svulik \(2016\)](#), [Paine \(2019\)](#), [Abdul-Razzak et al. \(2020\)](#), [Wolton \(2021\)](#).

⁶There is of course a much broader literature in political science studying the interplay between international and domestic politics. See, among many others, [Putnam \(1988\)](#), [Garrett and Lange \(1995\)](#), and [Frieden and Rogowski \(1996\)](#).

threat and did not actually materialize in the subgame perfect equilibrium of our game. Instead, in the model we present here, ideology is central and foreign influence occurs along the equilibrium path.

A related recent literature in political science examines foreign intervention aimed at improving (or impairing, as the case may be) the quality of electoral procedures in target countries and the conflict between this high-minded motive and other geopolitical objectives of the influencer (see, for example, [Hyde, 2011](#); [Bush, 2012](#); [Donno, 2013](#)). [Bubeck and Marinov \(2017\)](#) and [Bubeck et al. \(2022\)](#) synthesize this tension with a model in which foreign powers can both intervene in the conduct of elections (“process” interventions) and intervene in favor of their preferred candidates (“candidate” interventions). These works show that the ideological positions of electoral candidates in target countries are an important driver of foreign influence. Our model embraces this observation as policy divergence between domestic candidates is necessary to observe foreign influence in equilibrium. We add to this existing work an entirely new element: the policy position (ideology) of the incumbent foreign influencer also needs to be considered. While, in existing work, the utility of the foreign power is taken for granted, we show that careful consideration of distributive domestic issues in the foreign power determine the direction of foreign influence, as mediated by capital mobility. We thus provide a microfoundation for foreign influence which is novel and explains ideological affinity.

Policy Diffusion At a broad level, our work connects with the voluminous literature on policy diffusion in political science, which examines the spread of ideas, policies, and behaviors across political systems and actors. It explores how innovations, norms, and practices are transmitted, adopted, and adapted within and between political contexts. A particularly influential contribution is the work of [Simmons and Elkins \(2004\)](#), who discuss two broad classes of diffusion mechanisms: one in which foreign policy adoptions alter the benefits of adoption for others and another in which these adoptions provide information about the costs or benefits of a particular policy innovation.⁷ In our theoretical model, rather than diffusion occurring through conventional channels, such as policy emulation or social learning, it takes place via foreign influence, which can be seen as a form of coercion. In their broad overview of the policy diffusion literature, [Dobbin et al. \(2007\)](#) discuss coercion theories of policy diffusion, and describe them as emphasizing the role of “powerful nation-states, and international financial institutions, that threaten sanctions or promise aid in return for fiscal conservatism, free trade, etc.” This coercion approach to

⁷An interesting contribution by economists to learning as a mechanism of diffusion is offered by [Buera et al. \(2011\)](#).

policy diffusion connects with Marxist thought, and in particular with Lenin’s theory of imperialism (see [Lenin, 1917](#)). Our approach is closest in spirit to this coercion approach but we do not limit attention to influence activities carried out by right-wing or pro-capital parties.⁸

Capital Mobility, Ideology, and Policy It has long been recognized that capital mobility affects domestic tax policy. Strategic interactions between governments can create a “race to the bottom” in which taxes on mobile factors are bid down, leading to inefficiently low levels of public revenues and thus poor public good provision.⁹ Our model allows governments to tax (immobile) labor income in addition to capital which means that tax policy is mostly about the distribution of tax burden between the two factors, hence the importance of considering ideology. In this vein, our approach contributes to a recent literature which emphasizes the ideological underpinnings of FDI policy. Indeed, inflows of FDI should increase labor income and hence left-wing governments are predicted to welcome FDI (see, for instance [Pinto and Pinto, 2008](#); [Pandya, 2010](#); [Pinto, 2013](#); [Pond, 2018a](#)). Our model also displays this mechanism, as inward capital flows increase wages when capital is scarce. In addition, as left-wing governments are interested in shifting the tax burden onto capital, they have yet another reason to want high capital stocks in the country. Crucially, we consider the implications of these forces for foreign influence. It is precisely because left-wing governments are interested in inward flows of capital that they produce foreign influence: if they manage to get a fellow left-wing government elected in a neighboring country, capital taxes there will increase leading to capital reallocation towards the domestic economy.

There is also a literature that examines the interaction between capital mobility and the political nature of a regime. Dictators and masses have lower bargaining power against capital-owning elites when capital is mobile, hence democratization is more likely under such circumstances and an open capital account can serve as a commitment device to low capital taxation or expropriation (see [Bates and Lien, 1985](#); [Freeman and Quinn, 2012](#); [Gao, 2022](#)).¹⁰ We add to this literature that capital mobility serves as a powerful motivator for foreign interventions that can result in regime change. More specifically, *pro-capital*

⁸[Quinn and Toyoda \(2007\)](#) empirically studies the role of ideology in the spread of financial globalization, but their focus is not on coercion mechanisms.

⁹Seminal contributions to that literature include the informal discussion in [Oates \(1972\)](#) and the formal models in [Wilson \(1986\)](#) and [Zodrow and Mieszkowski \(1986\)](#). See [Hatfield and Padró i Miquel \(2012\)](#) for a recent contribution. As pointed out by [Vogel \(1997\)](#) and subsequent work on the California effect (see, for instance [Vogel and Kagan, 2004](#)), international competition can in some cases lead to a race to top rather than a race to the bottom in regulatory policies.

¹⁰While [Pond \(2018b\)](#) distinguishes between redistribution and expropriation, with the latter benefitting regime elites, in our framework this distinction is moot (see Section 8.1).

foreign incumbents are motivated to induce regime change if democratic home politics result in dramatically lower capital returns. As we discuss in Section 8.1, the experiences in Iran, Guatemala and Chile are all consistent with this phenomenon.

Ideology and Electoral Competition By emphasizing the role of ideology in electoral competition, we naturally also connect with the political economy literature on this topic. [Alesina \(1988\)](#) showed how a lack of commitment would drive ideologically motivated candidates to announce and later implement distinct policies in the run up to an election, even when they are largely motivated to win the election. This lack of commitment is also a feature of the political equilibrium in our baseline model, but we will also demonstrate the robustness of our main insights to alternative assumptions on commitment, along the lines of [Wittman \(1983\)](#). By emphasizing the role of capital taxation as a redistributive tool, our work also relates to the seminal work of [Alesina and Rodrik \(1994\)](#). Relative to their work, we introduce international capital mobility (theirs is a closed-economy model), but we do not study the implications of our framework for economic growth. The interplay between ideology and redistribution in an open-economy environment has been studied by [Dutt and Mitra \(2005\)](#), but their focus is on trade policy choices, and their work does not consider the role of foreign influence.¹¹

3 A Model of Taxation with Capital Mobility

Our framework shares many features with standard models of tax competition (see [Wilson, 1986, 1991](#)). Governments raise income taxes to finance a public good in an environment in which income is generated in part by factors that are internationally mobile. Our introduction of taxes on immobile factors will however eliminate the standard public good underprovision result in that literature, and will allow us to focus attention on the distinctive aspects of our model.

3.1 Economic Environment

The world consists of N large countries indexed by i . Each country i is endowed with \bar{K}_i units of capital and \bar{L}_i units of labor. Capital is in the hands of a set of ‘capitalists’, who for simplicity do not supply labor, while \bar{L}_i is uniformly distributed among a set of ‘workers’, who for simplicity do not own capital. Capital is freely mobile across countries but labor is internationally immobile.

¹¹A branch of the literature on foreign influence mentioned above and reviewed in [Aidt et al. \(2021\)](#) has studied how foreign lobbying shapes trade policy ([Hillman and Ursprung, 1988](#); [Gawande et al., 2006](#)).

There are two goods consumed in each country i : a non-tradable public good G_i and a private consumption good Y_i which is produced under a neoclassical production technology that combines capital and labor. In particular, we have

$$Y_i = F_i(K_i, L_i),$$

where $F_i(K_i, L_i)$ features positive but diminishing marginal products. The public good is financed with a combination of a per-unit tax τ_i^L on labor and a per-unit tax τ_i^K on capital. The provision of public goods does not use any other resources. The private consumption good is freely traded across countries and we set its price to 1 worldwide.

Preferences are such that the joint utility of all agents of type $s = k, \ell$ is given by

$$U_i^s = \begin{cases} C_i^k & \text{if } s = k \\ C_i^\ell + v_i(G_i) & \text{if } s = \ell \end{cases}, \quad (1)$$

where superscripts k and ℓ denote capitalists and workers, respectively. Equation (1) indicates that all agents derive utility from consuming the private good, while workers in addition derive utility from the provision of the public good. This assumption can be interpreted as capitalists having a strict preference for privately provided goods over publicly provided goods.¹² We assume that the function v_i is twice differentiable, increasing and concave, i.e., $v_i' > 0$; $v_i'' < 0$.

3.2 Economic Equilibrium For Given Taxes

Given taxes τ_i^K and τ_i^L for all i , equilibrium in the world economy entails (i) consumers and firms optimizing worldwide, (ii) goods and factor markets clearing, and (iii) each government running a balanced budget. In this static model, consumers in i spend all of their income on the consumption good Y_i , so their optimization immediately implies good-market clearing, and C_i^s for each group $s = k, \ell$ is equal to the joint income of that group.

Firms hire capital and labor up to the point at which the marginal product of these factors equals their marginal cost. This implies that the remuneration per unit of capital is given by

$$r_i = r = \frac{\partial F_i(K_i, \bar{L}_i)}{\partial K_i} - \tau_i^K, \text{ for all } i = 1, \dots, N, \quad (2)$$

where, by setting $r_i = r$ for all i , we already impose perfect international capital mobility.

¹²It is straightforward but algebraically tedious to extend the analysis to the case in which the preferences for capitalists are also affected by the level of G_i .

The remuneration per unit of labor net of taxes is in turn given by

$$w_i = \frac{F_i(K_i, \bar{L}_i)}{\bar{L}_i} - \left(r + \tau_i^K\right) \frac{K_i}{\bar{L}_i} - \tau_i^L, \text{ for all } i = 1, \dots, N. \quad (3)$$

Notice that in equations (2) and (3), we already impose labor-market clearing (by setting $L_i = \bar{L}_i$), but we allow for $K_i \neq \bar{K}_i$, so that a country may import or export capital. At the global level, capital-market clearing imposes:

$$\sum_{j=1}^N K_j = \sum_{j=1}^N \bar{K}_j. \quad (4)$$

Government budget balance finally imposes

$$G_i = \tau_i^K K_i + \tau_i^L \bar{L}_i.$$

The only equilibrium objects are the global return to capital r , the vector of wages $\mathbf{w} = (w_1, \dots, w_N)$, and the vector of capital stocks $\mathbf{K} = (K_1, \dots, K_N)$. They can all be solved from equations (2), (3), and (4). With these equilibrium objects at hand, and noting $Y_i^k = r\bar{K}_i$ and $Y_i^\ell = w_i\bar{L}_i$, we can compute aggregate welfare for workers as

$$U_i^\ell = w_i\bar{L}_i + v_i(G_i) = F(K_i, \bar{L}_i) - \left(r + \tau_i^K\right) K_i - \tau_i^L \bar{L}_i + v_i(G_i), \quad (5)$$

and for capitalists as

$$U_i^k = r\bar{K}_i. \quad (6)$$

3.3 Effects of Taxes

We next study how changes in labor and capital taxes affect the equilibrium of the model. Notice that equations (2) and (4) uniquely pin down the allocation of capital across countries as well as the worldwide return to capital. As a result, these equilibrium objects are independent of labor taxes τ_i^L . An increase in a labor tax τ_i^L only raises the provision of public goods G_i in country i at the cost of reducing the remuneration of labor. This occurs because labor is supplied inelastically, so it bears the full incidence of taxes levied on it.

Conversely, the effects of capital taxes are much richer. Totally differentiating equations (2) and (4), it is straightforward to verify that:

Proposition 1. *When a country i raises its tax τ_i^K on capital, it (i) depresses the global return to capital r , (ii) decreases the capital stock K_i in country i , and (iii) increases the*

capital stock K_j in all other countries $j \neq i$.

Proof. See Appendix A.1.

This proposition summarizes the nature of cross-border policy externalities in our framework. A higher capital tax in any (non-negligible) country decreases the world return to capital, while also leading to capital outflows from this country to all other countries in the world. In other words, in our model, any attempt to have capitalists contribute to funding public goods is met with capital flight towards lower-tax jurisdictions. This tax-induced capital reallocation, however, reduces returns to capital worldwide.

4 Political Economy: Optimal Policies and Ideology

Having described our economic environment, we now turn to policy determination in the presence of political economy constraints. For the time being, we focus on the choices of an incumbent government that is not constrained by any electoral promises and that is not subject to foreign influence forces. We shall relax these assumptions below.

We will solve for optimal tax policy by an incumbent government that sets taxes on capital and labor to maximize a weighted sum of capitalists' and workers' welfare. We take this as a reduced form of a political process in which policy makers might put a different weight on different agents in society. We will be much more explicit about this political game in Section 6.

In particular, suppose that τ_i^L and τ_i^K are chosen to maximize $W_i(\beta_i) = U_i^\ell + \beta_i U_i^k$ or

$$W_i(\beta_i) = F(K_i, \bar{L}_i) - (r + \tau_i^K) K_i - \tau_i^L \bar{L}_i + v(\tau_i^K K_i + \tau_i^L \bar{L}_i) + \beta_i r \bar{K}_i. \quad (7)$$

Parameter β_i captures the ideology of the government in the distributive spectrum. For this reason, we shall denote a government with a high β_i as being *pro-capital* and a government with a low β_i as being *pro-labor*.

Our first result is that the level of provision of public goods is independent of ideology β_i . In particular, because r and \bar{K}_i are independent of τ_i^L , the first-order-condition for the choice of τ_i^L is given by

$$\frac{dW_i(\beta_i)}{d\tau_i^L} = -\bar{L}_i + v'(G_i) \bar{L}_i = 0, \quad (8)$$

which implies

$$v'(G_i^*) = 1. \quad (9)$$

Because labor is supplied inelastically, labor taxes are non-distortionary. Hence, governments

of all ideologies set them at a level that ensures that public good provision is efficient.¹³

Proposition 2. *The public good G_i is provided at the same level regardless of the ideology β_i of the incumbent government.*

By allowing governments to tax labor we shut down the main concern in the ‘race to the bottom’ literature, as governments in our model are always able to finance G_i .

This result does not imply, however, that *how* G_i is financed is independent of the preferences of the policy maker. To see this, consider the first-order condition associated with the choice of τ_i^K . Invoking equations (2) and (9), we can express the derivative of $W_i(\beta_i)$ in equation (7) with respect to τ_i^K as

$$\frac{dW_i(\beta_i)}{d\tau_i^K} = \underbrace{-\left(1 + \frac{dr}{d\tau_i^K}\right) K_i}_{dw_i/d\tau_i^K} + \underbrace{v'(G_i) \left(\tau_i^K \frac{dK_i}{d\tau_i^K} + K_i\right)}_{dv(G_i)/d\tau_i^K} + \beta_i \frac{dr}{d\tau_i^K} \bar{K}_i \leq 0. \quad (10)$$

The first term indicates that an increase in the capital tax τ_i^K has a direct negative impact on the wage received by workers ($dw_i/d\tau_i^K < 0$) due to the capital flight this tax induces, although such a negative effect is tampered by the reduction in the return to capital caused by that tax.¹⁴ The second term is associated with the increase in welfare for workers resulting from the larger funding for the public good which is born by taxes on capital, valued at the marginal utility of the public good ($dv(G_i)/d\tau_i^K > 0$).¹⁵ The third and final term reflects the negative impact of the capital tax on the welfare of capitalists on account of the lower return to capital.

Plugging equation (9) into (10), the first-order condition for the choice of τ_i^K can be written more compactly as:

$$\frac{dW_i(\beta_i)}{d\tau_i^K} = \tau_i^K \frac{dK_i}{d\tau_i^K} + \frac{dr}{d\tau_i^K} (\beta_i \bar{K}_i - K_i) \leq 0; \quad \tau_i^K \geq 0, \quad (11)$$

with complementarity slackness. We have established in Proposition 1 that $dK_i/d\tau_i^K < 0$,

¹³The resulting level of public good provision G_i^* is identical to the one that would be set by a utilitarian social planner absent capital mobility. Without capital mobility and with $\beta_i = 1$, we have

$$U_i^L + U_i^K = F(\bar{K}_i, \bar{L}_i) - \tau_i^K \bar{K}_i - \tau_i^L \bar{L}_i + v_i(\tau_i^L \bar{L}_i + \tau_i^K \bar{K}_i),$$

and thus both the choice of τ_i^L or τ_i^K ensure that $v'(G_i^*) = 1$. In that case, the utilitarian planner sees capital and labor taxes as perfect substitutes because, without capital mobility, capital is as inelastically supplied as labor.

¹⁴In Appendix A.1, we show that $-1 < dr/d\tau_i^K < 0$, so this first term is negative.

¹⁵This term is positive because country i should naturally operate on the left part of the Laffer curve, so $\tau_i^K K_i$ rises with τ_i^K .

so the first term in (11) cannot possibly be positive due to capital flight. However, by the same Proposition 1, $dr/d\tau_i^K < 0$, the sign of the second term in (11) crucially depends on the relative magnitude of $\beta_i \bar{K}_i$ and K_i . Let us consider the two possible scenarios.

First, if $\beta_i \bar{K}_i > K_i$, we necessarily have that the second term in (11) is negative, and thus $dW_i(\beta_i)/d\tau_i^K < 0$ for any τ_i^K . This in turn implies (given complementarity slackness) that the optimal tax on capital is 0. Countries with a high initial capital endowment are more likely to opt for zero capital taxation, but notice that such a policy may also be optimal for pro-capital governments in capital-scarce countries. In fact, we have that:

Proposition 3. *Regardless of its endowments, a sufficiently pro-capital government will necessarily set a zero tax on capital $\tau_i^K = 0$ and a labor tax satisfying $v'(\tau_i^L \bar{L}_i) = 1$.*

Proof. This amounts to showing that, for any \bar{K}_i , there always exists a threshold β_i^* such that $\beta_i \bar{K}_i > K_i$ for $\beta_i > \beta_i^*$. But $K_i < \sum_{j=1}^N \bar{K}_j$, so $\beta_i^* = (\sum_{j=1}^N \bar{K}_j) / \bar{K}_i$ is one such threshold.

Although a capital-importing country's utilitarian welfare (i.e., $W_i(\beta_i)$ for $\beta_i = 1$) would increase with a positive capital tax (see Hamada, 1966), this would come at the cost of lower welfare for capitalists, and thus a sufficiently pro-capital government abstains from taxing capital at all even when its country imports some capital.

In the second case in which $\beta_i \bar{K}_i < K_i$, the second term in (11) is necessarily positive and the optimal tax on capital becomes positive and given by

$$\tau_i^K = \frac{1}{\sum_{j \neq i}^N \frac{1}{-F_j^{KK}}} (K_i - \beta_i \bar{K}_i). \quad (12)$$

From this expression, it is then immediate to see that:

Proposition 4. *Regardless of its endowments, a sufficiently pro-labor government will necessarily set a positive capital tax given by (12) and a labor tax satisfying $v'(\tau_i^K K_i + \tau_i^L \bar{L}_i) = 1$.*

Proof. For $\beta_i \rightarrow 0$, $K_i > \beta \bar{K}_i$, and thus τ_i^K in (12) is necessarily positive.

A pro-labor government is particularly concerned with the welfare of workers, and thus is willing to use a positive capital tax as a redistributational tool even in circumstances (i.e., when the country exports capital) in which a utilitarian planner would choose a zero capital tax. Although a higher capital tax reduces both gross wages (for a given τ_i^L) and the return to capitalists, the fact that the provision of public goods is pinned down by

the condition $v'(G_i^*) = 1$ implies that an increase in τ_i^K necessarily lowers τ_i^L , and thus increases net-of-tax wages on that account. Intuitively, while capital taxes induce some capital flight which reduces wages, workers may benefit because the revenue raised allows the government to reduce labor taxes. For a small enough capital tax, this latter effect necessarily dominates, so there necessarily exists a positive capital tax that increase the welfare of workers (and thus of a sufficiently pro-labor government).¹⁶

Although Propositions 3 and 4 have focused on the polar cases of a very high or a very low β_i , it is straightforward to see from equation (12) that whenever the capital tax τ_i^K is positive and unique, its level is monotonically decreasing in pro-capital ideology β_i (see Appendix A.1).

5 Cross-Border Externalities of Taxes

To build the ground work for our analysis of foreign influence, we next study how the choices of capital and labor taxes in a given country (which we denote by *Home* and associate with *H* subscripts) affect the welfare in another country, as perceived by its government (which we denote by *Foreign* and associate with *F* subscripts). We are particularly interested in analyzing how the sign of this effect is mediated by the ideology of the government of this Foreign country. We begin the analysis with the general welfare function in (7), and we will later study particular cases.

A first straightforward observation is that labor taxes at Home generate *no externalities* in other countries because, as argued above, they have no bearing on the equilibrium return to capital or on the allocation of capital across countries.

Turning to the cross-border effects of capital taxes, we first note that totally differentiating equation (7), we obtain:

$$\frac{dW_F(\beta_F)}{d\tau_H^K} = \tau_F^K \frac{dK_F}{d\tau_H^K} + \frac{dr}{d\tau_H^K} (\beta_F \bar{K}_F - K_F). \quad (13)$$

There are two effects at play in this equation, which jointly determine the overall sign of $dW_F(\beta_F)/d\tau_H^K$. First, an increase in the home capital tax τ_H^K shifts capital toward the Foreign country ($dK_F/d\tau_H^K > 0$ as shown in Proposition 1), and this increases the tax base in Foreign, thus enhancing the funding for public goods in Foreign: this is the first term in the first-order-condition in (13) and it is necessarily non-negative. The second effect works through the impact of the increase in τ_H^K on the world return to capital r . The increase in

¹⁶The uniqueness of this optimal capital tax can be established by placing additional assumptions on the third derivative of the production function $F_i(K_i, \bar{L}_i)$ (see Appendix A.1).

τ_H^K necessarily lowers r (see Proposition 1) but whether that is beneficial or detrimental to the Foreign country depends on (i) whether Foreign imports or exports capital, and (ii) whether the Foreign government’s ideology is pro-capital or pro-labor (i.e., how high is β_F).

Remember from Proposition 3 that when β_F is sufficiently high, $\tau_F^K = 0$, and the first term vanishes. At the same time, the second term necessarily becomes negative when β_F is high. Thus $dW_F(\beta_F)/d\tau_H^K$ is necessarily negative for a sufficiently pro-capital government in Foreign. Intuitively, a pro-capital government does not tax capital, so attracting a higher tax base is irrelevant for the provision of public goods. Furthermore, such a government is particularly concerned with maximizing the return to capitalists, and hence it wants low capital taxes worldwide.

Conversely, when β_F is sufficiently low, by Proposition 4 we have that $\tau_F^K > 0$, while at the same time $\beta_F \bar{K}_F < K_F$. In such a case, $dW_F(\beta_F)/d\tau_H^K$ becomes a sum of two positive terms. Intuitively, a pro-labor government values the ability to tax capital, and thus will be concerned with relatively lower capital taxes at Home leading to capital flight from its country, thus eroding its tax base. Furthermore, low capital taxes at Home will also increase the return to capital and will thus tilt the distribution of income against Foreign workers.

In sum, we have that:

Proposition 5. *An increase in another country’s capital tax reduces welfare as perceived by a sufficiently pro-capital government, while it increases welfare as perceived by a sufficiently pro-labor government.*

Naturally, whether the capital taxes set by these other countries (Home in our example above) are higher or lower is a function of the identity of the incumbent government in those other countries. Proposition 5 thus hints at the existence of an incentive for governments to ‘export’ their ideology. Pro-capital governments want other governments to also be pro-capital and set low capital taxes, while pro-labor governments want other governments to also be pro-labor and set high capital taxes.

In our baseline we have focused on a model in which a public good is financed with capital taxes and labor taxes, and these instruments are the only ones at hand to redistribute utility across capitalists and workers. In Section 8.1, we will demonstrate that our main results in Propositions 1–5 apply in alternative settings in which capital is not taxed, but it may be expropriated. We will also show that our analysis is largely isomorphic to a more general case in which the distribution of income between capitalists and workers is shaped by other policies such as minimum wage legislation.

6 Political Equilibrium with No Foreign Influence

So far, we have only shown that policies that affect the distribution of income between capital and labor generate cross-border externalities that make countries benefit from other countries sharing their pro-capital or pro-labor bias. In Section 7, we will study more explicitly how these forces generate an incentive to export ideology, and how foreign influence activities shape policies worldwide, but before doing so, in this section we introduce our political game for the baseline case *without* foreign influence.

6.1 Political Structure and Voter Preferences

For that purpose, we build on a simplified version of the probabilistic voting model of foreign influence in [Antràs and Padró i Miquel \(2011\)](#).¹⁷ There is an election coming up in one of the countries, denoted by Home, the outcome of which is uncertain. Two parties run in that election: a Home pro-capital party (denoted with the subscript \mathcal{R}) and a Home pro-labor party (denoted with the subscript \mathcal{L}). Although parties may announce certain policies in the run-up to the election, voters understand that parties will ex-post set these policies at the level that maximizes their welfare given their ideology. We thus follow [Alesina \(1988\)](#) in assuming that electoral candidates cannot credibly commit to policies before they are elected. Voters anticipate that if the pro-capital party wins the election, it will set capital and labor taxes equal to $\tau_{H\mathcal{R}}^K$ and $\tau_{H\mathcal{R}}^L$ to maximize $W_H(\beta_{H\mathcal{R}})$ in equation (7), with that pro-capital party being associated with a relatively high value $\beta_{H\mathcal{R}}$ of β_H . Conversely, if the pro-labor party wins the election, it will implement capital and labor taxes equal to $\tau_{H\mathcal{L}}^K$ and $\tau_{H\mathcal{L}}^L$ to maximize $W_H(\beta_{H\mathcal{L}})$, with that party featuring a relatively low value $\beta_{H\mathcal{L}}$ of β_H .

The Home country is populated by a unit measure of individuals, a fraction κ of which are ‘capitalists’ (denoted with k subscripts), and the remaining fraction $1 - \kappa$ are workers (denoted with ℓ subscripts). If candidate $c \in \{\mathcal{R}, \mathcal{L}\}$ wins the Home election, capitalists and workers obtains a welfare level

$$U_{Hc}^s = \begin{cases} w_H(\tau_{Hc}^K, \tau_{Hc}^L) \bar{L}_H + v_H(G_{Hc}) + \sigma_{Hc}^k & \text{if } s = k \\ r(\tau_{Hc}^K) \bar{K}_H + \sigma_{Hc}^\ell & \text{if } s = \ell \end{cases} . \quad (14)$$

This expression is identical to (1) – after plugging in (5) and (6) – except for the fact that we now allow taxes to be a function of the winning party, and for the new term σ_{Hc}^s for $s = \{k, \ell\}$. This term reflects the standard assumption in probabilistic voting models,

¹⁷See [Persson and Tabellini \(2000\)](#) for a textbook treatment of the [Lindbeck and Weibull \(1987\)](#) classic framework.

that voters perceive candidates to differ in dimensions that are independent of their policy proposals. In particular, voters may care about characteristics such as competence, honesty or simply personal appeal and charisma. The term σ_{Hc}^s captures the additional utility due to these attributes that capitalists ($s = k$) and workers ($s = \ell$) enjoy at Home (or expect to enjoy at the time of casting the ballot, since σ_{Hc}^s contains many uncertain and subjective components) when party c is in power. We define by $\sigma_H^s \equiv \sigma_{HR}^s - \sigma_{HL}^s$ the bias due to non-policy dimensions that Home capitalists ($s = k$) and Home workers ($s = \ell$) have in favor of party \mathcal{R} at the time of casting the ballot.

Since perceptions can be affected both by deterministic and random elements, we model these biases as

$$\sigma_H^s = \rho_H + \xi_H^s \quad \text{for } s = \{k, \ell\},$$

where ρ_H is the deterministic part of the bias and where ξ_H^s is distributed uniformly in the interval $[-\frac{1}{2\gamma_H^s}, \frac{1}{2\gamma_H^s}]$.¹⁸ The higher is γ_H^s , the lower is the variance of the idiosyncratic shocks for group $s = \{k, \ell\}$, and the more will preferences be shaped by the impact of policies on welfare as well as by the deterministic part of the bias. Given the zero mean of ξ_H^s , the expected value of the difference $\sigma_{HR}^s - \sigma_{HL}^s$ is simply equal to ρ_H , and thus ρ_H is the *expected* pro-capital bias at Home. Note that ρ_H can take positive or negative values, and that we assume that this pro-capital bias is the same for capitalists and workers. Perhaps a more natural assumption would have been to let this bias be higher for capitalists than for workers, but this is not necessary for our results, and having a common ρ_H simplifies the derivations below.

To summarize, the timing of events in the model is as follows:

- ($t = 1$) The Home pro-capital and pro-labor parties announce a policy platform $(\tau_{Hc}^K, \tau_{Hc}^L)$ for $c = \mathcal{R}, \mathcal{L}$.
- ($t = 2$) The values of ξ_H^K and ξ_H^L are realized.
- ($t = 3$) Elections occur.
- ($t = 4$) Regardless of any electoral promises, the winning party implements a pair of policies to maximize $W_H(\beta_{Hc})$ in equation (7) where $\beta_{HR} > \beta_{HL}$.

¹⁸In assuming a uniform distribution, we follow the bulk of the probabilistic voting literature. This distributional assumption ensures the existence of an equilibrium and considerably simplifies the analysis.

6.2 Political Equilibrium

Notice that given the lack of commitment associated with electoral announcements, the only policies that can be credibly announced at stage $t = 1$ are those implemented at stage $t = 4$, which we have characterized above in Section 4. From Proposition 2, we know that both parties will set a common level of public good provision, and thus $v_H(G_{HR}) = v_H(G_{HL})$. Furthermore, from Proposition 3, if the pro-capital party is sufficiently pro-capital, it will necessarily set $\tau_{HR}^K = 0$, while from Proposition 4, if the pro-labor party is sufficiently pro-labor, it will necessarily set $\tau_{HL}^K > 0$.

Anticipating these policies, voters will vote for the party that offers them a higher welfare level, considering both the implications of these policies for their real income, as well as their non-policy idiosyncratic preferences. As we show in Appendix A.2, we can summarize the electoral outcome as follows:

Proposition 6. *The pro-capital party will win the Home election with probability*

$$\mathbb{P}_{HR} = \frac{1}{2} + \Delta_H^u + \chi_H \rho_H, \quad (15)$$

and the pro-labor capital will win with the complementary probability $1 - \mathbb{P}_{HR}$, where ρ_H is the expected pro-capital bias at Home, and where Δ_H^u and χ_H are given by

$$\Delta_H^u \equiv \kappa \gamma_H^K \left(r(\tau_{HR}^K) - r(\tau_{HL}^K) \right) \bar{K}_H + (1 - \kappa) \gamma_H^L \left(w_H(\tau_{HR}^K, \tau_{HR}^L) - w_H(\tau_{HL}^K, \tau_{HL}^L) \right) \bar{L}_H$$

and

$$\chi_H \equiv \kappa \gamma_H^K + (1 - \kappa) \gamma_H^L,$$

respectively.

Proof. See Appendix A.2.

This Proposition summarizes how the electoral outcome depends on voters' perceptions of how the two parties' policies affect their welfare (as captured by the term Δ_H^u), as well as on the non-policy preferences of voters for the pro-capital or pro-labor party (as reflected in the term $\chi_H \rho_H$). The first term Δ_H^u combines the positive effect of \mathcal{R} being elected on the return to capital $r(\tau_{HR}^K) > r(\tau_{HL}^K)$ and its negative impact on net wages $w_H(\tau_{HR}^K) < w_H(\tau_{HL}^K)$.¹⁹ The balance of these two effects is in turn shaped by the share κ

¹⁹Note that $\tau_{HR}^K < \tau_{HL}^K$ implies $r(\tau_{HR}^K) > r(\tau_{HL}^K)$. Furthermore, the capital tax set by a lower β_H party (i.e., the Left), is closer to the capital tax that maximizes wages, with the latter corresponding to the case $\beta_H \rightarrow 0$. Thus, $w(\tau_{HR}^K) < w(\tau_{HL}^K)$.

of capitalists in the population, as well as the relative sensitivity of capitalists and workers to policy-related welfare, as captured by the relative value of γ_H^K and γ_H^L . These same parameters also shape the impact of the deterministic pro-capital bias of voters on the electoral outcome, as captured in the definition of χ_H .

7 Exporting Ideology

As discussed in Section 5, the outcome of the election in the Home country is relevant to other countries because capital taxes at Home generate externalities on other countries. We now allow the incumbent of one of these other countries, referred to as Foreign, to take actions that aim at manipulating electoral results at Home.

The real-world variety of foreign influence actions that governments take is considerable. They range from public statements in which positive inducements and dire consequences are conditioned onto the outcome of the upcoming elections, to various forms of public image-burnishing events such as well-publicized state visits, to financial or otherwise sponsorship of elements of a candidate’s campaign. For example, as elections in Taiwan approach, China routinely makes statements which openly support the KMT party and decry the consequences of a victory for pro-independence candidates. Similarly, the European Union has often made it clear that the result of an upcoming election in a country applying for EU membership will have consequences for the membership process.²⁰ In Italy, the American government became financially embroiled for decades as it furnished support for the Christian Democrats – Gaddis (1987).

The dataset assembled by Bubeck and Marinov (2019) provides some guidance as to the relative frequency of these strategies. As mentioned in the Introduction, between 1946 and 2012, about two-thirds of competitive elections were subject to some form of foreign intervention. Around 45% of these influence operations consisted of public endorsements and photo-ops. Direct campaign help, including financial support and propaganda operations, also occurred frequently, in 31% of influenced elections. Finally, in 25% of cases, rewards and punishments were publicly tied to the outcome of elections.

Following Antràs and Padró i Miquel (2011) and Bubeck and Marinov (2017), we capture this wide variety of foreign influence operations in a reduced-form manner by assuming that these costly actions affect the opinion that voters have of their candidates in the foreign

²⁰See, for instance, “Western officials have told the Slovaks unambiguously that they can forget about joining the western military alliance and the EU if they return the strongman former prime minister Vladimir Meciar to power.” The Guardian, September 19, 2002.

country, as captured by the non-policy pro-capital bias ρ_H .²¹ To link ρ_H to the actions of the Foreign government in the simplest possible way, we let $\rho_H = e_F$, and assume that exerting an effort level e_F to influence the Home election entails a cost $\frac{1}{2\phi_F} (e_F)^2$, where a low value of ϕ_F reflects that Foreign is relatively inefficient at inflicting international pressure. Note that we let e_F take either positive or negative values, so foreign influence can be favorable or detrimental for the electoral prospects of the pro-capital party at Home.

The timing of events of this expanded game with foreign influence is identical to the one without foreign influence except that we now introduce a period $t = 1.5$ – after the parties announce their policies but before ξ_H^k and ξ_H^ℓ are realized – in which the incumbent party in Foreign decides how much effort e_F to exert with the goal of affecting the electoral outcome at Home. Because the two parties at Home cannot commit to policies during the electoral campaign, foreign influence can only shape *who* gets elected rather than which policies are ex-post implemented. We will relax this assumption in Section 8.4 and study a variant of the model with commitment, which generates richer effects of foreign influence.

With these assumptions, the Foreign incumbent will choose a foreign influence level e_H that maximizes its expected welfare inclusive of effort costs, which is given by

$$\tilde{W}_F(\beta_F) = \left(\frac{1}{2} + \Delta_H^u + \chi_H e_F\right) W_F(\beta_F; \tau_{HR}^K) + \left(\frac{1}{2} - \Delta_H^u - \chi_H e_F\right) W_F(\beta_F; \tau_{HL}^K) - \frac{1}{2\phi_F} (e_F)^2, \quad (16)$$

where $W_F(\beta_F; \tau_{HR}^K)$ and $W_F(\beta_F; \tau_{HL}^K)$ are evaluated according to expression (7), and where $(1/2)(e_F)^2/\phi_F$ is the cost of exerting foreign influence.

Given our assumption on the lack of commitment regarding tax choices, foreign influence has no direct impact on the ex-post implemented policies τ_{HR}^K and τ_{HL}^K at Home. Furthermore, although the Foreign tax choice τ_F^K of the incumbent government affects the size of Δ_H^u , the same lack of commitment implies that Home voters understand that τ_F^K will eventually be set to maximize Foreign welfare, regardless of any announcements made by the Foreign government in the run-up of the Home election. Thus, foreign policy announcements are powerless in influencing the Home election, and therefore e_F is the *only* foreign influence lever available to the Foreign incumbent.

Straightforward differentiation of equation (16) indicates that the optimal influence effort of the Foreign country is given by

$$e_F = \chi_H \phi_F \left[W_F(\beta_F; \tau_{HR}^K) - W_F(\beta_F; \tau_{HL}^K) \right]. \quad (17)$$

²¹Our approach in Antràs and Padró i Miquel (2011) built in turn on the work on special interest groups by Baron (1994) and Grossman and Helpman (1996). Relative to those papers, we assume that the value of ρ_H can be affected by foreign governments as opposed to domestic lobbies.

If the Foreign incumbent perceives a higher welfare when the right wins the election at Home, it will try to influence that foreign election such that the right wins (or $e_F > 0$). Conversely, if the Foreign incumbent perceives a higher welfare when the left wins in j , e_H will instead be set at a negative value, so Foreign will try to influence Home’s election in favor of the left. The specific level of exerted influence is also shaped by the sensitivity of Home voters to such an influence (as captured by χ_H) and by the technology of Foreign in that activity (as reflected in ϕ_F).

Crucially, whether the Foreign incumbent perceives a higher welfare when the pro-capital party wins the election at Home depends on its own ideological orientation. As shown in Proposition 5, if the Foreign incumbent is sufficiently pro-capital, it will certainly prefer that the pro-capital party wins the Home election, as this will result in lower capital taxes at Home. More formally, we necessarily have that $W_F(\beta_F; \tau_{HR}^K) > W_F(\beta_F; \tau_{HL}^K)$ for a sufficiently high β_F . As a result, a sufficiently pro-capital Foreign government will have an incentive to carry out foreign influence to attempt to ‘export’ its ideology and enhance the chances that the Home government also ends up being ruled by a pro-capital party.

Conversely, if the Foreign incumbent is sufficiently pro-labor, Proposition 5 instead indicates that if the pro-capital party wins the Home election, Foreign welfare as perceived by the Foreign incumbent will go down (or $W_F(\beta_F; \tau_{HR}^K) < W_F(\beta_F; \tau_{HL}^K)$ for a sufficiently low β_F). Thus, a sufficiently pro-labor Foreign government will also have an incentive to ‘export’ its ideology abroad to try to increase the likelihood that the Home government also ends up being ruled by a pro-labor party.

We summarize this discussion as follows:

Proposition 7. *A sufficiently pro-capital incumbent in a Foreign country will take actions to increase the likelihood that an election at Home is won by a pro-capital party, while a sufficiently pro-labor Foreign incumbent will instead take actions to increase the likelihood that the election at Home is won by a pro-labor party.*

Although in the next section we will extend our framework in many directions to provide a guide for future empirical analyses of foreign influence, it may be useful to outline here some of the empirical predictions of our model. The fundamental empirical contribution of this framework to the study of foreign influence is the consideration of supply effects. Past empirical work in Bubeck and Marinov (2019) find evidence that polarization in the platforms of Home parties drive foreign influence. Our framework is consistent with this phenomenon.²² We add, however, a novel insight with empirical implications: the

²²From equation (17), pro-capital incumbents’ level of foreign influence is increasing in $W_F(\beta_F; \tau_{HR}^K) -$

ideological position of the Foreign incumbent drives the direction of such influence. In other words, when foreign influence is “observable,” our model predicts that it should feature an ideological alignment, with pro-capital (respectively, pro-labor) incumbent governments favoring pro-capital (respectively, pro-labor) candidates in foreign elections. Furthermore, the level of foreign influence by pro-capital (respectively, pro-labor) incumbents should be higher, the more pro-labor (respectively, pro-capital) is the candidate in the Home election, an important refinement of the polarization hypothesis. In addition, foreign influence should also be more pronounced whenever voters are more impressionable (or sensitive to “messages” during electoral campaign), and whenever the influencing country has a disproportionately large ability at influencing (e.g., a widespread propaganda network).

In many circumstances, however, foreign influence activities remain unobserved. In those cases, our model still delivers implications distinct from existing models with or without foreign influence. In particular, our framework predicts that pro-capital parties should be more likely to win elections whenever other countries in the world (especially those with a good technology for influencing) are themselves pro-capital, with this effect being disproportionately large, the more left-leaning is the pro-labor candidate running against the candidate favored by capitalists.

Empirically, this result suggests that we should observe ideological ‘waves’ sweeping regions, as partisan victories in one country generate influence in favor of co-partisan parties in other countries.²³ The recent “pink wave” of 21st century left-wing governments in Latin America is one such continent-wide phenomenon. Beginning in 1998 with Chávez’s accession to power in Venezuela, a first pink wave included Argentina, Bolivia, Ecuador, Honduras and Nicaragua, who all elected left-wing presidents within ten years. Similarly, in Chile, Brazil, Panamá, Uruguay and Guatemala the moderate left took power in the same period. While the following decade produced some setbacks (what some dubbed a “conservative wave” which included Bolsonaro in Brazil and Macri in Argentina) the wave continued to roll through Mexico, Honduras, the return of the left in both Brazil and Argentina as well as the accession to power of Petro in Colombia, a country which had never previously elected a left-wing President.²⁴ This ‘political wave’ phenomenon is by no means limited to Latin America, as attested by the right-wing populist wave in the West, starting in the mid

$W_F(\beta_F; \tau_{HC}^K)$, with this term being larger whenever the pro-labor candidate at Home is highly pro-labor (so τ_{HC}^K is higher).

²³See Section 8.2 and Section 8.3 for a formal examination of multilateral influence and dynamic effects, respectively.

²⁴See journalistic mentions of this wave in “The ebbing of the pink tide” *The Economist*, November 16, 2015; “Resurgence of the ‘Pink Tide’? Revisiting Left Politics in Latin America ” EPW, December 23, 2019; “Latin-America’s new ‘Pink Tide’ gains pace as Colombia shifts left: Brazil up next ” Reuters, May 21, 2023.

8 Extensions and Further Empirical Predictions

Our baseline model may appear to be simplistic and restrictive in many dimensions. On the economic front, both the distribution of income (or welfare) between capitalists and workers and the cross-border effects of policies are shaped by a single instrument, namely capital taxes. On the political-economy front, we have restricted attention to instances of unilateral foreign influence involving a single election, in which the only role of foreign influence was to affect which party gets elected rather than the winning party's policies. In this section, we develop a number extensions of our framework to illustrate the wider applicability of our insights, with the goal of deriving additional empirical predictions from it. To save on space, we describe our main results informally and relegate the mathematical details to the Appendix.

8.1 Beyond Capital Taxes: Expropriation and Pure Redistribution

In our baseline we have focused on a model in which a public good is financed with capital taxes and labor taxes, and these instruments are the only ones at hand to redistribute utility across capitalists and workers. We now explore the robustness of our results to alternative settings in which (i) capital is not taxed, but it can be expropriated, and (ii) the distribution of income between capitalists and workers is shaped by policies other than the existence of public goods.

A. Capital Expropriation

Suppose that instead of taxing capital, the main policy tool affecting capital chosen by the government in country i is the probability ϕ_i^K with which capital is expropriated, with the proceeds of the expropriation used to finance the public good G_i . Firms continue to hire capital and labor up to the point at which the marginal product of these factors equals their (expected) marginal cost, so given perfect international capital mobility, the remuneration

²⁵See “[League of Nationalists](#) ” The Economist, November 19, 2016; “[Europe’s populists are waltzing into the mainstream](#) ” The Economist, February 3, 2018.

per unit of capital in country i will satisfy

$$r_i = r = (1 - \phi_i^K) \frac{\partial F_i(K_i, \bar{L}_i)}{\partial K_i}. \quad (18)$$

Analogously to Proposition 1, it is straightforward to show (see Appendix A.3) that a higher expropriation ϕ_i^K decreases the expected remuneration of capital ($dr/d\phi_i^K < 0$), but it also leads to capital outflows ($dK_i/d\phi_i^K < 0$; $dK_j/d\phi_i^K > 0$ for $j \neq i$).

Welfare of a government with bias β_i is

$$W_i(\beta_i) = U_i^\ell + \beta_i U_i^K = F(K_i, \bar{L}_i) - \frac{r}{1 - \phi_i^K} K_i - \tau_i^L \bar{L}_i + v \left(\tau_i^L \bar{L}_i + \frac{\phi_i^K}{1 - \phi_i^K} r K_i \right) + \beta_i r \bar{K}_i,$$

where note that $r/(1 - \phi_i^K)$ is the effective cost of capital faced by firms. Because labor taxes are non-distortionary, the choice of τ_i^L will again ensure that the public goods is provided at a level such that $v'(G_i^*) = 1$, just as in equation (9), regardless of the value of β_i . Hence, Proposition 2 continues to apply when a capital tax is replaced by a probability of expropriation.

Turning to the choice of this expropriation probability ϕ_i^K , straightforward differentiation indicates that this choice satisfies the following first-order condition

$$\frac{dW_i(\beta_i)}{d\phi_i^K} = \frac{\phi_i^K r}{1 - \phi_i^K} \frac{dK_i}{d\phi_i^K} + \frac{dr}{d\phi_i^K} (\beta_i \bar{K}_i - K_i) \leq 0; \quad \phi_i^K \geq 0,$$

with complementarity slackness. This condition is essentially identical to (11) and it carries the same implications. Specifically, if β_i is high enough to ensure that $\beta_i \bar{K}_i > K_i$, we necessarily have that $dW_i(\beta_i)/d\phi_i^K < 0$ for any $\phi_i^K > 0$, and thus it is optimal to never expropriate capital (or $\phi_i^K = 0$). Conversely, when β_i is low enough to ensure that $\beta_i \bar{K}_i < K_i$, the optimal expropriation rate is necessarily positive and given by

$$\phi_i^K = \frac{\frac{dr}{d\phi_i^K}}{\frac{\partial F_i(K_i, \bar{L}_i)}{\partial K_i} \frac{dK_i}{d\phi_i^K}} (K_i - \beta_i \bar{K}_i). \quad (19)$$

In sum, Propositions 3 and 4 continue to apply when a capital tax is replaced by a probability of capital expropriation, implying that a positive expropriation rate is only optimal for a sufficiently pro-labor government.

Turning to the cross-border effects of policies, notice that the impact of an increase in

the Home expropriation rate on Foreign is given by

$$\frac{dW_F(\beta_F)}{d\phi_H^K} = \frac{\phi_F^K r}{1 - \phi_F^K} \frac{dK_F}{d\phi_H^K} + \frac{dr}{d\phi_H^K} (\beta_F \bar{K}_F - K_F). \quad (20)$$

The first term in this expression is necessarily non-negative and captures the fact that an increase in the Home expropriation tax shifts capital toward the Foreign country ($dK_F/d\phi_H^K > 0$), and this increases the Foreign tax base, and thus the provision of public goods in that country. Note, however, that the size of this effect is mediated by the degree of capital expropriation in Foreign. If the Foreign government is sufficiently pro-capital, it will set a zero expropriation rate, and this first term will vanish. The second term in (20) captures the impact on Foreign welfare of the decrease in the world return to capital r caused by Home's increase in the expropriation rate ϕ_H^K . As in the case of an increase in a capital tax, whether this effect is beneficial or detrimental to the Foreign country depends on (i) whether Foreign imports or exports capital, and (ii) whether Foreign's policy-relevant welfare function is biased toward capital or labor (i.e., how high is β_F). It is then straightforward to see that the result in Proposition 5 continues to apply when a capital tax is replaced by a probability of capital expropriation. Therefore, an increase in another country's expropriation risk reduces welfare as perceived by a sufficiently pro-capital government, while it increases welfare as perceived by a sufficiently pro-labor government.

B. Purely Redistributive Policies

In our baseline model, capital was taxed and its proceeds were used to finance a public good. In this section, we show that the main (economic) results of our model survive even in the absence of a public good when focusing on policies that redistribute income from capital to labor. With that goal in mind, we now assume there is only one private (numéraire) good in the economy, produced under the same technology $Y_i = F_i(K_i, L_i)$ as in our baseline model. In the absence of any taxes or other redistribution policies, income from this good would be distributed as follows

$$Y_i = F_i(K_i, L_i) = \underbrace{\frac{\partial F_i(K_i, \bar{L}_i)}{\partial K_i} \times K_i}_{\text{capital income}} + \underbrace{F_i(K_i, \bar{L}_i) - \frac{\partial F_i(K_i, \bar{L}_i)}{\partial K_i} \times K_i}_{\text{labor income}}$$

Let us assume, however, that country i can put in place policies which redistribute income from capital to labor. Specifically, suppose there is a policy lever v_i that engineers an

alternative distribution of income as follows:

$$Y_i = F_i(K_i, L_i) = \underbrace{\frac{\partial F_i(K_i, \bar{L}_i)}{\partial K_i} \times K_i - v_i K_i}_{\text{capital income}} + \underbrace{F(K_i, \bar{L}_i) - \frac{\partial F_i(K_i, \bar{L}_i)}{\partial K_i} \times K_i + v_i K_i}_{\text{labor income}}. \quad (21)$$

Clearly, a specific capital tax $\tau_i^K = v_i$ with its proceeds being redistributed in a lump-sum manner to labor satisfies equation (21), but we view v_i as potentially encompassing a wider set of policies. For instance, Home may develop labor-market institutions that confer labor with enough bargaining power to be able to capture a certain share of income, where a higher v_i may be for instance be associated with a higher rate of unionization or higher minimum wage legislation.

Despite the existence of these policies, we continue to assume that capital is perfectly internationally mobile, and thus the remuneration of capital in country i must satisfy

$$r_i = r = \frac{\partial F_i(K_i, \bar{L}_i)}{\partial K_i} - v_i, \text{ for all } i = 1, \dots, N. \quad (22)$$

In this environment with pure redistribution, welfare of a government with bias β_i is given by

$$W_i(\beta_i) = U_i^\ell + \beta_i U_i^k = F(K_i, \bar{L}_i) - r K_i + \beta_i r \bar{K}_i.$$

Although this welfare level does *not* depend directly on v_i , it does so indirectly via the impact of v_i on the world return to capital r , as inferred from equation (22).

The first-order condition characterizing the choice of v_i is given by

$$\frac{dW_i(\beta_i)}{dv_i} = v_i \frac{dK_i}{dv_i} + \frac{dr}{dv_i} (\beta_i \bar{K}_i - K_i) \leq 0; \quad v_i \geq 0,$$

which is identical to (11) with v_i replacing τ_i^K . Similarly, we have that

$$\frac{dW_F(\beta_F)}{dv_H} = v_F \frac{dK_F}{dv_H} + \frac{dr}{dv_H} (\beta_F \bar{K}_F - K_F),$$

which is also identical to (13) with v_i replacing τ_i^K for $i = H, F$. It is then straightforward to see that the main results in our economic model will continue to apply in this environment.

In sum, the existence of public goods is *not* necessary for our main results. Propositions 1–5 apply for this more general redistributive policy tool v_i . Pro-capital countries naturally prefer pro-capital policies (low v_i) in their own country, but also in foreign countries, while pro-labor governments prefer pro-labor (high v_i) policies both in their own country as well

as abroad.

C. Expropriation, Ideology, and Regime Change

The results in this section demonstrate that the logic of the framework naturally extends to policy tools that reduce returns to capital and increase labor welfare. Similarly, the reduced form of the political game in Section 7 applies to any Foreign effort to (probabilistically) replace the government, and thus the policies, at Home. This implies that covert operations to induce favorable regime change should also follow the predictions of the model: influencing countries that are led by incumbents that are more pro-capital should be more eager to intervene in countries where the political process has led to capital expropriation or otherwise reduced capital returns. The record of CIA interventions during the Cold War is consistent with this prediction.

In Iran, Mossadegh's rise to power was quickly followed by a nationalization of British-owned Anglo-Iranian assets on May 1, 1951. The British government sought US aid in rectifying this situation, but the Truman administration limited its intervention to attempts to broker a peaceful deal. The Eisenhower administration, inaugurated in January 1953, took a very different approach and joint coup plans between MI6 and CIA were approved in July. The coup initially failed, but eventually resulted in Mossadegh's overthrow in August, 1953. While it may seem strange that the United States would intervene on behalf of British capital-owners, it is consistent with our framework: a reduction in capital returns in one country reduces the global rate of return and thus affects all capital owners. This being said, the return of the Shah to power was very helpful to American capital: American companies received 40% of the new National Iranian Oil consortium (Kinzer, 2008).

The Eisenhower administration was also quick to act in Guatemala. While the 1945 election of Arevalo had begun to irritate the planters by improving labor conditions, the 1951 accession of Jacobo Arbenz to power, who promised comprehensive land reform, alarmed both domestic coffee planters and American-owned United Fruit Company, which owned 40% of Guatemala's land. By 1953, a series of announced reforms implied the immediate or future expropriation of more than 400,000 acres of land from United Fruit Company. Under intense lobbying by United Fruit, Eisenhower approved a plan to overthrow Arbenz in late 1953 and by June 1954 Coronel Carlos Castillo Armas had come to power on the back of a CIA-orchestrated coup (Kinzer and Schlesinger, 2005; Weiner, 2007).

In 1970, left-wing Allende won elections Chile despite sustained US support for the Christian Democrats. He proposed nationalizing the copper mines, which sourced the most important industry in Chile. Two American-owned companies, Kennecott and Anaconda,

controlled the lion's share of this sector and other American companies such as Pepsi-Cola and ITT also played a major role in Chile's economy. In July, 1971 the Chilean legislature approved nationalization of the mines and bargaining over the compensation package began. Nixon had authorized an anti-Allende plan as early as 1970 and, by January of 1971, coup planning and funding had begun. While the full extent of CIA participation in the 1973 coup is not known, there is evidence that the CIA supported it and had previous knowledge of Pinochet's plan (Kornbluh, 2013; Prados, 2006).

In all these cases Home governments were sharply reducing returns to capital via expropriation and nationalization. There is evidence that these policies were among the main drivers of American intervention and that economic benefits to American capital-owners followed from these operations (Kinzer, 2006; Dube et al., 2011; Berger et al., 2013). Notably, all these interventions took place under Republican administrations. Furthermore, in the case of Iran, a sharp change of approach took place when there was an alternation of party in power in the United States. The logic of the model predicts exactly this pattern as high β incumbents (ostensibly, Republican Party administrations) are expected to be more interested in protecting capital returns abroad.

One possible counter-example to this pattern is the failed Bay of Pigs operation against Fidel Castro in Cuba in April 1961, which took place during the Kennedy administration. After his accession to power in 1959, Castro moved to expropriate all foreign landholdings, which happened to be mostly American-owned. Later, in retaliation for economic sanctions, the Cuban government proceeded to nationalize all other US-held assets. Hence, returns to American-owned capital assets in Cuba were central to the dispute between the two governments and we would predict Republican administrations to be eager to intervene. It is important to note, therefore, that operations against Castro had been first approved by Eisenhower in March, 1960. When Kennedy assumed power in 1961, he found a fully-formed program ready to be deployed and difficult to stop, as at that point the United States had been training and arming Cuban exiles for months. Analysts argue that Kennedy's decision to scale back direct military US involvement and to cut down air support was the final nail in the coffin of this operation (Vandenbroucke, 1984; Kornbluh, 1998; Prados, 2006; Weiner, 2007). This suggests that the intervention would have been substantially more robust should Nixon have prevailed in the 1960 presidential elections.²⁶

²⁶To be sure, the US Democratic administrations became embroiled in foreign campaigns, such as in South East Asia in the late 1960s and early 1970s. Nevertheless, it is very difficult to argue that returns to capital were an important driver of, say, the operation to substitute Diem in South Vietnam, and hence these interventions fall outside the scope of our model (Kinzer, 2006).

8.2 Multilateral Influence

We next consider an extension of our framework to a world in which multiple countries seek to affect the electoral outcome in the Home country. Using subscripts j to denote all $N - 1$ countries other than Home, we denote by e_j the foreign influence effort carried out by country j in trying to shape the election at Home. We assume that these costly actions again affect the non-policy preferences of voters, and specify the non-policy pro-capital bias ρ_H as:

$$\rho_H = \sum_{j \neq H} \mu_j e_j.$$

A higher value of μ_j denotes a higher efficacy of country j in exerting influence, and has a similar interpretation as the parameter ϕ_j in the cost of exerting effort, which we continue to specify as $(1/2)(e_j)^2 / \phi_j$.

The equilibrium of this multilateral game of foreign influence is analogous to that in our baseline model, so following the same steps as in Section 7, each country j will exert an effort level equal to

$$e_j = \chi_H \mu_j \phi_j \left[W_j(\beta_j; \tau_{HR}^K) - W_j(\beta_j; \tau_{HL}^K) \right]. \quad (23)$$

In line with Proposition 7, sufficiently pro-capital foreign governments will take actions to increase the likelihood that an election at Home is won by a pro-capital party, while sufficiently pro-labor foreign incumbents will take actions to increase the likelihood that the election at Home is won by a pro-labor party.

This extension illustrates that the incentive to exert foreign influence will be different across countries, depending on their ‘technology’ of influence (as captured by the parameters μ_j and ϕ_j). Countries with lower costs or higher efficacy in influencing will naturally exert more influence. Furthermore, all countries will exert more influence whenever voters in the Home country are more impressionable, as captured by χ_H . Also quite naturally, equation (23) indicates that the level of foreign influence by country j will depend on the extent to which policies at Home generate externalities in country j , as reflected by the term $W_j(\beta_j; \tau_{HR}^K) - W_j(\beta_j; \tau_{HL}^K)$. This difference is in turn shaped by the various fundamentals of the model. In particular, note that the difference $W_j(\beta_j; \tau_{HR}^K) - W_j(\beta_j; \tau_{HL}^K)$ will be shaped by the degree of ideological polarization at Home, as such polarization will be associated with a bigger gap between τ_{HL}^K and τ_{HR}^K .

Finally, we note that the magnitude of the pro-capital or pro-labor bias of the incumbent in country j should matter for the level of e_j . Disproportionately biased incumbents in j will, other things equal, be more likely to exert high levels of foreign influence, as the gap

$W_j(\beta_j; \tau_{HR}^K) - W_j(\beta_j; \tau_{HL}^K)$ is disproportionately high in absolute value for very high and very low values of β_j . When β_j is close to 0, the desired capital tax for Home is 0 so a high capital tax at Home (i.e., τ_{HL}^K) will be particularly costly, while when $\beta_j \rightarrow \infty$, a low capital tax at Home (i.e., τ_{HR}^K) will also be particularly welfare-reducing.

Given these results, we can sharpen some of the predictions of our model outlined in Section 7. More specifically, even when foreign influence is not observable, our framework predicts that the probability of a pro-capital party winning an election at Home is positively affected by the *share of pro-capital* incumbents around the world, and analogously for pro-labor parties. This result links back to our discussion of ideological ‘waves’ at the end of Section 7. We will draw some further implications of this complementarity in the next section.

8.3 Staggered Elections

We next consider the case in which elections occur in more than one country. For simplicity, we begin by considering a two-country model with a Home and a Foreign country, in which elections in a given country occur every T (e.g., 4) years. Home and Foreign elections are scheduled in a staggered manner, so there is an election worldwide every $T/2$ years. Although the game is repeated indefinitely, politicians are only active for a maximum of two terms (e.g., $2T$ years), so they care at most about the outcome of two elections in their country. For simplicity, we assume that politicians do not discount the future while in office.

At any point in time, there are two types of incumbents at Home and in Foreign: first-term incumbents and second-term incumbents. Behavior of second-term incumbents is identical to that discussed in our baseline model. They implement their preferred policies and also seek to influence the election in the other country in a manner captured by the foreign influence equation (17). Although that equation relates to the efforts of a second-term incumbent in Foreign, a completely analogous equation applies for second-term Home incumbents.

As in our baseline model, first-term incumbents also implement their preferred capital taxes, but their choice of foreign influence is now distinct than that of second-term incumbents. These incumbents not only benefit from the policies put in place by foreign elected governments with their same ideology, but they also internalize the fact that in influencing elections in other countries, they also (probabilistically) affect the identity of the foreign incumbents that may be trying to influence their own future reelection. For instance, a pro-capital Foreign incumbent may not only want to help a Home pro-capital party get elected to benefit from the lower capital taxes this Home government would set, but also

because they anticipate that a Home pro-capital incumbent will be more likely in the future to help the pro-capital Foreign government to get reelected in future elections in Foreign.

Although demonstrating this result is straightforward, the formal details are cumbersome, so we relegate them to Appendix A.4. We summarize this as follows:

Proposition 8. *Sufficiently biased foreign incumbents have an incentive to take actions to increase the likelihood that the election at Home is won by a party sharing their ideology. First-term Foreign incumbents exert disproportionately higher influence because they realize that an ideologically aligned Home incumbent will exert positive effort in getting that Foreign incumbent reelected in the future.*

Proof. See Appendix A.2.

Returning to our discussion of empirical predictions at the end of Section 7, this extension implies that when foreign influence is observable (or can be somehow proxied), it should be disproportionately applied by first-time incumbents rather than by lame ducks. When foreign influence activities remain unobserved, our model still predicts that pro-capital parties should be more likely to win elections whenever other countries in the world are ruled by first-term pro-capital countries rather than pro-labor parties or lame ducks.

Although this falls outside the scope of this paper, we hypothesize that an analysis of a full-fledged multi-country environment with staggered elections is likely to generate rich dynamics, with governments being concerned about the “balance of power” between pro-capital and pro-labor governments in world politics. More specifically, our model suggests that the higher the share of countries governed by pro-labor (pro-capital) parties, the more likely it will be that future governments in other countries are also pro-labor (resp. pro-capital), which in turn increases the share of future countries that are governed by pro-labor (resp. pro-capital) governments. Consequently, if pro-capital or pro-labor governments happen to have a better ‘technology of influence’ their ideology could quickly become dominant in world politics. This resonates with the discussion on ideological ‘waves’ in Section 7, though it suggests a refined test leveraging information on whether incumbent parties are expected to remain in power or not.

8.4 Commitment

We finally relax our assumption that parties cannot credibly commit to their electoral promises. In particular, we study the diametrically opposite case in which they can fully commit to their announced capital taxes. For simplicity, we revert back to a scenario

of unilateral influence, in which only a Foreign incumbent influences the outcome of an upcoming election at Home. The fact that parties are bound by their electoral promises changes the incentives of the Foreign incumbent to exert foreign influence because it is no longer the case that the only manner in which the choice of capital taxes at Home can be altered is by impacting the identity of the Home election. More specifically, the Home parties electoral platform announcement are relevant for the election prospects (given that voters understand that the announced policies will indeed be implemented), so the Foreign incumbent can now exert foreign influence efforts in a manner contingent on those announcements.

The analysis of the political game with commitment is significantly more involved than in our baseline case without commitment, but in Appendix A.5 we demonstrate the following result:

Proposition 9. *A sufficiently pro-capital (respectively, pro-labor) incumbent in a Foreign country will take actions to increase the likelihood that an election at Home is won by a pro-capital (resp. pro-labor) party. Regardless of the outcome of the Home election, when the Foreign incumbent is sufficiently pro-capital (respectively, pro-labor), the Home parties will announce capital taxes that are weakly lower (resp. higher) than those they would announce in the absence of foreign influence.*

Proof. See Appendix A.5.

The first statement of the proposition demonstrates that our ‘exporting ideology’ result in Proposition 7 is robust to assumptions regarding commitment to electoral ‘promises’. More specifically, foreign incumbents have an incentive to try to exert foreign influence in the ‘extensive margin’ in the sense of trying to boost the electoral prospects of a Home party with an aligned ideology. The second statement in Proposition 9 is novel to this extension of the model, and shows that, under commitment, foreign influence also operates through an ‘intensive margin’. If the foreign incumbent is a pro-capital party, both parties at Home announce capital taxes that are (weakly) *lower* than in the absence of foreign influence. The ‘tilt to the right’ by the pro-labor party occurs in order to reduce the size of the foreign intervention in support of their domestic pro-capital opponent. Conversely, if the foreign incumbent is a pro-labor party, both parties at Home announce capital taxes that are (weakly) *higher* than with no foreign influence. As we show in Appendix A.5, despite affecting the announced policies, foreign influence does not generally give rise to policy convergence, and thus foreign influence remains positive along the equilibrium path, as in our baseline model.

In terms of the set of empirical predictions outlined in previous sections, this extension indicates that, when foreign influence is not observable, its effects can still be inferred not just from the outcome of electoral contests, but also from the policy platforms of parties contesting these elections. More specifically, one should observe pro-capital parties proposing and implementing more pro-labor policies when coexisting with powerful pro-labor foreign governments, while pro-labor parties should propose and implement more pro-capital policies when coexisting with powerful pro-capital foreign governments. The fact that left-wing governments in the post-Cold War era have generally renounced nationalization and expropriation of capital assets is consistent with this prediction. When the sole hegemon is pro-capital, proposing policies that dramatically curtail returns to capital would likely induce a strong American foreign intervention. Moderating policy proposals is a natural course of action for left-wing candidates if they want to improve their electoral success.

9 Conclusion

The realm of international politics is rife with instances of foreign influence aimed at shaping political outcomes in other countries. Furthermore, foreign influence is often ideological in nature, in the sense that countries typically try to promote and support foreign parties or candidates abroad that share their ideological beliefs or values. This paper presents an economic rationale for understanding the interplay between ideology, foreign influence, and policy choices. By employing a model of tax competition, our paper has first shed light on the preferences of pro-capital and pro-labor governments in setting capital and labor taxes based on their ideological leanings. We have shown that pro-capital governments favor lower capital taxes in their countries but also in foreign countries, while pro-labor governments prefer higher capital taxes both at home and abroad. When considering the foreign influence activities of governments, we have demonstrated that incumbents may strategically engage in foreign influence efforts to increase the likelihood of their ideologically aligned parties winning elections in foreign countries.

Understanding the mechanics of foreign influence, ideology, and policy choices is crucial in comprehending the complex landscape of international politics. By providing insights into the economic underpinnings of these interactions, this paper contributes to a deeper understanding of how nations seek to promote their interests abroad and how ideological alignments shape policy outcomes.

Further research in this area could explore additional factors influencing foreign influence activities, such as cultural or historical ties, regional dynamics, or the role of non-state

actors. Additionally, empirical studies can be conducted to test the theoretical predictions and shed light on the real-world implications of foreign influence efforts on policy outcomes in different countries.

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A Appendix

A.1 Proof of Proposition 1

In this Appendix, we study how changes in capital taxes affect the allocation of capital across countries, as well as the worldwide return to capital. We begin by totally differentiating equation (2) to find:

$$\frac{dr}{d\tau_i} = \frac{\partial^2 F_i(K_i, \bar{L}_i)}{\partial (K_i)^2} \frac{dK_i}{d\tau_i} - 1 \quad \text{for all } i = 1, \dots, N, \quad (\text{A.1})$$

and

$$\frac{dr}{d\tau_j} = \frac{\partial^2 F_i(K_i, \bar{L}_i)}{\partial (K_i)^2} \frac{dK_i}{d\tau_j} \quad \text{for } j \neq i. \quad (\text{A.2})$$

Totally differentiating the capital-market clearing condition (4) further implies

$$\sum_{j=1}^N \frac{dK_j}{d\tau_i} = 0,$$

which, using (A.1) and (A.2), can be written as

$$\frac{1}{\frac{\partial^2 F_i(K_i, \bar{L}_i)}{\partial (K_i)^2}} + \frac{dr}{d\tau_i} \sum_{j=i}^N \frac{1}{\frac{\partial^2 F_j(K_j, \bar{L}_j)}{\partial (K_j)^2}} = 0,$$

and thus

$$\frac{dr}{d\tau_i} = \frac{-1}{\frac{\partial^2 F_i(K_i, \bar{L}_i)}{\partial (K_i)^2} \sum_{j=1}^N \frac{1}{\frac{\partial^2 F_j(K_j, \bar{L}_j)}{\partial (K_j)^2}}} < 0. \quad (\text{A.3})$$

Note that $|dr/d\tau_i|$ is necessarily smaller than 1.

Plugging in (A.1), this in turn implies

$$\frac{dK_i}{d\tau_i} = \frac{\sum_{j \neq i}^N \frac{1}{\frac{\partial^2 F_j(K_j, \bar{L}_j)}{\partial (K_j)^2}}}{\frac{\partial^2 F_i(K_i, \bar{L}_i)}{\partial (K_i)^2} \sum_{j=1}^N \frac{1}{\frac{\partial^2 F_j(K_j, \bar{L}_j)}{\partial (K_j)^2}}} < 0 \quad (\text{A.4})$$

Finally, plugging in (A.2) into (A.3), we have

$$\frac{dK_i}{d\tau_j} = \frac{-1}{\frac{\partial^2 F_j(K_j, \bar{L}_j)}{\partial(K_j)^2} \frac{\partial^2 F_i(K_i, \bar{L}_i)}{\partial(K_i)^2} \sum_{i=1}^N \frac{1}{\frac{\partial^2 F_i(K_i, \bar{L}_i)}{\partial(K_i)^2}}} > 0. \quad (\text{A.5})$$

In sum, when a country i raises its tax τ_i^K on capital, it (i) depresses the global return to capital r , (ii) decreases the capital stock K_i in country i , and (iii) increases the capital stock K_j in all other countries $j \neq i$.

We note also that

$$\frac{dr/d\tau_i^K}{dK_i/d\tau_i^K} = \frac{1}{\sum_{j \neq i}^N \frac{1}{\frac{\partial^2 F_j(K_j, \bar{L}_j)}{\partial(K_j)^2}}}.$$

Because $\partial^2 F_j(K_j, \bar{L}_j) / \partial(K_j)^2 < 0$, when τ_i^K rises and K_j rises for all $j \neq i$, the terms $\partial^2 F_j(K_j, \bar{L}_j) / \partial(K_j)^2$ increase or decrease depending on the third derivative of the production function $F_j(K_j, \bar{L}_j)$. When this third derivative is positive, as in the Cobb-Douglas case, τ_i^K rises and $(dr/d\tau_i^K) / (dK_i/d\tau_i^K)$ falls. This in turn implies that the optimal capital tax in equation (12), i.e.,

$$\tau_i^K = \frac{dr/d\tau_i^K}{dK_i/d\tau_i^K} (K_i - \beta_i \bar{K}_i),$$

is necessarily unique. To see this, note that we can express this expression as

$$K_i - \tau_i^K \frac{1}{\frac{dr/d\tau_i^K}{dK_i/d\tau_i^K}} = \beta_i \bar{K}_i,$$

where the left-hand side is monotonically decreasing in τ_i^K because (i) K_i decreases in τ_i^K , and (ii) $(dr/d\tau_i^K) / (dK_i/d\tau_i^K)$ also decreases in τ_i^K .

From this last expression it is also clear that the lower is β_i , the higher is the capital tax τ_i^K , as stated in the main text. A non-negative third derivative of the production function with respect to capital is sufficient for this result.

A.2 Proof of Proposition 6

Given their preferences in (14), and their anticipation of the policies that the pro-capital ‘right’ R and the pro-labor ‘left’ L would implement, Home capitalists vote for R whenever

$$\left(r(\tau_{H\mathcal{R}}^K) - r(\tau_{H\mathcal{L}}^K) \right) \bar{K}_H + \rho_H + \xi_H^s > 0.$$

Given the uniform distribution of ξ_H^s , this implies that the share P_{HR}^K of Home capitalists who vote for the pro-capital party is given

$$\mathbb{P}_{HR}^K = \frac{1}{2} + \gamma_H^K \left(\left(r \left(\tau_{HR}^K \right) - r \left(\tau_{HL}^K \right) \right) \bar{K}_H + \rho_H \right).$$

Similarly, a share P_{HL}^K of workers votes for the pro-capital party, where P_{HL}^K is given by

$$\mathbb{P}_{HL}^K = \frac{1}{2} + \gamma_H^L \left(\left(w_H \left(\tau_{HR}^K, \tau_{HR}^L \right) - w_H \left(\tau_{HL}^K, \tau_{HL}^L \right) \right) \bar{L}_H + v_H \left(G_{Hc} \right) - v_H \left(G_{Hc} \right) + \rho_H \right).$$

As long as if γ_H^K and γ_H^L are small enough, these probabilities necessarily lie between 0 and 1. Allowing for corner solutions would be straightforward, though it would complicate the algebra while not generating additional insights.

The overall vote share of the right is then

$$\mathbb{P}_{HR} = \kappa \mathcal{P}_{HR}^K + (1 - \kappa) \mathcal{P}_{HR}^L,$$

where remember that κ is the share of capitalists in the (voting) population.

Simple manipulations then show that

$$\begin{aligned} \mathbb{P}_{HR} &= \frac{1}{2} + \kappa \gamma_H^K \left(r - r \left(\tau_{HL}^K \right) \right) \bar{K}_H + (1 - \kappa) \gamma_H^L \left(w_H \left(\tau_{HR}^K, \tau_{HR}^L \right) - w_H \left(\tau_{HL}^K, \tau_{HL}^L \right) \right) \bar{L}_H \\ &\quad + \left(\kappa \gamma_H^K + (1 - \kappa) \gamma_H^L \right) \rho_H, \end{aligned}$$

which corresponds to the claim in Proposition 6.

A.3 Expropriation

In this Appendix, we study how changes in expropriation rates affect the allocation of capital across countries, as well as the worldwide return to capital. We begin by totally differentiating equation (18) to find:

$$\frac{dr}{d\phi_i^K} = -\frac{\partial F_i \left(K_i, \bar{L}_i \right)}{\partial K_i} + \left(1 - \phi_i^K \right) \frac{\partial^2 F_i \left(K_i, \bar{L}_i \right)}{\partial \left(K_i \right)^2} \frac{dK_i}{d\phi_i^K}, \quad (\text{A.6})$$

and

$$\frac{dr}{d\phi_j} = \left(1 - \phi_i^K \right) \frac{\partial^2 F_i \left(K_i, \bar{L}_i \right)}{\partial \left(K_i \right)^2} \frac{dK_i}{d\phi_j^K} \text{ for } j \neq i. \quad (\text{A.7})$$

Totally differentiating equation the capital-market clearing condition (4) further implies

$$\sum_{j=1}^N \frac{dK_j}{d\phi_i^K} = 0,$$

which, using (A.6) and (A.7), can be written as

$$\frac{\frac{\partial F_i(K_i, \bar{L}_i)}{\partial K_i}}{(1 - \phi_i^K) \frac{\partial^2 F_i(K_i, \bar{L}_i)}{\partial (K_i)^2}} + \frac{dr}{d\phi_i^K} \sum_{j=1}^N \frac{1}{(1 - \phi_j^K) \frac{\partial^2 F_j(K_j, \bar{L}_j)}{\partial (K_j)^2}} = 0,$$

and thus

$$\frac{dr}{d\phi_i^K} = \frac{-\frac{\partial F_i(K_i, \bar{L}_i)}{\partial K_i}}{(1 - \phi_i^K) \frac{\partial^2 F_i(K_i, \bar{L}_i)}{\partial (K_i)^2} \sum_{j=1}^N \frac{1}{(1 - \phi_j^K) \frac{\partial^2 F_j(K_j, \bar{L}_j)}{\partial (K_j)^2}}} < 0. \quad (\text{A.8})$$

Plugging in (A.6), this in turn implies

$$\frac{dK_i}{d\phi_i^K} = \frac{\sum_{j \neq i}^N \frac{1}{(1 - \phi_j^K) \frac{\partial^2 F_j(K_j, \bar{L}_j)}{\partial (K_j)^2}}}{(1 - \phi_i^K) \frac{\partial^2 F_i(K_i, \bar{L}_i)}{\partial (K_i)^2} \sum_{j=1}^N \frac{1}{(1 - \phi_j^K) \frac{\partial^2 F_j(K_j, \bar{L}_j)}{\partial (K_j)^2}}} \frac{\partial F_i(K_i, \bar{L}_i)}{\partial K_i} < 0.$$

And plugging (A.8) into (A.7) delivers

$$\frac{dK_i}{d\phi_j^K} = \frac{-\frac{\partial F_j(K_i, \bar{L}_i)}{\partial K_j}}{(1 - \phi_j^K) \frac{\partial^2 F_j(K_i, \bar{L}_i)}{\partial (K_j)^2} (1 - \phi_i^K) \frac{\partial^2 F_i(K_i, \bar{L}_i)}{\partial (K_i)^2} \sum_{j=1}^N \frac{1}{(1 - \phi_j^K) \frac{\partial^2 F_j(K_j, \bar{L}_j)}{\partial (K_j)^2}}} > 0 \text{ for } j \neq i.$$

In sum, when a country i raises its expropriation rate ϕ_i^K on capital, it (i) depresses the global return to capital r , (ii) decreases the capital stock K_i in country i , and (iii) increases the capital stock K_j in all other countries $j \neq i$.

We also note that

$$\frac{dr/d\phi_i}{dK_i/d\phi_i} = \frac{-1}{\sum_{j \neq i}^N \frac{1}{(1 - \phi_j^K) \frac{\partial^2 F_j(K_j, \bar{L}_j)}{\partial (K_j)^2}}},$$

and thus the optimal expropriation rate, whenever $K_i > \beta_i \bar{K}_i$, is given by (see equation

(19)):

$$\phi_i^K = \frac{-1}{\frac{\partial F_i(K_i, \bar{L}_i)}{\partial K_i} \sum_{j \neq i}^N \frac{1}{(1-\phi_j) \frac{\partial^2 F_j(K_j, \bar{L}_j)}{\partial (K_j)^2}}} (K_i - \beta_i \bar{K}_i).$$

A.4 Proof of Proposition 8

In this Appendix, we study the version of our model with staggered elections leading to Proposition 8.

As stated in the main text, at any point in time, there are two types of incumbents at Home and in Foreign: first-term incumbents and second-term incumbents. Behavior of second-term incumbents is identical to that discussed in our baseline model. Analogously to equation (17) in the main text, we have that Foreign and Home second-term incumbents set

$$e_{Fc} = \chi_H \phi_F \left[W_F(\beta_F; \tau_{HR}^K, \tau_{Fc}^K) - W_H(\beta_H; \tau_{HR}^K, \tau_{Fc}^K) \right],$$

and

$$e_{Hc} = \chi_F \phi_H \left[W_H(\beta_H; \tau_{Hc}^K, \tau_{FR}^K) - W_F(\beta_F; \tau_{Hc}^K, \tau_{FR}^K) \right].$$

Furthermore, given our assumption of a lack of commitment regarding tax choices, these second-term incumbents continue to implement their preferred capital taxes, as they cannot credibly commit to implementing alternative values that may benefit their aligned candidate in the other country's election.

As in our baseline model, and again due to the lack of commitment, first-term incumbents also always implement their preferred capital taxes, but their choice of foreign influence is now distinct than that of second-term incumbents. To see this, consider the expected welfare of a first-term incumbent over its political horizon. Let us assume this first-time incumbent is a pro-capital party or politician. We can distinguish between four distinct periods in the lifetime of an elected politician: a first period right after being elected but before the first election in the other country; a second period right after the election abroad but before his or her domestic election; a third period right after being re-elected or after losing the reelection, but before a second election in the other country; and a fourth and last period right after the second election and until the end of his or her political life. For simplicity, we ignore discounting during that political lifetime.

In the first period, right after being elected, this incumbent enjoys a payoff equal $W_F(\beta_{FR}; \tau_{Hc}^K)$, where β_{FR} is its own pro-capital bias, and where τ_{Hc}^K is the capital tax implemented at Home, which depends on the bias of that incumbent party at Home.

In the second period, the Foreign incumbent is still in power, but its payoff depends on the outcome of the election at Home, so

$$\mathbb{P}_{HR}(e_{FR1}) W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) + (1 - \mathbb{P}_{HR}(e_{FR1})) W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) - \frac{1}{2\phi_F} (e_{FR1})^2.$$

After plugging in (15), this equation is analogous to equation (16) in the main text.

In the third period, the welfare of this pro-capital party is shaped by whether it wins its own election in that third period. Specifically, the Foreign incumbent realizes that its electoral prospects depends on the level of foreign influence put in place by the Home incumbent. Crucially, this level of Home influence is shaped by the pro-capital or pro-labor bias of the Home incumbent, which the Foreign incumbent tried to affect in the previous period. More formally, at the time of setting the foreign influence level e_{FR1} in period 2, the Foreign pro-capital incumbent expects a third period payoff equal to

$$\begin{aligned} & \mathbb{P}_{HR}(e_{FR1}) \left[\mathbb{P}_{FR}(e_{HR}) W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) + (1 - \mathbb{P}_{FR}(e_{HR})) W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FL}^K) \right] \\ & + (1 - \mathbb{P}_{HR}(e_{FR1})) \left[\mathbb{P}_{FR}(e_{HL}) W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) + (1 - \mathbb{P}_{FR}(e_{HL})) W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FL}^K) \right]. \end{aligned}$$

In its last period, the expected payoff at the time of setting e_{FR1} in period 2 is

$$\begin{aligned} & \mathbb{P}_{HR}(e_{FR1}) \mathbb{P}_{FR}(e_{HR}) \times \\ & \quad \times \left[\mathbb{P}_{HR}(e_{FR2}) W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) + (1 - \mathbb{P}_{HR}(e_{FR2})) W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) - \frac{1}{2\phi_F} (e_{FR2})^2 \right] \\ & + \mathbb{P}_{HR}(e_{FR1}) (1 - \mathbb{P}_{FR}(e_{HR})) \\ & \quad \times \left[\mathbb{P}_{HR}(e_{FL1}) W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FL}^K) + (1 - \mathbb{P}_{HR}(e_{FL1})) W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FL}^K) \right] \\ & + (1 - \mathbb{P}_{HR}(e_{FR1})) \mathbb{P}_{FR}(e_{HL}) \times \\ & \quad \times \left[\mathbb{P}_{HR}(e_{FR2}) W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) + (1 - \mathbb{P}_{HR}(e_{FR2})) W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) - \frac{1}{2\phi_F} (e_{FR2})^2 \right] \\ & + (1 - \mathbb{P}_{HR}(e_{FR1})) (1 - \mathbb{P}_{FR}(e_{HL})) \times \\ & \quad \times \left[\mathbb{P}_{HR}(e_{FL1}) W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FL}^K) + (1 - \mathbb{P}_{HR}(e_{FL1})) W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FL}^K) \right] \end{aligned}$$

This Foreign expected welfare depends on who wins the second Home election, which is shaped by the second-term foreign influence effort e_{F2} . But note that e_{FR1} is still relevant for expected welfare because the Foreign pro-capital incumbent cares about whether he is an incumbent or not at that (which is shaped by e_{HR} or e_{HL} , which is in turn shaped by e_{FR1}).

Notice that this last payoff is the only one shaped by e_{FR2} , and that e_{FR2} is set to

maximize

$$\mathbb{P}_{HR}(e_{FR2}) W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) + (1 - \mathbb{P}_{HR}(e_{FR2})) W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) - \frac{1}{2\phi_F} (e_{FR2})^2$$

so

$$\begin{aligned} e_{FR2} &= \phi_F \frac{\partial \mathbb{P}_{HR}(e_{FR2})}{\partial e_{FR2}} \left[W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) - W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) \right] \\ &= \phi_F \chi_H \left[W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) - W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) \right], \end{aligned}$$

where in the last line, we have used

$$\mathbb{P}_{HR}(e_{F2}) = \frac{1}{2} + \Delta_H^u + \chi_H e_{F2}.$$

This confirms our claim above that second-term incumbents set foreign influence at the same level as in our baseline model.

The choice of e_{FR1} is more complicated. The derivative of overall expected welfare (ignoring discounting) with respect to e_{FR1} is given by

$$\begin{aligned} & \frac{\partial \mathbb{P}_{HR}(e_{FR1})}{\partial e_{FR1}} \left[W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) - W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) \right] - \frac{e_{FR1}}{\phi_F} \\ & + \frac{\partial \mathbb{P}_{HR}(e_{FR1})}{\partial e_{FR1}} \left\{ \begin{array}{l} \mathbb{P}_{FR}(e_H) \left[W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) - W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) \right] \\ + (1 - \mathbb{P}_{FR}(e_H)) \left[W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FL}^K) - W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FL}^K) \right] \end{array} \right\} \\ & + \frac{\partial \mathbb{P}_{HR}(e_{FR1})}{\partial e_{FR1}} (\mathbb{P}_{FR}(e_{HR}) - \mathbb{P}_{FR}(e_{HL})) \\ & \times \left[\begin{array}{l} \mathbb{P}_{HR}(e_{FR2}) W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) + (1 - \mathbb{P}_{HR}(e_{FR2})) W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) - \frac{1}{2\phi_F} (e_{FR2})^2 \\ - \mathbb{P}_{HR}(e_{FL1}) W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FL}^K) - (1 - \mathbb{P}_{HR}(e_{FL1})) W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FL}^K) \end{array} \right]. \end{aligned} \quad (\text{A.9})$$

This may look like a complicated expression, but note the following observations:

1. The first line of (A.9), when equated to 0, is identical to the first-order condition for the choice of effort of a second-term incumbent.
2. In the second line of (A.9), because

$$\mathbb{P}_{HR}(e_{F1}) = \frac{1}{2} + \Delta_H^u + \chi_H e_{F1},$$

we have that

$$\frac{\partial \mathbb{P}_{HR}(e_{FR1})}{\partial e_{FR1}} = \chi_H > 0. \quad (\text{A.10})$$

3. In the same second line of (A.9), as long as the Foreign incumbent is sufficiently pro-capital, it will always prefer lower capital taxes at Home (regardless of who is the incumbent in Foreign in the second term), so we necessarily have

$$W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) - W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) > 0 \quad (\text{A.11})$$

and

$$W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FL}^K) - W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FL}^K) > 0. \quad (\text{A.12})$$

Note that equations (A.10), (A.11) and (A.12) jointly imply that the term in the second line of the cumbersome derivative in (A.9) is necessarily positive.

4. In the third line of (A.9), $\partial P_{HR}(e_{FR1})/\partial e_{FR1} > 0$ and $P_{FR}(e_{HR}) - P_{FR}(e_{HL}) > 0$, as long as the Home incumbent tries to favor its ideologically aligned Foreign party, implying $e_{HR} > 0$ and $e_{HL} < 0$. This is evident for second-term Home incumbents, but we conjecture that the same will be true for first-term Home incumbents, and we will later verify that this conjecture is true.
5. In the fourth line of (A.9), note that we have

$$\begin{aligned} & \mathbb{P}_{HR}(e_{FR2}) W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) + (1 - \mathbb{P}_{HR}(e_{FR2})) W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) - \frac{1}{2\phi_F} (e_{FR2})^2 > \\ & \mathbb{P}_{HR}(0) W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) + (1 - \mathbb{P}_{HR}(0)) W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) \end{aligned}$$

because $e_{FR2} \neq 0$ can only deliver a higher welfare level to the Foreign second-term incumbent.

6. Furthermore, as long $e_{HL} < 0$,

$$\begin{aligned} & \mathbb{P}_{HR}(0) W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) + (1 - \mathbb{P}_{HR}(0)) W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) > \\ & \mathbb{P}_{HR}(e_{FL1}) W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FL}^K) + (1 - \mathbb{P}_{HR}(e_{FL1})) W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FL}^K) \end{aligned}$$

because we can express this as

$$\begin{aligned} & \mathbb{P}_{HR}(0) \left[W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) - W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FL}^K) \right] \\ & + (1 - \mathbb{P}_{HR}(0)) \left[W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) - W_F(\beta_F; \tau_{HL}^K, \tau_{FL}^K) \right] > \\ & - (\mathbb{P}_{HR}(0) - \mathbb{P}_{HR}(e_{FL1})) \left[W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FL}^K) - W_F(\beta_F; \tau_{HL}^K, \tau_{FL}^K) \right], \end{aligned}$$

which necessarily holds because $W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FR}^K) > W_F(\beta_{FR}; \tau_{HR}^K, \tau_{FL}^K)$, $W_F(\beta_{FR}; \tau_{HL}^K, \tau_{FR}^K) > W_F(\beta_F; \tau_{HL}^K, \tau_{FL}^K)$, and $P_{HR}(0) > P_{HR}(e_{FL1})$, as long as $e_{FL1} < 0$.

In sum, as long as the effort levels of Home incumbents satisfy $e_{HR} > 0$ and $e_{HL} < 0$, and as long as $e_{FL1} < 0$, we have that first-term Foreign incumbents will have a marginal return to investing in foreign influence that is higher than for second-term Foreign incumbents. Intuitively, a pro-capital Foreign incumbent may not only want to help a Home pro-capital party get elected to benefit from the lower capital taxes this Home government would set, but also because they anticipate that a Home pro-capital incumbent will be more likely in the future to help the Foreign pro-capital government to get reelected in future elections in Foreign. This implies that $e_{FR2} > e_{FR1} > 0$.

A completely analogous set of derivations implies that first-term Home incumbents also set $e_{HR2} > e_{HR1} > 0$, which confirms our conjecture that $e_{HR} > 0$, regardless of whether the Home incumbent is a first- or second-term incumbent. Similarly, when studying the choices of first-term pro-labor incumbents, it can be verified following a completely analogous set of steps that first-term pro-labor incumbents will also exert more foreign influence, which in this case implies $e_{HL2} < e_{HL1} < 0$ and $e_{FL2} < e_{FL1} < 0$. This in turn implies that our conjectures $e_{HL} < 0$ and $e_{FL1} < 0$ above are verified. This completes the proof of Proposition 8.

A.5 Proof of Proposition 9

In this Appendix, we analyze the version of our model with commitment leading to Proposition 9. When the Home parties can credibly commit to their announced capital taxes, the timing of events of the political game is as follows:

- ($t = 1$) The Home pro-capital and pro-labor parties announce a policy platform $(\tau_{Hc}^K, \tau_{Hc}^L)$ for $c = R, L$.
- ($t = 1.5$) The incumbent party in Foreign decides how much effort e_F to exert with the goal of affecting the electoral outcome at Home.

- ($t = 2$) The values of ξ_H^K and ξ_H^L are realized.
- ($t = 3$) Elections occur at Home.
- ($t = 4$) Policies announced at $t = 1$ are implemented by the winning party and payoffs are realized.

It is intuitive (though we will demonstrate this formally below) that, given the above timing of events, for a given $(\tau_{Hc}^K, \tau_{Hc}^L)$ for $c = R, L$, the choice of e_F will be analogous to that in the main text, and given by

$$e_F = \chi_H \phi_F \left[W_F(\beta_F; \tau_{HR}^K) - W_F(\beta_F; \tau_{HL}^K) \right]. \quad (\text{A.13})$$

It is then clear that the first statement in Proposition 9 is necessarily true. A sufficiently pro-capital incumbent in a Foreign country will perceive $W_F(\beta_{FR}; \tau_{HR}^K) > W_F(\beta_{FR}; \tau_{HL}^K)$ and will thus take actions to increase the likelihood that an election at Home is won by a pro-capital party (or $e_{FR} > 0$). Conversely, a sufficiently pro-labor incumbent in a Foreign country will perceive $W_F(\beta_{FL}; \tau_{HR}^K) < W_F(\beta_{FL}; \tau_{HL}^K)$, and will thus take actions to increase the likelihood that an election at Home is won by a pro-labor party (or $e_{FL} > 0$).

The main novel aspect of the analysis with commitment is that capital taxes τ_{HR}^K and τ_{HL}^K are now set in stone at $t = 1$ by each of the two parties at Home, and thus these choices are partly shaped by how these policies will affect their electoral prospects, internalizing the impact of those choices on the foreign influence function in (A.13). Assuming that parties, are risk neutral, the pro-capital party at Home sets τ_{HR}^K to maximize

$$\tilde{W}_H(\beta_{HR}) = \mathbb{P}_{HR} W_H(\beta_{HR}, \tau_{HR}^K) + (1 - \mathbb{P}_{HR}) W_H(\beta_{HR}, \tau_{HL}^K),$$

while the pro-labor party at Home sets τ_{HL}^K to maximize

$$\tilde{W}_H(\beta_{HL}) = \mathbb{P}_{HR} W_H(\beta_{HL}, \tau_{HR}^K) + (1 - \mathbb{P}_{HR}) W_H(\beta_{HL}, \tau_{HL}^K).$$

As in our baseline model, the probability P_{HR} is given by

$$\mathbb{P}_{HR} = \frac{1}{2} + \Delta_H^u + \chi_H \rho_H,$$

with

$$\Delta_H^u \equiv \kappa \gamma_H^K \left(r(\tau_{HR}^K) - r(\tau_{HL}^K) \right) \bar{K}_H + (1 - \kappa) \gamma_H^L \left(w_H(\tau_{HR}^K, \tau_{HR}^L) - w_H(\tau_{HL}^K, \tau_{HL}^L) \right) \bar{L}_H,$$

$$\chi_H \equiv \kappa \gamma_H^K + (1 - \kappa) \gamma_H^L,$$

and

$$\rho_H = e_F.$$

A Pro-Capital Home Incumbent Consider first the problem solved by a pro-capital Home incumbent. The derivative of $\tilde{W}_H(\beta_{HR})$ with respect to τ_{HR}^K is given by

$$\frac{d\tilde{W}_H(\beta_{HR})}{d\tau_{HR}^K} = \mathbb{P}_{HR} \frac{\partial W_H(\beta_{HR}, \tau_{HR}^K)}{\partial \tau_{HR}^K} + \frac{\partial \mathbb{P}_{HR}}{\partial \tau_{HR}^K} [W_H(\beta_{HR}; \tau_{HR}^K) - W_H(\beta_{HR}; \tau_{HL}^K)]$$

and

$$\begin{aligned} \frac{\partial \mathbb{P}_{HR}}{\partial \tau_{HR}^K} &= \frac{\partial \Delta_H^u}{\partial \tau_{HR}^K} + \chi_H \frac{\partial e_F}{\partial \tau_{HR}^K} \\ &= \kappa \gamma_H^K \bar{K}_H \frac{dr(\tau_{HR}^K)}{d\tau_{HR}^K} + (1 - \kappa) \gamma_H^L \bar{L}_H \frac{dw_H(\tau_{HR}^K)}{d\tau_{HR}^K} + \chi_H \frac{\partial e_F}{\partial \tau_{HR}^K} \\ &= \kappa \gamma_H^K \bar{K}_H \frac{dr(\tau_{HR}^K)}{d\tau_{HR}^K} + (1 - \kappa) \gamma_H^L \bar{L}_H \frac{dw_H(\tau_{HR}^K)}{d\tau_{HR}^K} + \chi_H \phi_F \frac{\partial W_F(\beta_F; \tau_{HR}^K)}{\partial \tau_{HR}^K}. \end{aligned}$$

When setting the derivative $d\tilde{W}_H(\beta_{HR})/d\tau_{HR}^K$ to 0, the resulting optimal tax τ_{HR}^K will be distinct from the one in our baseline model, which simply sets

$$\frac{\partial W_H(\beta_{HR}, \tau_{HR}^K)}{\partial \tau_{HR}^K} \leq 0; \quad \tau_{HR}^K \geq 0,$$

because we will typically have

$$\frac{\partial \mathbb{P}_{HR}}{\partial \tau_{HR}^K} \neq 0.$$

The reason for this departure is twofold. On the one hand, and even in the absence of foreign influence (i.e., $e_F = 0$), the pro-capital Home incumbent now realizes that even though it may desire a very low (possibly 0) capital tax, if most of the voters are workers, such a policy announcement will cost the party lots of votes (note $dw_H(\tau_{HR}^K)/d\tau_{HR}^K > 0$), so this will attenuate its incentive to set a very low capital tax. On the other hand, foreign influence further shapes the choice of τ_{HR}^K because the pro-capital Home party understands that announcing a τ_{HR}^K in line with the ideology of the Foreign incumbent will enhance its electoral prospects.

What is the direction of the latter departure? Notice that it is driven by the sign of

$$W_H(\beta_{H\mathcal{R}}; \tau_{H\mathcal{R}}^K) - W_H(\beta_{H\mathcal{R}}; \tau_{H\mathcal{L}}^K) > 0,$$

which is positive because $\tau_{H\mathcal{R}}^K$ is a preferred policy for the Home pro-capital party, and by the sign of

$$\frac{\partial W_F(\beta_F; \tau_{H\mathcal{R}}^K)}{\partial \tau_{H\mathcal{R}}^K}.$$

From Proposition 5, this term will be positive when the Foreign government is sufficiently pro-labor, while it will be negative when the Foreign incumbent is sufficiently pro-capital. Regardless of the outcome of the election and the particular way in which commitment would affect policies in the absence of foreign influence, we can thus conclude that when the Foreign incumbent is sufficiently pro-capital, the Home pro-capital party will announce capital taxes that are weakly lower than those they would announce in the absence of foreign influence, while if the Foreign incumbent is sufficiently pro-labor, the Home pro-capital party will announce capital taxes that are weakly higher than those they would announce in the absence of foreign influence. We have thus established the second statement in Proposition 9 for the case of a pro-capital Home incumbent.

A Pro-Labor Home Incumbent The optimal policies set by a pro-labor Home incumbent can be solved analogously. We provide the details for completeness. The derivative of $\tilde{W}_H(\beta_{H\mathcal{L}})$ with respect to $\tau_{H\mathcal{L}}^K$ is given by

$$\frac{d\tilde{W}_H(\beta_{H\mathcal{L}})}{d\tau_{H\mathcal{L}}^K} = (1 - \mathbb{P}_{H\mathcal{R}}) \frac{\partial W_H(\beta_{H\mathcal{L}}, \tau_{H\mathcal{L}}^K)}{\partial \tau_{H\mathcal{L}}^K} + \frac{\partial (1 - \mathbb{P}_{H\mathcal{R}})}{\partial \tau_{H\mathcal{L}}^K} [W_H(\beta_{H\mathcal{L}}; \tau_{H\mathcal{L}}^K) - W_H(\beta_{H\mathcal{L}}; \tau_{H\mathcal{R}}^K)]$$

with

$$\begin{aligned} \frac{\partial \mathbb{P}_{H\mathcal{R}}}{\partial \tau_{H\mathcal{L}}^K} &= \frac{\partial \Delta_H^u}{\partial \tau_{H\mathcal{L}}^K} + \chi_H \frac{\partial e_F}{\partial \tau_{H\mathcal{L}}^K} \\ &= \frac{\partial \Delta_H^u}{\partial \tau_{H\mathcal{L}}^K} + \chi_H \phi_F \frac{\partial W_F(\beta_F; \tau_{H\mathcal{L}}^K)}{\partial \tau_{H\mathcal{R}}^K}. \end{aligned}$$

When setting the derivative $d\tilde{W}_H(\beta_{H\mathcal{L}})/d\tau_{H\mathcal{L}}^K$ to 0, the resulting optimal tax $\tau_{H\mathcal{R}}^K$ will be distinct from the one in our baseline model, which simply sets

$$\frac{\partial W_H(\beta_{H\mathcal{L}}, \tau_{H\mathcal{L}}^K)}{\partial \tau_{H\mathcal{L}}^K} \leq 0; \quad \tau_{H\mathcal{L}}^K \geq 0,$$

because we will typically have

$$\frac{\partial \mathbb{P}_{HR}}{\partial \tau_{HL}^K} \neq 0.$$

In part this is due to the fact that, even in the absence of foreign influence (i.e., $e_F = 0$), the pro-labor Home incumbent now realizes that even though it may desire a high capital tax, if many of the voters are capitalists, such a policy announcement will cost the party lots of votes (note $dr_H(\tau_{HL}^K)/d\tau_{HL}^K < 0$), so this will attenuate its incentive to set a very high capital tax. On the other hand, foreign influence further shapes the choice of τ_{HL}^K because the pro-labor Home party understands that announcing a τ_{HL}^K in line with the ideology of the Foreign incumbent will enhance its electoral prospects.

What is the direction of the latter departure? Notice that it is driven by the sign of

$$W_H(\beta_{HL}; \tau_{HL}^K) - W_H(\beta_{HL}; \tau_{HR}^K) > 0,$$

which is positive because τ_{HL}^K is a preferred policy for the Home pro-labor party, and by the sign of

$$\frac{\partial W_F(\beta_F; \tau_{HL}^K)}{\partial \tau_{HL}^K}.$$

From Proposition 5, this term will be positive when the Foreign government is sufficiently pro-labor, while it will be negative when the Foreign incumbent is sufficiently pro-capital.

We can thus safely conclude that, regardless of the outcome of the election and the particular way in which commitment would affect policies in the absence of foreign influence, when the Foreign incumbent is sufficiently pro-capital, the Home parties will announce capital taxes that are weakly lower than those they would announce in the absence of foreign influence, while if the Foreign incumbent is sufficiently pro-labor, the Home parties will announce capital taxes that are weakly higher than those they would announce in the absence of foreign influence. This completes the proof of Proposition 9.