



# The Politics of Sovereign Finance

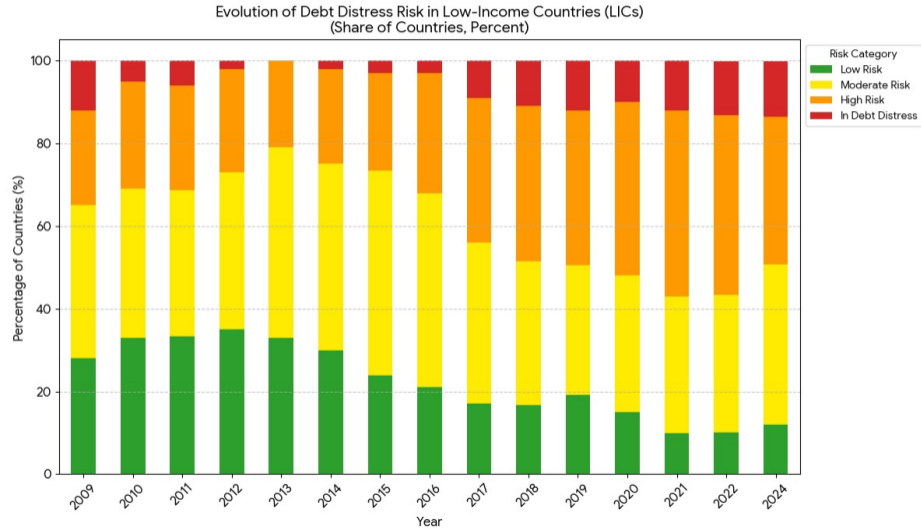
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Layna Mosley (Princeton University)

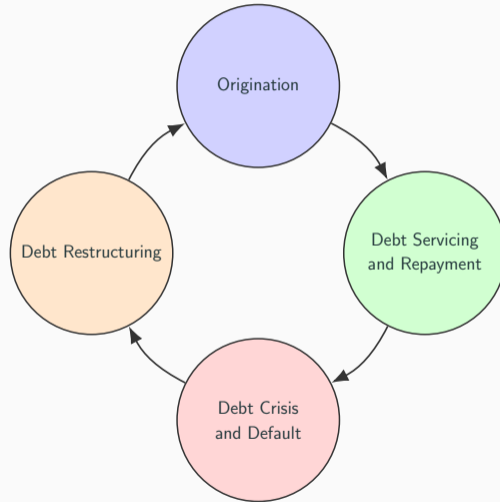
# Introduction

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# Debt Pressures in Low Income Countries



# The Debt Life Cycle



## Overview: Foundations

- Borrowing is a means to some (political, economic) end
- Borrowing – and financial openness more generally – has political causes and consequences

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- Borrowing outcomes represent intersection of supply (creditors) and demand (borrowers).
- Governments typically service and repay their debts
  - Crisis and restructuring is only part of the life cycle of debt.

## Overview: Actors

- Creditors
  - Private sector: institutional investors (bondholders); commercial banks; resource-backed lenders
  - Official sector: governments (and government-connected institutions, e.g. China Ex-Im); multilateral development banks

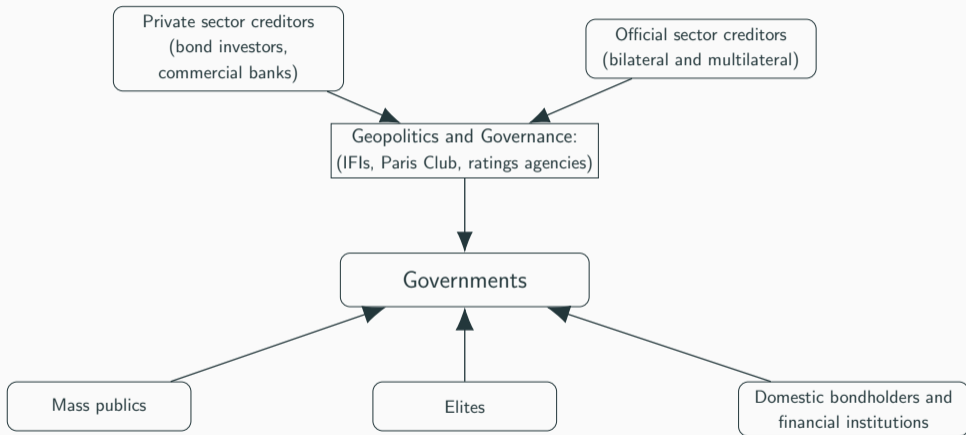
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  - Governments, government ministries, SOEs others with government guarantees.
  - Mass publics: care about economic performance; use market signals to evaluate governments.
  - Domestic bondholders

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  - Domestic bondholders
- Governance
  - IMF: assess debt sustainability; central role in crises; sometimes also a creditor.
  - Paris Club governments (and non-Paris Club governments)
  - Sovereign credit ratings agencies
  - Bondholders' committees

# Creditors, Domestic Politics and Geopolitics



## Choices over Creditors

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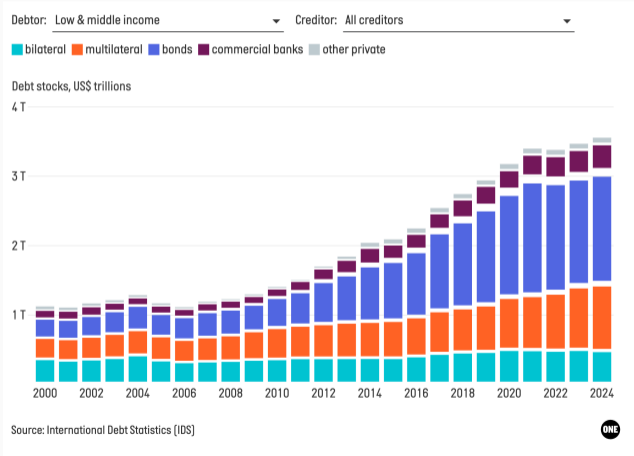
# The Old Politics of Sovereign Finance



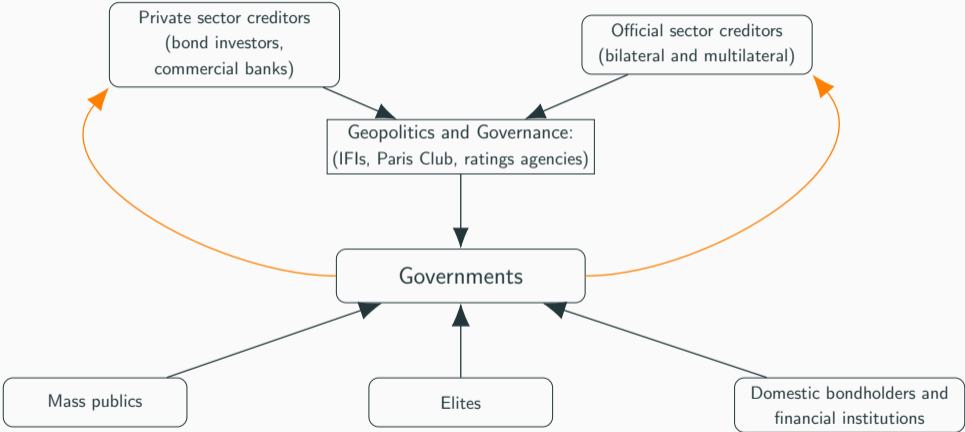
- Financial globalization as a constraint on government policies.
- The "golden straitjacket" and bond market vigilantes
- A "second image reversed" account of politics & sovereign finance
- Global South governments had few borrowing options.

# The New Politics of Sovereign Finance

- Supply **and** demand side, even for Global South borrowers.



# Creditors, Domestic Politics and Geopolitics



## Choices over Creditors

- Governments make choices about borrowing vs. taxation; about how much to borrow; from which creditors to borrow; and on which terms to borrow.

## Choices over Creditors

- Governments make choices about borrowing vs. taxation; about how much to borrow; from which creditors to borrow; and on which terms to borrow.
- With increased creditor diversity & global liquidity, more countries have options.
  - Also [Bunte \(2018\)](#), [Cormier \(2023\)](#), [Zeitz \(2019, 2024\)](#).
- [Mosley and Rosendorff \(2023\)](#): governments' underlying preferences over economic policy transparency help explain these choices.

## Choices over Creditors

- Some governments have an underlying propensity for obfuscation, motivated by political survival.
- Creates incentives to hide the existence of new debt commitments.
- Governments may worry that borrowing decisions will undermine their domestic support.
- These concerns may be greater with
  - history of debt crises and austerity
  - high levels of existing debt

## Choices over Creditors

- Banks: Fewer legal, and more relationship-specific, reporting requirements. Loan contracts rarely public.
- Bonds: Broader set of potential creditors; “road shows” for institutional investors; detailed prospectus.

**Claim: Bank lending requires less disclosure.**

- Multilateral: More principals; plus IFI staff; often specific disclosure requirements; “good governance” and data standards.
- Bilateral: Fewer parties to the loan transaction; lending often strategically motivated ([Zeitz and Mosley in progress](#)). Some non-disclosure provisions.

**Claim: Bilateral lending requires less disclosure.**

## Choices over Creditors: Findings

- We consider choices between private creditors and between official creditors for a broad set of low- and middle-income countries.
- More fiscally transparent governments are more likely to borrow in bonds (as a share of private borrowing).
- More fiscally transparent governments are more likely to borrow multilaterally (as a share of official borrowing).

**Table 1: Transparency and Bonds Credit (share of private credit)**

Transparency Index [HRV]	0.051**	0.049*	0.094***	0.066***
	(0.022)	(0.025)	(0.014)	(0.021)
Observations	1,763	1,599	1,472	1,019
$R^2$	0.25	0.27	0.34	0.28
Countries	86	83	79	70
Outcome mean	0.16	0.16	0.16	0.20
Country FE	✓	✓	✓	✓
Year FE	✓	✓	✓	✓
Econ. fundamentals		✓	✓	✓
Additional covariates			✓	✓
Domestic financial conditions				✓

*Notes:* All specifications are estimated using OLS. Economic fundamentals controls are GDP per capita (log), GDP (log), growth, and trade (% of GDP). Additional covariates are FDI inflows, natural resource rents, foreign aid, debt crisis, external debt, democracy, right and left ideology. Domestic financial conditions are domestic lending interest rates and financial system deposits as a ratio of GDP. Standard errors clustered by country are in parentheses. \*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

**Table 2: Transparency and Bilateral Credit (share of official credit)**

Transparency (HRV)	-0.034*** (0.009)	-0.024** (0.010)	-0.024* (0.013)	-0.028** (0.013)
Observations	2,554	2,298	2,132	1,447
$R^2$	0.21	0.22	0.21	0.19
Countries	88	86	82	78
Outcome mean	0.10	0.10	0.09	0.08
Country FE	✓	✓	✓	✓
Year FE	✓	✓	✓	✓
Econ. fundamentals		✓	✓	✓
Additional covariates			✓	✓
Domestic financial conditions				✓

*Notes:* All specifications are estimated using OLS. Economic fundamentals controls are GDP per capita (log), GDP (log), growth, and trade (% of GDP). Additional covariates are FDI inflows, natural resource rents, foreign aid, debt crisis, external debt, democracy, right and left ideology. Domestic financial conditions are domestic lending interest rates and financial system deposits as a ratio of GDP. Standard errors clustered by country are in parentheses. \*  $p < 0.1$ , \*\*  $p < 0.05$ , \*\*\*  $p < 0.01$ .

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- We consider choices between private creditors and between official creditors for a broad set of low- and middle-income countries.
- More fiscally transparent governments are more likely to borrow in bonds (as a share of private borrowing).
- More fiscally transparent governments are more likely to borrow multilaterally (as a share of official borrowing).
- Results are robust to inclusion of geopolitical indicators; other measures of transparency; binary DV; SUR
- We report similar results for an analysis of municipal-level borrowing in Mexico.

**Table 3: Transparency and Commercial Borrowing in Mexican Municipalities**

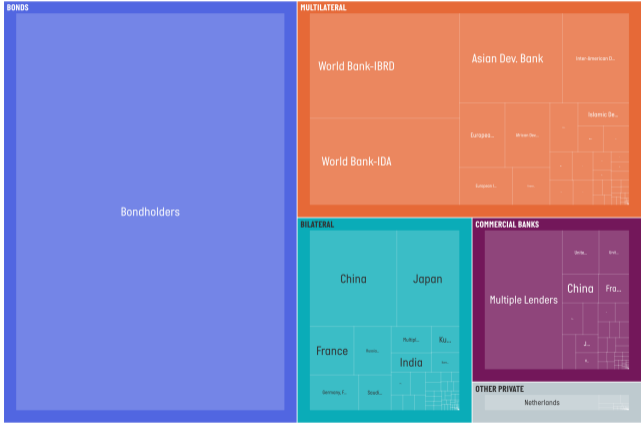
	Bond Credit (as a share of total commercial credit)		
Transparency	0.108** (0.050)	0.136** (0.065)	0.197** (0.083)
Observations	1,733	762	762
Outcome mean	0.44	0.43	0.43
Outcome std. dev.	0.49	0.49	0.49
Year FE	✓	✓	✓
Municipality FE	✓	✓	✓
Economic fundamentals		✓	✓
Party/Electoral controls			✓

*Notes:* All specifications are estimated using OLS. Economic fundamentals are municipal debt, fiscal transfers, tax revenue, population and agricultural production. Standard errors clustered by municipality are in parentheses. \* denotes  $p < 0.1$ , \*\* denotes  $p < 0.05$ , \*\*\* denotes  $p < 0.01$ .

# The New Politics of Sovereign Finance: Debt Stocks

Latest value debt stocks, US\$

Debtor: Low & middle income



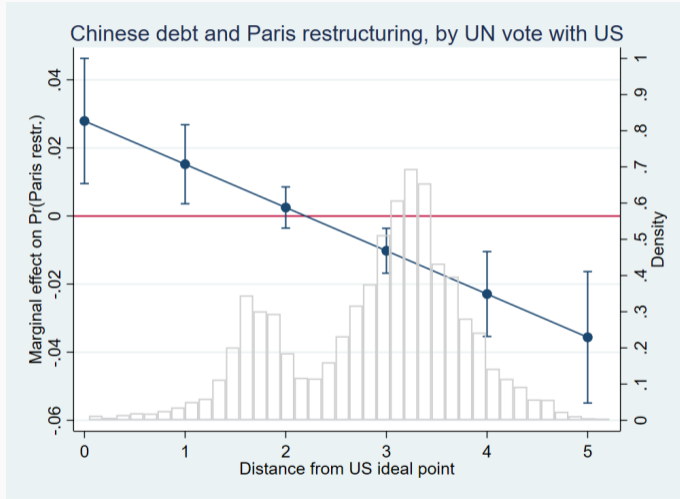
Source: International Debt Statistics (IDS)



## Creditor composition also matters for...

- Governments' ability to reach an agreement with Paris Club bilateral creditors.
  - Ballard-Rosa, Mosley & Rosendorff in progress: Governments with more debt to China → less likely to conclude Paris Club debt restructuring.
- Stronger effect when borrower is **geopolitically distant** from the US and close to China.
- Debt to China matters for restructuring of **official**, but not of private sector, obligations.
- No evidence of similar effects on Paris Club relief for other emerging creditors (e.g. Brazil, Saudi Arabia).

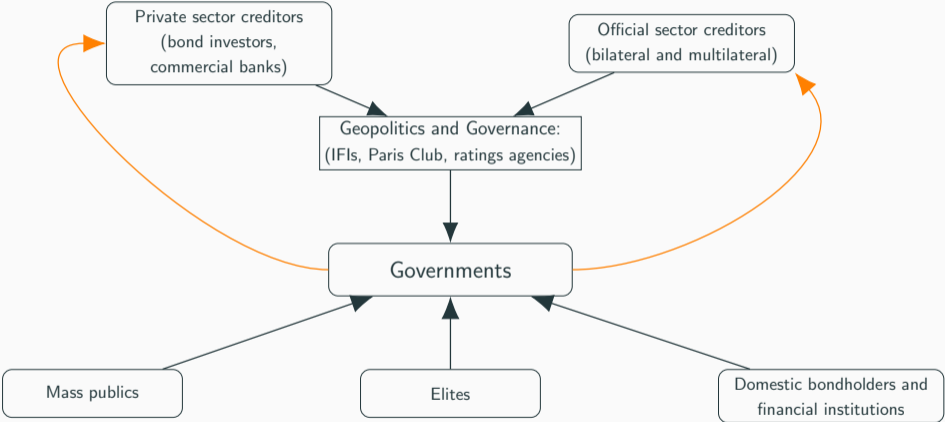
# Creditor composition also matters for...



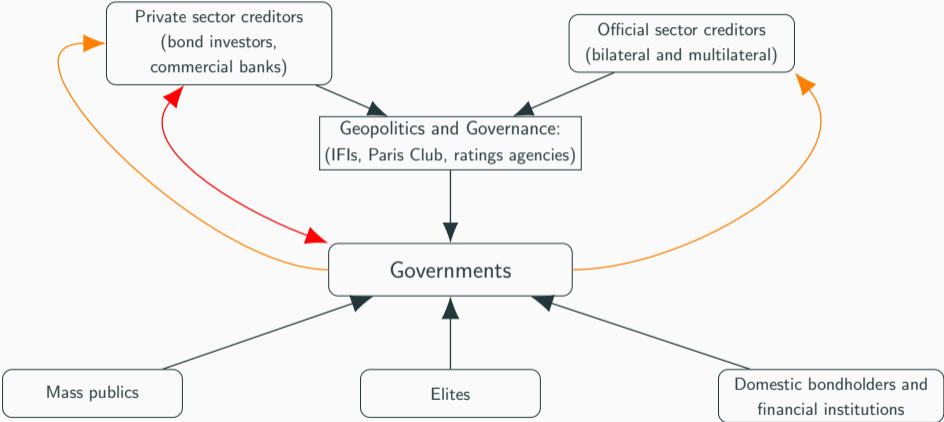
# Domestic Politics & Sovereign Bond Issuance

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# Creditors, Domestic Politics and Geopolitics



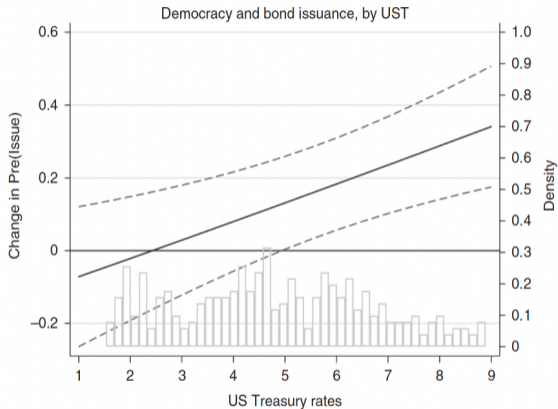
# Creditors, Domestic Politics and Geopolitics



## Domestic Politics and Sovereign Bonds

- How do sovereign debt investors assess risks related to elections, government change, government ideology and democratic institutions?
  - Bernhard & Leblang 2006, Brooks et al. 2022, Gray 2013, Mosley 2003
- Ballard-Rosa, Mosley & Wellhausen 2021: attention to domestic political institutions varies across the global capital cycle.
- We expect a democratic advantage (North & Weingast 1989; Schultz & Weingast 1996) to exist only when liquidity is low and investors are risk averse.
  - Previous analyses: sovereign credit ratings (Beaulieu, Cox & Saiegh 2012); spreads in secondary markets.
  - We look instead at primary market bond issues; 234,000 bonds and 130 countries.

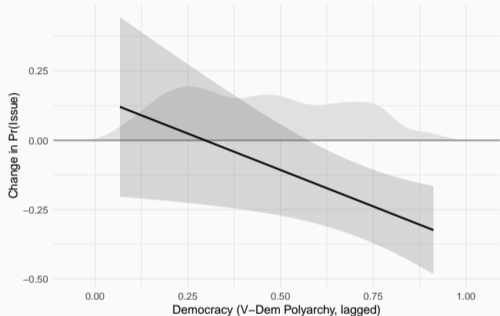
# The Conditional Democratic Advantage



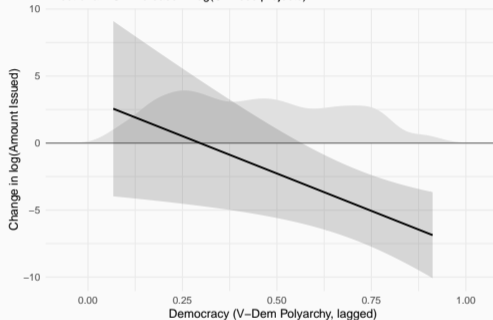
- No evidence that geopolitics (proximity to US) is associated with issuance.

# Chinese Finance and the Democratic Advantage

Marginal effect of Chinese finance on probability of issuance  
Effect of a 1 SD increase in log(Chinese projects)

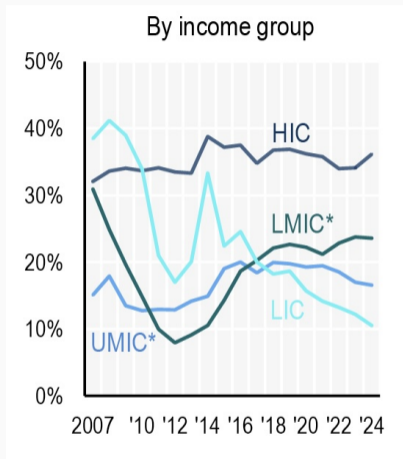


Marginal effect of Chinese finance on amount issued  
Effect of a 1 SD increase in log(Chinese projects)



- Ahuja, Mosley & Rosendorff in progress: The marginal effect of (instrumented) Chinese finance on bond issuance **declines** with democracy  $\Rightarrow$  Chinese finance blunts the democratic institutional advantage by **reducing democracies' need for private market capital.** [▶ Table](#)

# Foreign Currency Denominated Share of Outstanding Bond Debt

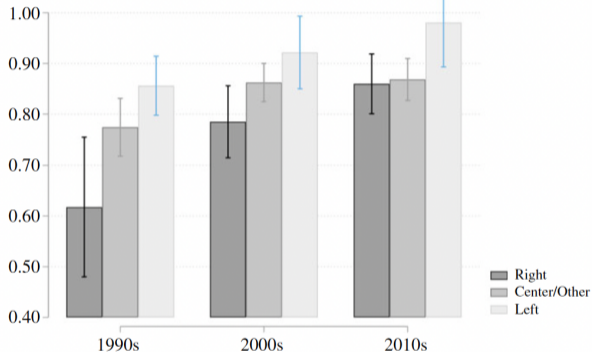


“Original sin” [Eichengreen et al 2003](#) less of a constraint for many emerging and frontier market countries.

## Domestic Currency Denomination and Government Ideology

- Right governments prefer to mitigate currency risk and reduce borrowing costs.
- Foreign currency borrowing also can tie successor governments' hands.
- Left governments prefer flexibility of domestic denomination: option to monetize debt.
- Country-month (share of debt that is domestic currency), based on issue level data, 1990-2016, 131 countries.
  - OLS with standard errors clustered by country; robust to two-stage Heckman estimation.

# Domestic Currency Denomination and Government Ideology

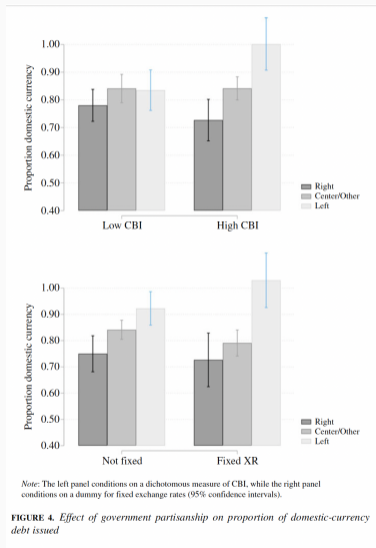


*Note:* Estimated proportion of domestic-currency-denominated sovereign bonds (in non-OECD countries), averaged by government partisanship and decade (95% confidence intervals).

**FIGURE 6.** *Estimated proportion of domestic-currency-denominated sovereign bonds (in non-OECD countries)*

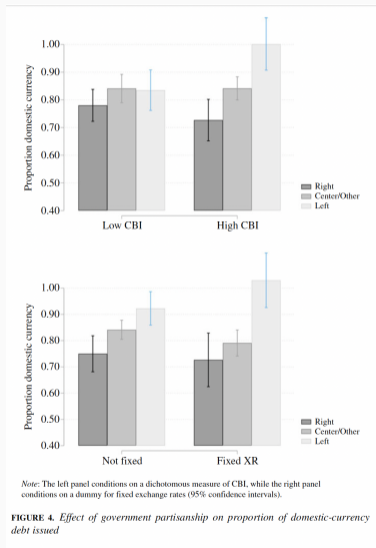
Note that  
partisanship does  
not predict  
timing or amount  
of issuance.

# Currency Denomination and Domestic Politics



- Domestic issuance more likely with politically independent central banks.
- And with fixed exchange rates.
- Domestic currency issuance is greater, especially for left governments, when global liquidity is higher.
- As time in office increases, left governments more likely to issue in domestic currency.

# Currency Denomination and Domestic Politics

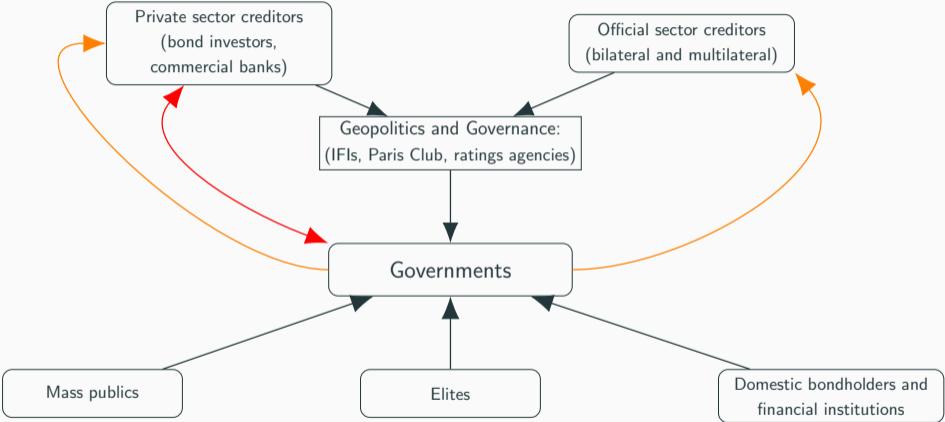


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- And with fixed exchange rates.
- Domestic currency issuance is greater, especially for left governments, when global liquidity is higher.
- As time in office increases, left governments more likely to issue in domestic currency.
- Tradeoffs: domestic currency associated with shorter maturities and larger coupons.

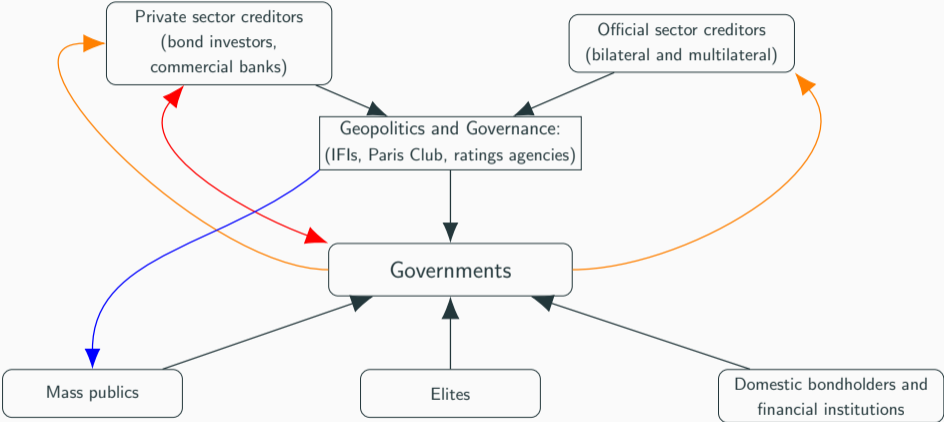
# International Markets and Mass Politics

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# Creditors, Domestic Politics and Geopolitics



# Creditors, Domestic Politics and Geopolitics



# Sovereign Credit Ratings and Leader Approval

- Signals from international investors can affect mass political attitudes.
  - Brooks, Cunha & Mosley in progress: How does information about international investors' views affect assessments of presidential candidates?
  - Ballard-Rosa, Loeffler, Mosley & Rosendorff: If credit ratings changes often do not move markets, why do governments care so much about them?

## Credit ratings downgrades

- Standard view: Sovereigns worry about credit ratings due to effect on cost of capital (e.g., Cantor & Packer 1996, DiGiuseppe & Shea 2016, Bodea & Hicks 2018)
- Market participants: by the time a rating changes, markets often have priced in all relevant information (Gonzalez-Rosada & Yeyeti 2008, Hartelius et al. 2008).

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- Market participants: by the time a rating changes, markets often have priced in all relevant information (Gonzalez-Rosada & Yeyeti 2008, Hartelius et al. 2008).
- Nevertheless, governments seek to avoid downgrades.
  - Avoid negative *domestic political consequences*.

## Economic competence and governments' political survival

- Canonical retrospective voting model (with full information): citizens will punish incumbents for poor economic performance (Ferejohn 1986, Fearon 1999).
- BUT: in a world of incomplete information, voters face non-trivial costs in acquiring economic information.
- We argue that signals from international economic actors can serve as *heuristics* to help information-constrained citizens attribute responsibility for aggregate economic conditions (Cunha et al. 2022, Nguyen et al. 2023).

## Citizen economic assessment and incomplete information

- Citizens value government economic competence, but they lack perfect information about its true value  $\theta \sim N(\mu, \frac{1}{\delta})$ .
- All citizens have private signal  $s_i \sim N(\theta, \frac{1}{\sigma})$  about government competence.
- Citizens also receive a (shared) public signal from international agency on government's credit rating  $r \sim N(\theta, \frac{1}{\rho})$ .
- So, citizens' expectation of government competence =  $E[\theta|s_i, r] = \frac{\delta\mu + \sigma s_i + \rho r}{\delta + \sigma + \rho}$

- Citizens' assessments of government competence will fall (rise) with decline (increase) in credit rating ( $\frac{\partial E[\theta|s_i,r]}{\partial r} > 0$ ).
- The magnitude of this effect will be larger for individuals with less precision in their private assessment of government economic competence ( $\frac{\partial^2 E[\theta|s_i,r]}{\partial \sigma \partial r} < 0$ ).

Proxies for imprecision ( $\sigma$ ):

- (1) Financial sophistication (micro-level).
- (2) Monetary volatility (micro- & macro-level).
- (3) Economic policy transparency (macro-level).

- Citizens' approval of incumbents declines with credit ratings downgrades.
- The decrease in response to credit ratings is larger for citizens lacking *precision in economic understanding* (education, transparency).
- The decrease in response to declines in credit ratings is larger in environments of *price volatility*.

## Empirical Evidence: Interrupted Survey Design

- 53 national surveys (from 33 countries, 2008-2024; Gallup World Poll) were in the field when a credit rating change occurred.

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- DV: “Do you approve or disapprove of the way [Leader] is handling [his/her] job as [leader title]?”
  - Rescale so that 0 = “Disapprove,” 0.5 = “Don’t know”, 1 = “Approve”
- IV: *Post-downgrade* or *post-upgrade*

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- IV: *Post-downgrade* or *post-upgrade*
- $Exec. approval_{i,c} = \beta_1 Downgrade_c + \beta_2 Post_i + \beta_3 Downgrade_c \cdot Post_i + \mu_c + \epsilon_i$
- Heterogeneous effects:
  - Individual-level measure of *education*.
  - Daily measure of *exchange rate volatility* ( $\sigma_{XR}$ , past 5 days).

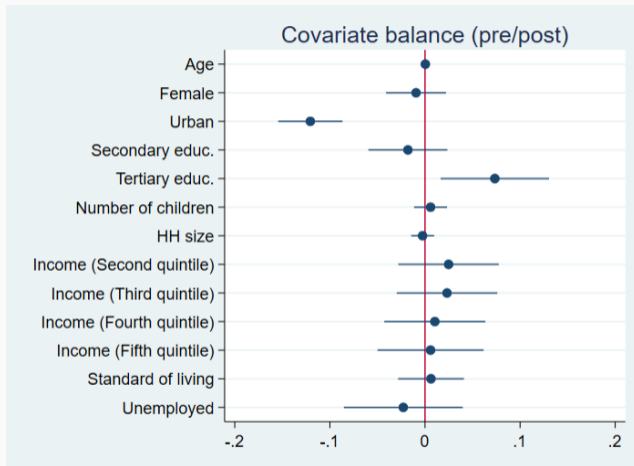
# OLS Results

	Exec. approval (5 day window)	Exec. approval (2 day window)
Credit rating downgrade	-0.078*** (0.021)	-0.138*** (0.032)
Post announcement	0.013 (0.015)	0.021 (0.021)
Rating downgrade · Post	-0.052** (0.021)	-0.068** (0.031)
Observations	12,803	6,297
Country FE	✓	✓
R-squared	0.111	0.121

*Note:* Robust standard errors clustered by country in parentheses. \*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

# Matching results

- Identifying assumption: exact date of rating change is exogenous to local political conditions in a country.
- [Muñoz et al. \(2020\)](#) suggest using matching when survey implementation may not have been done simultaneously around the country.
- Entropy balancing ([Hainmueller 2012](#)) across treated and control units along age, gender, education and urban residence.



## Matching results

	Exec. approval (5 day window)	Exec. approval (2 day window)
Post downgrade announcement	-0.030** (0.012)	-0.037** (0.019)
Observations	6,905	3,196
Country FE	✓	✓
R-squared	0.112	0.120

*Note:* Robust standard errors clustered by country in parentheses. \*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

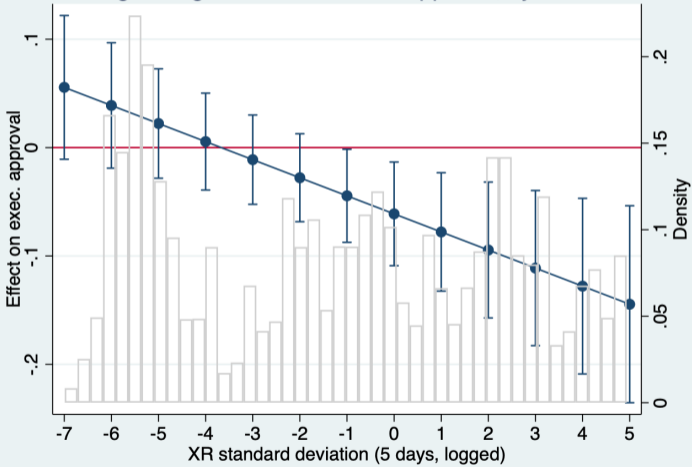
# Heterogeneous Effects

	Exec. approval (5 day window)	Exec. approval (5 day window)
Post downgrade	-0.015 (0.017)	-0.061** (0.024)
Low education	0.003 (0.026)	
Post · Low educ.	-0.069** (0.032)	
$\sigma_{XR}$ (past 5 days, logged)		0.006 (0.005)
Post · $\sigma_{XR}$		-0.017*** (0.006)
Demog. controls	✓	✓
Country FE	✓	✓
Observations	6,905	3,550
R-squared	0.115	0.168

Note: Robust standard errors clustered by country in parentheses. \*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

# Marginal effect of downgrade, by XR volatility

Credit rating downgrade and executive approval, by variance in XR



- Alternative matching estimator (propensity score matching).
- Placebo political outcomes (view of U.S., personal internet use, trust in financial system).
- Placebo timing of treatment (+/- 1 week).
- Do not find that objective economic conditions (exchange rate level) significantly different pre/post treatment.
- Replicate UESD results using “barometer” regional surveys & 20 national surveys.

# Credit rating upgrades

	Exec. appr. (5 day)	Exec. appr. (2 day)	Exec. appr. (5 day)	Exec. appr. (5 day)
Post upgrade announcement	0.015 (0.015)	0.025 (0.021)	0.017 (0.017)	0.027 (0.024)
Low education			0.009 (0.027)	
Post · Low educ.			-0.021 (0.033)	
$\sigma_{XR}$ (past 5 days, logged)				-0.018* (0.010)
Post · $\sigma_{XR}$				0.014*** (0.005)
Demog. controls			✓	✓
Country FE	✓	✓	✓	✓
Observations	5,913	3,117	5,830	3,420
R-squared	0.111	0.121	0.119	0.142

Note: Robust standard errors clustered by country in parentheses. \*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

## Panel Data, 70 countries, 31 years

- DV: Quarterly executive approval (Executive Approval Project v3.0), 70 countries, 1990-2021.
  - *net executive approval.*
- IV: Change in credit rating by S&P, Moody's, or Fitch.
  - *Any change, any downgrade, any upgrade, average change.*
- Controls: GDP per capita, Change in GDP, Average external debt, Trade, Oil rents, FDI inflows, Polyarchy (VDem).
- $NetApproval_{it} = \beta RatingsChange_{it-1} + \gamma X_{it-1} + \mu_i + f(t) + \epsilon_{it}$

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- $NetApproval_{it} = \beta RatingsChange_{it-1} + \gamma X_{it-1} + \mu_i + f(t) + \epsilon_{it}$
- Conditional hypotheses:
  - *Economic transparency (HRV)*
  - *Standard deviation of XR (Refinitiv)*

## Credit ratings and executive approval, panel data

	Net approval	Net approval	Net approval	Net approval
Any rating change	-0.996 (0.905)			
Any downgrade		-6.584*** (1.583)		
Any upgrade			3.334*** (1.046)	
Average rating change				2.534*** (0.879)
Controls	✓	✓	✓	✓
Observations	4,436	4,436	4,436	4,436
R-squared	0.109	0.114	0.110	0.112
Number of countries	60	60	60	60

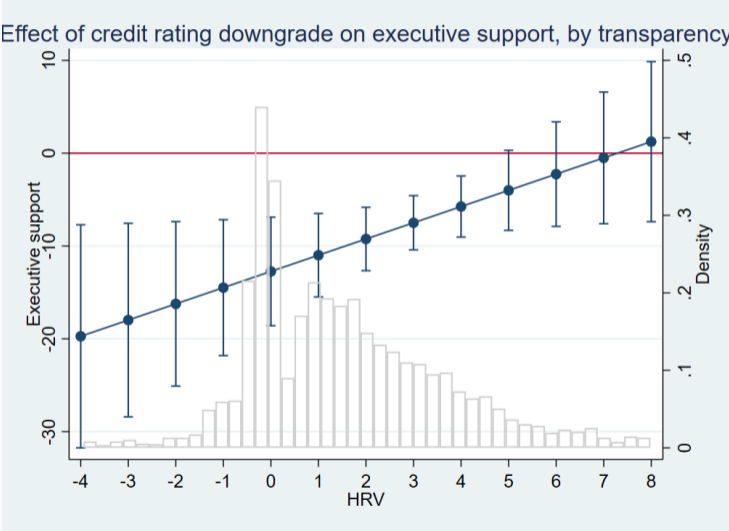
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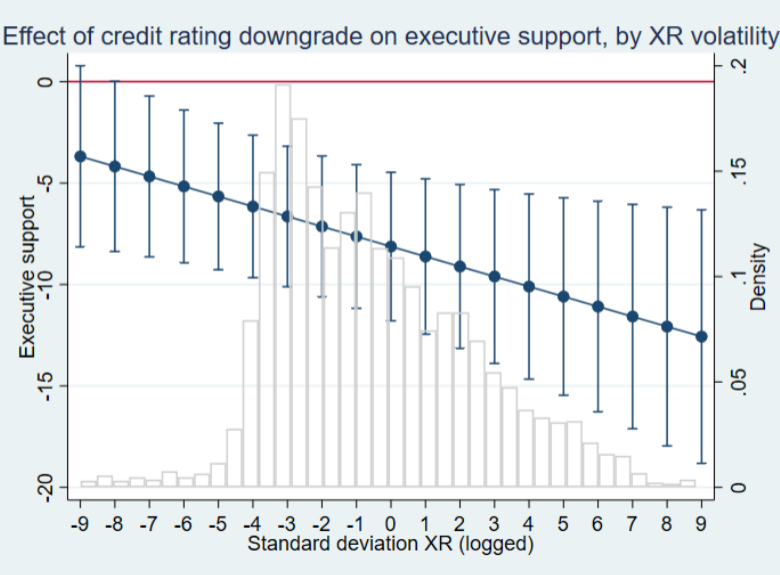
	Net approval	Net approval
Downgrade	-13.575*** (3.357)	-8.127*** (1.868)
HRV	-1.793* (0.969)	
Downgrade · HRV	1.824* (0.936)	
$\sigma_{XR}$ (past 4 quarters, logged)		0.680 (0.698)
Downgrade · $\sigma_{XR}$		-0.493** (0.227)
Controls	✓	✓
Country FE	✓	✓
Time FE	✓	✓
Observations	4,458	4,248
R-squared	0.131	0.125
Number of countries	60	59

Note: Robust standard errors clustered by country in parentheses. \*\*\*  $p < 0.01$ , \*\*  $p < 0.05$ , \*  $p < 0.1$

# Marginal effect of ratings downgrade, by transparency



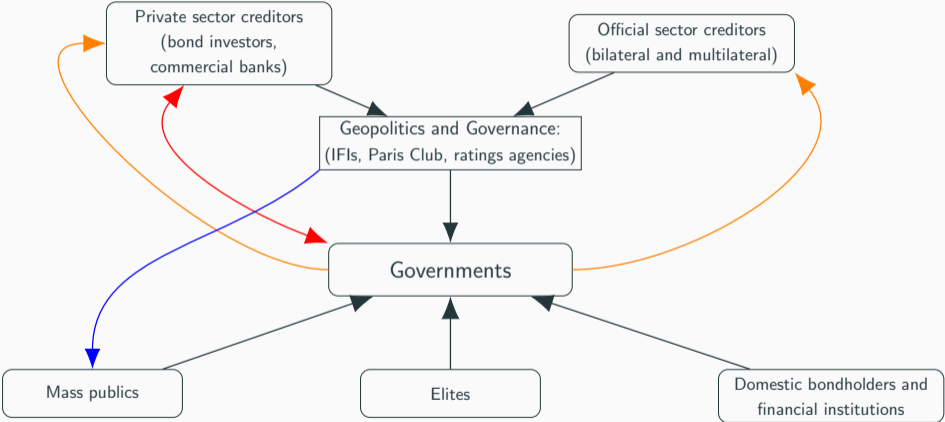
# Marginal effect of rating downgrade, by XR volatility



# International Financial Markets and Mass Opinion

- Voters have difficulty holding incumbents accountable for their economic performance, given the challenges of attributing blame.
- External actors can inform domestic political audiences about government economic competence.
- Changes in country credit ratings matter for domestic public support for incumbent politicians, especially for low-sophistication voters, and during volatile monetary conditions.
- Other international signals, e.g. IMF article IV reports, also may matter.

# Creditors, Domestic Politics and Geopolitics



- Domestic political institutions affect the availability and pricing of sovereign debt.
- Government decisions related to borrowing (as well as to default and restructuring) are affected by their calculus of political survival.
- Geopolitics also matters, especially in a diverse creditor landscape.
  - Bilateral debt is cheaper for allies (Zeitz and Mosley in progress)

- Domestic politics affect the availability and pricing of sovereign finance.
- Government decisions about origination (as well as around default and restructuring) are affected by political survival concerns.
- Geopolitics also matters, especially in a diverse creditor landscape.
  - Bilateral debt is cheaper for allies (Zeitz and Mosley in progress)
- Future research: domestic **and** external debt.

Thanks!

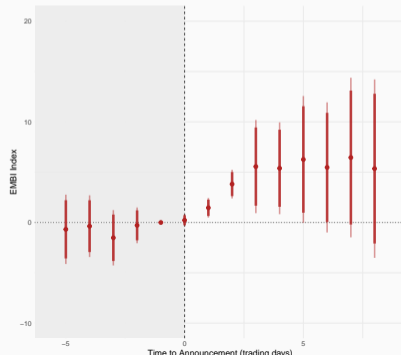


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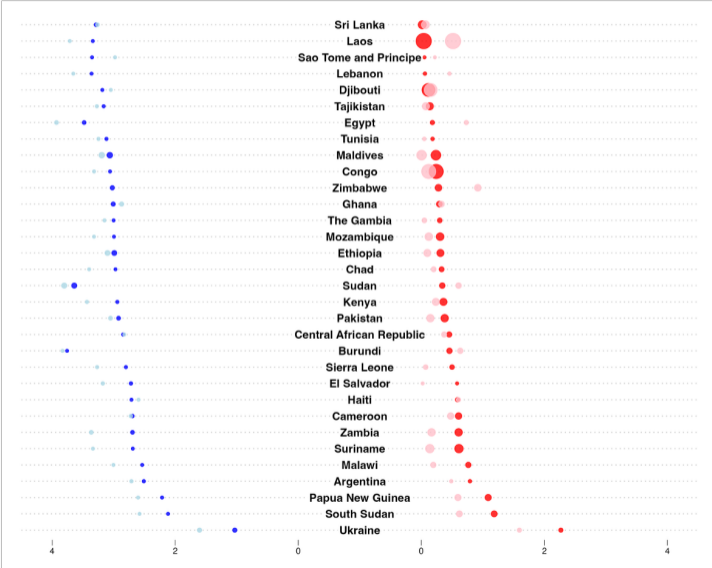
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# Bond Market Responses to Chinese Loans

- [Liu and Mosley 2025](#): Risk premiums are significantly higher immediately after announcements of new Chinese loans.
- Larger effects for general purpose and liquidity (vs. project) loans.
- Likely related to bondholders' concerns about transparency of Chinese lending, as well as concerns over comparability of treatment.



# US, China and Debt



**TABLE 1.** *Domestic currency issuance and other bond terms*

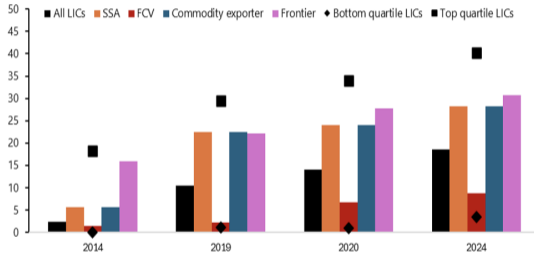
<i>Variables</i>	(1) <i>% domestic</i>	(2) <i>% domestic</i>	(3) <i>% domestic</i>
AVERAGE MATURITY	-0.019*** (0.003)		-0.020*** (0.003)
AVERAGE COUPON		0.000 (0.003)	0.005** (0.002)
Baseline controls	✓	✓	✓
Full controls	✓	✓	✓
Observations	8,187	8,187	8,187
R-squared	0.146	0.087	0.149
Number of countries	79	79	79

*Notes:* This table reports results of OLS regressions of domestic currency issuance (by month) on alternative terms of bonds (by month), as well as a set of control variables defined earlier. Country fixed effects are suppressed, as is a cubic polynomial in time. \* $p < .10$ ; \*\* $p < .05$ ; \*\*\* $p < .01$ .

Robust standard errors clustered by country in parentheses.

# The Growth of Domestic Debt

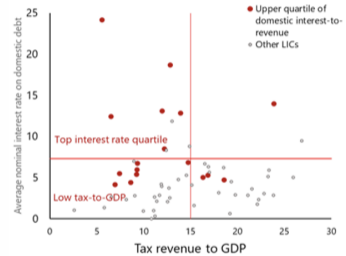
## Evolution of Public Domestic Debt Service-to-Revenues \* median



Source: WB and IMF LIC DSF database as of June 2025.

\* Revenues including grants.

## Average nominal interest rate on domestic debt 2024



Source: WB-IMF LIC DSF database as of end-June 2025. Nominal interest rate is estimated based on the interest payments over total domestic debt.

# Table: Effect of Chinese Finance by Regime Type

	<i>Dependent variable:</i>		
	Any Issuance	Frequency	Log Amount
	(1)	(2)	(3)
Log(Chinese Projects)	0.209 (0.240)	126.490* (67.282)	4.434 (4.852)
Democracy	1.276** (0.627)	647.710*** (175.470)	25.973** (12.655)
Liquidity/Investor Risk (lagged)	-0.119*** (0.026)	-3.713 (7.339)	-2.388*** (0.529)
Log(Chinese Projects) × Democracy	-0.704** (0.311)	-326.887*** (87.062)	-14.946** (6.279)
Country FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Controls	Yes	Yes	Yes
Observations	1,689	1,689	1,689
Adjusted R <sup>2</sup>	0.536	0.422	0.614

Note:

\*p<0.1; \*\*p<0.05; \*\*\*p<0.01

**Table 4:** Summary Statistics by Treatment Group (after entropy balancing)

	Treatment		Control	
	Mean	Variance	Mean	Variance
Age	42.74	329.2	42.75	329.3
Female	0.56	0.25	0.56	0.25
Secondary educ.	0.61	0.24	0.61	0.24
Tertiary educ.	0.15	0.13	0.15	0.13
Urban	0.38	0.24	0.38	0.24